

# Effect of Current Ratio, Net Profit Margin, Debt Equity Ratio, Return on Equity on Financial Distress

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**Abstract.** The purpose of the study was to provide empirical evidence regarding the current ratio, net profit margin, debt-equity ratio, return on Equity, to financial distress. The dependent variable in the study is financial distress using the Altman z-score method. The current ratio is specified in this study as the ratio of existing assets to current liabilities; the net profit margin is defined as the ratio of current year profit to sales; the return on Equity is defined as the ratio of current year profit to company equity, and the debt-equity ratio is defined as the ratio of liabilities to current year profit. The sample in this study was 96 data from 24 goods and consumption sector manufacturing companies listed on the Indonesia Stock Exchange in 2016-2019. This study used purposive sampling techniques. Data analysis techniques are utilized using multiple linear regression methods. The results also showed that the Current Ratio, Net Profit Margin, Debt Equity Ratio, Return on Equity simultaneously had a significant influence in predicting financial distress in the company. In contrast, the results of the hypothesis test study partially showed that the current ratio, debt-equity ratio, return on Equity had a significant influence. Favorable to financial distress. Meanwhile, the net profit margin harm economic desperation.

**Keywords:** financial distress, model Altman z-score, current ratio, net profit margin, debt-equity ratio, return on Equity

## I. INTRODUCTION

Financial distress indicates a condition where the company is experiencing financial difficulties and is threatened not to maintain it (Atmaja, 2008). Financial problems show the challenges that are often encountered by manufacturing companies in the consumer goods sector. The number of small and large companies that go bankrupt is caused by economic conditions that affect the company's activities and performance. Financial statements can be used as a benchmark of the bankruptcy of a company. Analysis of financial statements shows it is crucial to predict the sustainability of a company's establishment. These predictions are significant for company owners and management to prevent the possibility of financial distress. Financial distress indicates a decrease in the financial condition experienced by a company that occurred before going into bankruptcy. Financial difficulties experienced by a company can make investors, prospective investors, and creditors reluctant to invest. If the solution to this problem is not common ground, the company will certainly go bankrupt. If the losses experienced by the company last for two consecutive periods, it can be estimated that the company is experiencing financial distress (Agusti, 2013).

In general, the current ratio is often used to analyze the company's working capital position by comparing the number of existing assets with current debt (Ginting, 2017). The current ratio is used to determine how much capacity the business has to meet its commitments. In the study, Current assets can be used to pay short-term, time-consumed finances affected by the current ratio. This is because the ability to pay debts smoothly shows essential things in the company's activities and a picture of the company's debt relationship with creditors.

Net Profit Margin (NPM) shows the comparison of operating profit with sales. This ratio describes the percentage of net income received by the company in each deal, as it includes all elements and cost revenue (Kasmir, 2014). stated that Net Profit Margin (NPM) has a significant effect on financial distress. The higher the profit margin ratio, the better the company's ability to get a profit. Companies with high Net Profit Margin (NPM) will not experience financial difficulties because high profits will not lower economic conditions.

Rikah (2016) states that the Debt Equity Ratio (DER) shows the relationship between the long-term amount and the capital itself given to the company's owner. Defines the debt-equity ratio used to measure how much total money alone is financed by total debt. Suppose the debt-equity ratio is getting more minor than the company's ability to pay debt better and the greater the debt-equity percentage. In that case, the company's ability to pay debts is getting worse. Companies that cannot afford debts will be liquidated because they are considered to have gone bankrupt (Sartono, 2001).

The valuation of the income of the owners of the company related to the capital they have invested in the company is called Return On Equity (Rohmadini, 2018). Return on Equity (ROE) or a company's capacity to generate profits based on a comparison of net profit to cost Equity was used by shareholders to evaluate a company's ability to create net income concerning dividend income.

However, that distinguishes this study from previous research by adding the Return on Equity (ROE) variable and the research object and year of analysis used. Researchers used research objects on consumer goods manufacturing companies on the Indonesia Stock Exchange in 2016-2019. Based on the explanation above, the purpose of this study is to examine what factors affect financial distress in consumer goods manufacturing companies listed on the IDX in 2016-2019 and as a material. Evaluation and improvement of the company where the company needs to anticipate financial distress so that this testing will benefit the relevant parties.

## **II. LITERATUR REVIEW**

### **Signaling Theory**

The signaling theory was first proposed by Spence (1973). The signaling theory states that signs related to the condition and picture of a company discuss the instability of increases and price declines in the market to affect shareholder decisions. According to Hendrianto, in the theory of financial distress, it is said that managers issue liberal accounting if the company's financial condition is excellent and stable. In contrast, managers will hold conservative accounting if the company's financial situation is poor and its existence is doubtful. (Muflihah, 2017). According to Khairudin and Wandita (2017), an investor considering and determining whether to invest in a company needs related information that shows signaling theory. Signaling theory puts forward their report issued by the company against the decision of a shareholder as an outside party.

### **Agency Theory**

According to agency theory, agency theory describes agency relationships as contracts between one or more people (principals) involving others (agents) to carry out some services under the name of principal involving delegation of authority to the agent. Compared to principals, managers as agents have excellent information regarding the company's operations, and selfish managers are likely to engage in illegal or manipulative activities to increase one's wealth

### **Current Ratio**

Harahap (2013) defines the current ratio as a company's ability to pay off its short-term debt with existing assets. This ratio can be calculated by comparing existing assets divided by existing debt. The greater the current ratio value, the smaller the financial distress. The company has some liquid assets such as cash or money used to pay off its debt and finance its operational activities in the transaction period. The company does not experience financial difficulties or bankruptcy. States that the current ratio shows the general ratio used in analyzing a company's working capital position by comparing the number of existing assets with existing debt.

### **Net Profit Margin**

In obtaining sales profits generated by a company, the management uses Net profit margin as a benchmark. Profit margin is used to calculate a company's ability to generate earnings on certain sales (Kasmir, 2014). The profit margin ratio can be used as an external consideration in making decisions related to the company. This is seen in the company's financial statements. This ratio is used to measure net income on sales and describe the company's net income on total sales (Fahmi, 2015).

### **Debt Equity Ratio**

Brigham and Houston (2009) define the Debt Equity Ratio (DER) as the oracle used to calculate total capital financed with incremental debt. The higher the debt-equity ratio (DER), the greater the burden borne by the company on outsiders, thus lowering the company's performance because the level of dependence on outsiders is higher. Debt Equity Ratio (DER) shows the relationship between the long-term amount and the capital itself given to the owner of the company

### **Return on Equity**

The Return on Equity (ROE) ratio is used to determine how well a business utilizes its resources to generate a return on Equity. It is computed using accounting-based performance indicators and equals net income divided by common shareholders' Equity. Equity The next section discusses the return on Equity, which measures the revenue (income) provided to business owners on the money they have put in the business.

### **Financial Distress**

Financial distress is a condition in which the company experiences economic sustainability. Companies that are in financial difficulty are companies that have an interest coverage ratio (ratio of operating profit to interest expense) of less than 1 (one) (Wardhani, 2007). Next according to financial distress shows the term used by the company to describe the company's financial condition when experiencing difficulties. Financial distress starts from the company's inability to meet its obligations, especially short-term obligations, including liquidity obligations and liabilities in the solvency category. The economic distress condition of a company must be known early so that the company's management can take initial actions in anticipation of the company leading to bankruptcy (Agusti, 2013). Suppose the business shows a negative number on operating profit. In that case, net income and equity book value and the company's emerging, the company can be categorized as experiencing financial distress (Sarina et al., 2020).

### III. RELATIONSHIPS BETWEEN VARIABLES

#### Relationship between Current Ratio and Financial Distress

The higher the current asset comparison result, the higher the company's ability to cover its short-term liabilities. The greater the current ratio value of a company, the better the company's condition so that it will be far from financial distress. This is because the ability to pay debts smoothly shows essential things in the company's activities, as well as being a picture of the company's debt relationship with creditors in the study, Yuliana et al. (2020) gave results if the current ratio positively influences the possibility of financial distress. Next concluded that the current ratio has a positive effect on financial distress. The current ratio can affect the ability to pay all short-term financial liabilities at maturity using current assets.

H<sub>1</sub>: Current ratio has a positive effect on the company's financial distress.

#### Net Profit Margin (NPM) and Financial Distress

The greater the company's net profit margin, the higher the level of shareholder trust because the company is considered productive, thus indicating the slight possibility of the company experiencing financial distress. It can be used as information. For shareholders in investment decision making in provided results that net profit margin has a positive influence on the prediction of financial distress that occurs in the company. It was stated that net profit margin has a significant positive effect on financial distress. The higher the profit margin ratio, the better the company's ability to get high profits.

H<sub>2</sub>: Net profit margin positively affects the company's financial distress.

#### Relationship debt-equity ratio (DER) and financial distress

The lower the debt-equity ratio, the company can pay off the debt without risk too much interest in the owner of capital. The total amount of assets must be greater than the total number of liabilities for the deficit to be covered by the company's assets (Masud, 2011). Which demonstrated that the debt-to-equity ratio has a statistically significant beneficial effect on financial hardship. Furthermore, based on debt-equity ratio has a positive influence on financial distress.

H<sub>3</sub>: debt-equity ratio has a positive effect on the company's financial distress.

#### Relationship of Return on Equity (ROE) and Financial Distress

The higher the profit generated, the possibility of a budget that is not used by the company. If, if this is not considered it can be ascertained that the company experienced bankruptcy before experiencing financial difficulties (Masud, 2011). In which gave the results that the ratio of return on Equity has a significant positive effect on financial distress that return on Equity has a positive influence on economic desperation.

H<sub>4</sub>: Return on Equity has a positive effect on the company's financial distress.

#### Relationship Current Ratio, Net Profit Margin, Debt Equity Ratio, Return on Equity and Financial Distress.

Current ratio can affect the ability to pay all short-term financial liabilities at maturity using existing assets. The higher the recent asset comparison result, the higher the company's ability to cover its short-term liabilities. Ginting's research states that the current ratio positively influences financial distress. Net profit margin is very significant to financial distress with the higher the profit margin ratio, the better the company's ability to high profits. Then stated that it provides the debt equity ratio has a significant favorable influence on financial distress. Masud research provides the debt equity ratio has a significant favorable influence on financial distress. The debt equity ratio the company can pay off the debt without sacrificing too much interest of the owner of capital. It can be said that the higher the profit obtained allows the existence of funds that are idle or not used by the company's funds following, which supposed needs. which provides results that the return on equity ratio has a significant positive effect on financial distress.

H<sub>5</sub>: Current ratio, net profit margin, debt-equity ratio, return on Equity simultaneously affect the company's financial distress.

### IV. RESEARCH MODEL

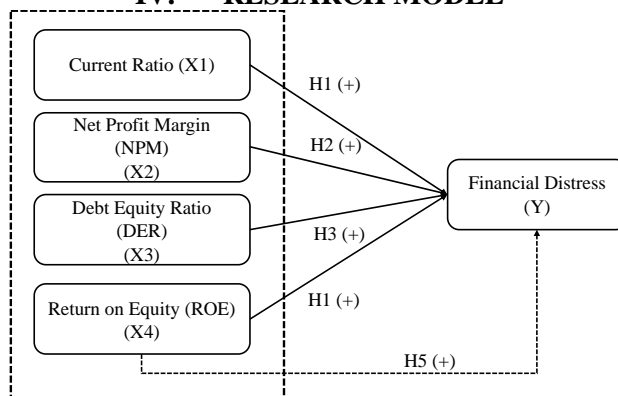


Figure 1 Research Model

Information:

-----: The overall influence of independent variables Current Ratio, Net Profit Margin (NPM), Debt Equity Ratio (DER), and Return on Equity (ROE) together (simultaneously) on financial distress dependent variables.

-----: The effect of each independent variable current ratio, net profit margin (NPM), debt equity ratio (DER), and return on Equity (ROE) partially on the dependent irregular financial distress.

**V. RESEARCH METHODOLOGY**

There is one dependent variable in this study, which is financial distress, and four independent variables, which are the current ratio, net profit margin (NPM), debt equity ratio (DER), and return on Equity (ROE). Current Ratio is determined by dividing current assets by current liabilities. Net Profit Margin (NPM) is computed by dividing its net revenue generated on each sale by its current liabilities. (Harahap, 2011). Debt Equity Ratio (DER) by dividing the total debt to be paid by the company in cash to the lender by Return On Equities (ROE) with return on ordinary equity and net income against common Equity that measures the rate of return typical on shareholder investment. The study used the Altman Z-Score method

The research design used is causal research that shows research to investigate causal relationships that always involve one or more independent variables or causes of the research hypothesis and its relationship to one or more dependent variables (Rina). In casual research using quantitative shortness because this study investigated the influence of Current Ratio, Net Profit Margin (NPM), Debt Equity Ratio (DER), and Return On Equity (ROE) on financial distress by proving the significant influence of independent variables on dependent variables

The population in this study is a company in the manufacturing sector of consumer goods listed on the Indonesia Stock Exchange. This study used secondary data from the company's annual financial statements sourced from the official website of the Indonesia Stock Exchange (<https://www.idx.co.id>) for the period 2016-2019. The sample in this research was selected as many as 24 companies for 4 years, namely in 2016-2019, the number of financial statements sampled in this research was 96 financial statements. Sampling is a sampling technique used is purposive sampling specification considerations only.

**VI. RESEARCH RESULTS**

Descriptive Statistical Test Results

	N	Minimum	Maximum	Mean	Std. Deviation
X1_CR	96	.58615	15.82231	3.4226860	2.50627326
X2_NPM	96	-.15337	1.90099	.1104492	.20331591
X3_DER	96	.08330	4.94652	.7812184	.82950976
X4_ROE	96	-.06592	2.24458	.1927453	.26721961
Y_FD	96	.97481	11.33930	4.7246037	2.23862779
Valid N (listwise)	96				

The descriptive statistical analysis results show that the current ratio variable has an average value of 3.42268 and a standard deviation of 2.50627. The minimum value obtained is 0.58615 which shows importance of CLEO companies in 2016 and the maximum value of 15.82231 which offer importance value of CAMP companies in 2017. For variable net profit margin has an average value of 0.11044 and a standard deviation of 0.20331. The minimum value obtained is -0.15337 which importance's the value of ALTO company in 2018 and the maximum value of 1.90099 importance shows the value of MERK companies in 2018. The debt equity ratio variable has an average value of 0.781218 and a standard deviation of 0.82950. The minimum value obtained is 0.08 importance which shows the value of SIDO companies in 2016 and the maximum value of 4.94 importance which shows the value of SCPI companies in 2016. The return on equity variable has an average value of 0.192745 and a standard deviation of 0.26721. The minimum value obtained is -0.06 importance which shows the value of INAF companies in 201 weight a maximum value of 2. indicates which indicates the company value of MERK in 2018.

One-Sample Kolmogorov-Smirnov Test.		Multicollinearity Test Results			
N	Unstandardized Residual	Type	Collinearity Statistics		
Normal Parameters <sup>a,b</sup>	Mean		Tolerance	VIF	
	Std. Deviation	.0000000	X1_CR	0.966	1.036
Most Extreme Differences	Absolute	.86749827	X2_NPM	0.317	3.154
	Positive	.080	X3_DER	0.918	1.089
	Negative	-.080	X4_ROE	0.317	3.156
Test Statistic		.080			
Asymp. Sig. (2-tailed)		.144 <sup>c</sup>			

The normality data testaimstodeterminewhether the data is nousuallymisinformation ornot. The datais said to be normaldistribution if probability value of >0.05. The normality test result obtained a probability value of 0.114 which weighed less than 0.05. So, it was concluded that the research data was normally distributed.

The results of the multicollinearity test analysis showed that all VIF values of research variables were below the value of 10 and the more significance value indicates greater than 0.1. This shows that there is no multicollinearity in the data.

**Heteroscedasticity Test Results**

Type		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.404	.111		3.635	.000
	X1_CR	.085	.021	.394	4.070	.000
	X2_NPM	-.459	.450	-.172	-1.019	.311
	X3_DER	-.064	.065	-.097	-.980	.330
	X4_ROE	.408	.343	.201	1.190	.237

Heteroscedasticity test results show thatthe probabilityvalueof variableX<sub>1</sub>is0.000 unstable ableX<sub>2</sub>is0.311 andvariableX<sub>3</sub>is0.330 and variable X<sub>4</sub>is0. 237.Variables X<sub>2</sub>, X<sub>3</sub>, X<sub>4</sub> are smallerthan0.05. So, itwas concludedthatthere isheteroscedasticityin the data, namelyvariableX<sub>1</sub>.

**Test Result F**

Type		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig
1	(Constant)	2.903	.196		14.788	
	X1_CR	.683	.037	.765	18.494	.000
	X2_NPM	-1.327	.794	-.121	-1.670	.098
	X3_DER	-1.078	.114	-.399	-9.423	.000
	X4_ROE	2.455	.605	.293	4.062	.000

The Anova test orFtest results in a significance value (0.000) smallerthan0.05 then the regression model is fit. This means that there is a simultaneous influence of independent variables on dependent variables.

Variable X	Sig	Information
X1_CR	0,000	Effect on Y
X2_NPM	0,098	It does not affect Y
X3_DER	0,000	Effect on Y
X4_ROE	0,000	Effect on Y

Partial test results of variable X whichprovide valuwith a significancellevel of <0.05then means thatthevariableaffectsvariableY.

**Determination Coefficient Test Results**

Type	R	R Square	Adjusted R Square	R Std. Error of the Estimate
1	.922 <sup>a</sup>	.850	.843	.88635913

The results of the independent variable determination coefficient test consistingofcurrent ratio, net profit margin, debt equity ratio, and return on Equity to financial distresswith the sizeof thecompanyas a variablemoderation

Value Adjusted R Square Value (R<sup>2</sup>)0.843, meaning thatindependent variables can explain 84.3% of variation Y. Other reasons outside the model explain the rest (100%-84.3% = 15.7%).

**Multiple Linear Regression Test Results**

Type		Unstandardized Coefficients		Standardized	t	Sig.
		B	Std. Error	Coefficients Beta		
1	(Constant)	2.903	.196		14.788	.000
	X1_CR	.683	.037	.765	18.494	.000
	X2_NPM	-1.327	.794	-.121	-1.670	.098
	X3_DER	-1.078	.114	-.399	-9.423	.000
	X4_ROE	2.455	.605	.293	4.062	.000

Based on the results of multiple linear regression tests, the equation can be derived as follows:

$$Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

**Or**

$$FD = a + \beta_1 CR + \beta_2 NPM + \beta_3 DER + \beta_4 ROE + e$$

The constant value is 2.903. If the independent variable equals zero, then the value of Y will decrease by 2,903 units. The regression coefficient value of  $\beta_1$  Current Ratio is positive at 0.683. Positive value means that there is a unidirectional relationship, meaning that if variable X1 increases by one unit, then the value of Y will increase by 0.683 units. Assuming the variables of constant magnitude. And vice versa.

The regression coefficient value of  $\beta_2$  Net Profit Margin is negative at 1,327. Negative value means that there is a relationship in the opposite direction, meaning that if variable X2 increases by one unit, then the value of Y will decrease by 1,327 units assuming the variables of constant magnitude. And vice versa. The regression coefficient value of  $\beta_3$  Debt Equity Ratio is positive at 1,078. A positive value means a relationship in the opposite direction, meaning that if variable X3 increases by one unit, then the value of Y will decrease by 1,078 units assuming the variables of constant magnitude. And vice versa. The regression coefficient value of  $\beta_4$  Return on Equity is positive at 2,455. Positive value means that there is a unidirectional relationship, meaning that if variable X4 increases by one unit, then the value of Y will increase by 2,455 units. Assuming the variables of constant magnitude. And vice versa.

Hypothesis	Value	Significance	Information
H1: Current ratio has a positive effect on the company's financial distress.	0,000		Accepted
H2: Net Profit Margin negatively affects the company's financial distress.	0,098		Rejected
H3: Debt Equity Ratio has a positive effect on the financial distress of the company.	0,000		Accepted
H4: Return on Equity has a positive effect on the company's financial distress.	0,000		Accepted
H5: Current Ratio, Net Profit Margin, Debt Equity Ratio, Return on Equity positively affect the company's financial distress.	0,000		Accepted

## VII. DISCUSSION

The first hypothesis multiple linear regression analysis results, namely the Current Ratio, positively affect the company's financial distress. So H1 was accepted, these results were in line with the research and prove the current ratio influences financial distress. Current balance can affect the ability to pay all short-term financial obligations at maturity using existing assets. This is because the ability to pay debt smoothly shows essential things in the company's activities and picture of the company's debt relationship with creditors.

The results of the second hypothesis of multiple linear regression analysis, namely Net Profit Margin negatively affect the company's financial distress. So H2 was rejected, this result is in line with the research and proves net profit margin does not involve financial distress. Net profit margin indicates the company's ability to generate net profit from sales. That means the more significant the net profit margin value suggests that the company effectively generates profits. It is used to treat financial distress.

The results of the third hypothesis of multiple linear regression analysis, namely Debt Equity Ratio, positively affect the company's financial distress. So H3 was received, these results are in line with Masud research, proving that debt equity ratio influences financial distress. Because the lower the debt equity ratio of the company can pay off debt without sacrificing too much interest of the owner of capital. The total amount of assets must be greater than the total

number of liabilities for the debt to be covered by the company's assets.

The fourth hypothesis of multiple linear regression analysis results, namely Return on Equity, positively affects corporate financial distress. So H4 was accepted, these results are in line with Masud (2011); Widati (2018) which proves the return on Equity affects financial distress. Return on Equity shows in measuring a company's ability to make a profit based on a comparison of net income with cost of equity commonly used in calculating the level of return on the investment ordinary on shareholders.

The results of the fifth hypothesis multiple linear regression analyses are, namely Current Ratio, Net Profit Margin, Debt Equity Ratio, Return on Equity, have a positive effect on corporate financial distress. So H5 was accepted, these results are in line with Masud (2011); Nurhidayah (2017) that proves the effect on financial distress.

## VIII. RESULT

The data used in this study amounted to 96 data from 24 companies with consumer goods sector manufacturing company objects listed on the Indonesia Stock Exchange in 2016-2019. This study has multiple linear regression results that show the current ratio, net profit margin, debt equity ratio, return on Equity simultaneously positively affect the company's financial distress. Current ratio has a positive effect on financial distress. Net profit margin negatively affects financial distress. Debt Equity Ratio has a significant effect on financial distress. Return on Equity has a positive effect on financial distress.

In this study, several things limit the implementation of research that can affect the results of this study. The prediction model used in this study only used the model. Altman Z-Score. There are still various prediction models that can be used. Including Springate, Zmijewski, Grover, and other models. Another limitation is the question of time, matter, data, and free variables used. Based on the results of testing of the sample, the conclusions obtained, and the study's limitations, the advice that can be given to be input and improve the next research by adding other factors that can affect the research. financial distress. Then, it is expected to include independent variables that adequately explain their effect on financial distress in a particular company, industry, or service, such as return on assets, asset turnover, net working capital, company size, and debt-to-assets ratio, as well as financial distress research models. Others include Springate, ZMajewski, and Grover.

Managerial implications on research for the company are management to pay more attention to corporate debt that is very risky for the company, if not noticed will cause financial distress. For example, suppose the company has experienced financial distress. In that case, it is expected that the company can improve relations with investors, creditors, and employees so that trust remains established, and improve the company's business activities for the better while for prospective investors to be more careful when doing so. Investment in the company, the decisions taken are not only focused on profit information but also consider non-financial information such as the company's financial condition and the existence of internal and external mechanisms of the company.

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