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Original Research Article

The Effect of Cash Flow, Board Independence, and Company Size on Financial Distress

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Abstract

Covid-19 has affected the world's economic sectors, including Indonesia. This can be seen from the declining of the company's operational activities until the threat of the company to become bankrupt, so that it can influence the stability of the country. The government tries its best to recover the economy. Therefore, the objective of this research is to test the effect of cash flow, board independence, and company size on financial distress. It is classified as causal research with quantitative approach. The population used in this research is all transportation and logistics companies listed in Indonesia Stock Exchange (IDX) period 2019-2021. The sampling technique is simple random sampling with Slovin formulation, so that there are 72 samples used after outliers. All the information of the samples are obtained from the annual financial statements downloaded from the official company's websites. The analysis technique is multiple regression linear with SPSS 22 as a research tool. The results indicate that cash flow has a significant effect on financial distress whereas board independence and company size do not have significant effects on financial distress.

Keywords: Financial Distress, Cash Flow, Board Independence, Company Size.

INTRODUCTION

Covid-19 gives a bad impact to all countries in the world, one of them is Indonesia. This pandemic makes the government find the ways out to recover the economy. Only 58.95% companies which were able to run their business normally due to the pandemic of Covid-19 and 82.45% companies experienced a decline in revenue (Badan Pusat Statistik, 2020). Moreover, Suharso Manoarfa Minister said that 60% companies in the world experienced bankruptcy according to the data from World Bank (www.economy.okezone).

Financial distress is the company's inability to meet obligations which can be an early feature before bankruptcy. The characteristic of financial difficulties is the inability of the company to fulfill its current liabilities (Meryana & Setiany, 2021). In Indonesia, financial distress cases can be seen in Garuda Indonesia Tbk where that company could not generate the profit and enough cash flow so that Garuda Indonesia has a difficulty in fulfilling the financial liabilities (www.investor.id). Besides, the financial matters occurred in Garuda Indonesia were triggered by the past management mistakes which had an impact on alleged acts of corruption (www.cnbcindonesia.com). In addition, throughout the first semester of 2020, transportation sector companies gave an unfavorable financial picture as indicated by a decrease in the number of passengers by more than five percent in May 2020. Due to the Covid-19, the transportation companies are trying to anticipate this problem by reducing the operating costs and postponing the purchase of capital goods (www.katadata.co.id).

It is very important for various parties to predict the financial distress by using financial analysis and company management arrangements, considering that if the company goes bankrupt, many parties associated with the company will be harmed. By conducting the financial analysis, companies are able to determine the optimal financial strategies so that the companies can operate sustainably (Meryana & Setiany, 2021). There are various models to predict the financial distress, such as Altman, Springate, Grover, and Zmijewski.

The first factor which influences financial distress is cash flow. Cash flow is one of the financial statements which shows how much cash receipts and

disbursements of a company has for a certain period of time (Bachtiar & Handayani, 2022). In running its business, every company will have inflow cash and outflow cash. If the inflow cash is more than the outflow cash in a period, then the company's cash flow is positive, and vice versa (Hariyanto, 2018). There are two methods in preparing statement of cash flows, such as direct and indirect method. This statement gives information from three activities; operating, investing, and financing (Nailufar *et al.*, 2018). The previous research conducted by (Christine *et al.*, 2019), (Bachtiar & Handayani, 2022), (Harto & Naisah, 2020), and (Nailufar *et al.*, 2018) stated that cash flow had an effect on financial distress. On the other hand, the previous research conducted by Isdina & Putri (2021), (Hariyanto, 2018), and (Indriani & Mildawati, 2019) stated that cash flow had no an effect on financial distress.

Board independence can be categorized as another factor that affects financial distress. Board independence is a part of the board of commissioners which have the main function to supervise the board of directors, especially about finance so the actions that can risk the company will not happen. Board independence has also a role to make sure that the company has already implemented a good corporate governance. Therefore, a high proportion of board independence will minimize the possibility of the company to experience the financial distress (Zhafirah & Majidah, 2019). The previous research conducted by (Hasniati *et al.*, 2017) and (Yusmaniarti *et al.*, 2022) stated that board independence had an effect on financial distress, whereas (Muslifiansyah *et al.*, 2022), (Annisa *et al.*, 2022), and (Dirman, 2020) stated that board independence had no an effect on financial distress.

The last factor which can affect the financial distress is company size. The size of a company is a scale which shows whether the company is small or big. Companies with high assets can give a signal to investors or creditors. Therefore, a big company size will minimize the possibility of the company to experience the financial distress (Zhafirah & Majidah, 2019). The previous research conducted by (Christine *et al.*, 2019) and (Zhafirah & Majidah, 2019) stated that company size had an effect on financial distress, whereas (Faldiansyah *et al.*, 2020), (Dirman, 2020), and (Muzharoatiningsih & Hartono, 2022) stated that there was no an effect between company size and financial distress.

This research is conducted because there are still inconsistent results or gaps from the previous research, as well as to analyze the effect of cash flow, board independence, and company size on financial distress. The results are expected to be a way for companies to analyze their financial conditions to predict whether experiencing financial distress or not. Also, these results can be a considering way for investors before investing their funds to the companies by looking and analyzing the financial information in the financial statements.

LITERATURE REVIEWS

Signaling Theory

Signaling theory is a theory which explains the actions taken by the signaler to influence the behavior of the signal receiver. Brigham & Houston (2010) stated that signal means the attitude which is taken by the company signaling about the prospects of the company's management. This signal can be conveyed through the financial statements which can be good or bad news (Hidayat *et al.*, 2021). This information will later be used by investors to help them make the investment decisions (Bachtiar & Handayani, 2022). Signaling theory was firstly introduced by Spence in 1973. The signal referred to this theory could be in various forms, either directly or through further analysis (Ghozali, 2020). The relevance of signaling theory to financial distress is that when a company has good quality in terms of finances and adequate conditions, it will give a positive signal to investors, whereas when the company is in a period of financial difficulty or poor performance, investors will receive a negative signal.

Financial Distress

Financial distress is an early symptom in the form of bankruptcy which will be experienced by a company (Muslifiansyah *et al.*, 2022). Financial distress is the company's inability to meet obligations which can be an early feature before bankruptcy. A company with a financial distress will have a liquidity problem, especially when the company does not have enough operating cash flow to fulfill its current liabilities, e.g. interest or account payable payments (Fahmi, 2014; Meryana & Setiany, 2021).

According to the signaling theory, if the company has a stabile financial condition, then there will be a positive signal. Investors will put a trust to the company to invest their funds in order to receiving the good returns. Otherwise, if the signal is negative, this means that investors will question the financial condition of the company. This negative signal can make the investor lose their trust to the invested company (Indriani & Mildawati, 2019).

Cash Flow

Cash flow is a statement that the company must prepare (Reeve *et al.*, 2010). The statement of cash flows provides information about how much a company earns inflow cash or spends outflow cash in a certain period of time (Bachtiar & Handayani, 2022). In addition, the statement of cash flow gives the information in the form of the company's ability to generate the cash from operating activities, pay all its maturing obligations, and pay dividends to investors. The results will be used by managers to assess the

company's past and future performance in terms of funding activities. Investors and creditors will also utilize the information in statement of cash flows to help them make decisions (Hariyanto, 2018).

Statement of Financial Accounting Standards (PSAK) Number 2 regulates the companies in preparing the statement of cash flows. This report can be prepared under two methods; direct and indirect. Direct method means statement of cash flows is prepared by disclosing the main group from gross cash receipts and gross cash payments. Indirect method means statement of cash flows is prepared by adjusting the profit loss based on the correction of the effects of transactions which are non-cash, deferrals, or accrual of cash receipts or payments for past and future (Ikatan Akuntan Indonesia, 2018).

Board Independence

Board independence consists of members who are not part of the control structure (Muslifiansyah *et al.,* 2022). Unlike other board of commissioners, board independence does not have a direct relationship with the company so they are neutral (Zhafirah & Majidah, 2019). Board independence has a function to keep the board of directors be responsible for its financial decisions and ensures that the business is protected from any potential harms. Therefore, board independence has a vital task so that the organization does not experience financial difficulties or financial distress (Hanafi & Breliastiti, 2016; Muslifiansyah *et al.,* 2022).

Company Size

Company size is one of the important factors in determining the use of applied accounting methods (Christine *et al.,* 2019; Hery, 2015). The size of a company can be seen from the total sales or assets owned (Faldiansyah *et al.,* 2020). Sinaga (2014) claims that large companies have a greater tendency to diversify their company operations than small companies. Thus, the size of the company will be profitable in terms of company capital. In line with the growth of the company, the larger the size, the greater the amount of funds needed by the company. This significant funding need can be met either by companies that finance their own capital or by financing with debt, especially long-term debt (Faldiansyah *et al.,* 2020). Company size is often used as an indicator of a company's bankruptcy risk, where companies with larger sizes are considered to be better able to deal with crises that arise in running their business (Christine *et al.,* 2019).

HYPOTHESIS

The Effect of Cash Flow on Financial Distress

Companies with a high cash flow in a long term will probably be able to pay their obligations, so that this will be a positive signal to the creditors with the company's ability to repay their investment funds. On the other hand, creditors will be skeptical of the company's ability to pay debts if the cash flow is small or even suffers long-term losses because this will give a negative signal. If this continues, then the creditors will stop trusting the companies with their credits because they assume that the companies are headed for financial distress (Indriani & Mildawati, 2019). Previous research conducted by (Christine *et al.,* 2019), (Bachtiar & Handayani, 2022), (Harto & Napisah, 2020), (Ramadhani & Nisa, 2019), and (Nailufar *et al.,* 2018) showed that cash flow had an effect on financial distress while (Hariyanto, 2018) and (Indriani & Mildawati, 2019) showed that cash flow had no an effect on financial distress. The first hypothesis proposed in this research is:

H_1: Cash flow significantly affects financial distress

The Effect of Board Independence on Financial Distress

Good corporate governance is one of the important things in the company in order to increase the efficiency. Board independence is expected to be independent and able to keep the stability between the minority and majority shareholders (Annisa *et al.,* 2022). Investors' confidence will be increasing due to the presence of the board independence which can control and monitor the activities of the company (Dirman, 2020). Previous research conducted by (Yusmaniarti *et al.,* 2022) and (Hasniati *et al.,* 2017) showed that board independence had an effect on financial distress, whereas (Dirman, 2020) and (Annisa *et al.,* 2022) showed that board independence had no an effect on financial distress. The second hypothesis proposed in this research is:

H_2: Board independence significantly affects financial distress

The Effect of Company Size on Financial Distress

The bigger of the size of the company, the more attention from the stakeholders to the company. Therefore, the management will be careful in doing the actions (Faldiansyah *et al.,* 2020). Companies with high assets will be easier to expand their business, so those companies will be safe from the financial distress (Pancawitri & Dillak, 2022). Also, (Salim & Dillak, 2021) stated that if the company size is high, then the financial distress will be low because big companies have good fundamental. Previous research conducted by (Salim & Dillak, 2021) and (Nilasari, 2021) showed that company size had an effect on financial distress, while (Pancawitri & Dillak, 2022) and (Faldiansyah *et al.,* 2020) showed that company size had no an effect of financial distress. The third hypothesis proposed in this research is:

H_3: Company size significantly affects financial distress

Based on the literature reviews, previous research, and the hypothesis that have been developed in previous parts, the conceptual framework model is presented below to help the readers understand about

the relationship among the independent variables to the dependent variable.

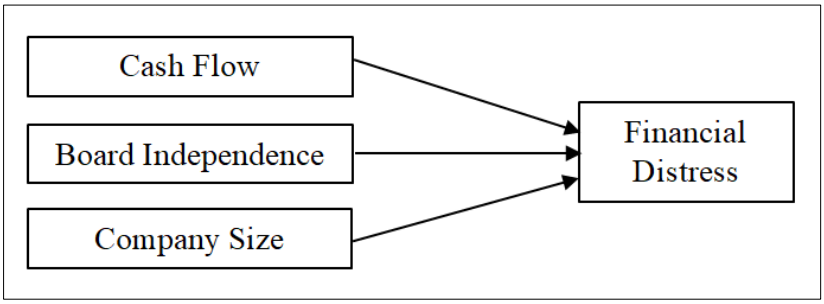

Figure 1: Conceptual Framework Model

RESEARCH METHODS

Population and Sample

The population used in this research is all transportation and logistics companies which are listed in Indonesia Stock Exchange (IDX) period 2019-2021. The sampling technique is a simple random sampling with Slovin formulation. From the results of sampling calculation, it is obtained 84 samples, but there are 12 data outliers, so the grand total of the samples used in this research are 72 samples.

Research Analysis Method

This research uses multiple linear regression with SPSS 22 as a tool to test the effect of cash flow, board independence, and company size on financial distress. The tests include descriptive statistics, classical assumption tests, adjusted R^2, goodness of fit, and partial t test.

The regression model in this research is stated as:

$$\mathbf{FD = \alpha + \beta_1 CF + \beta_2 BIND + \beta_3 SIZE + \varepsilon}$$

Where;

FD : Financial distress
CF : Cash flow
BIND : Board independence
SIZE : Company size
ε : Error

Table 1: Variable Operationalization

Variable Names	Indicators	Scale
Dependent Variable		
Financial Distress	Altman Z-Score: 1.2(X1) + 1.4(X2) + 3.3(X3) + 0.6(X4) + 1(X5) X1: working capital / total assets X2: retained earnings / total assets X3: profit before tax / total assets X4: market value of equity / total liabilities X5: sales / total assets	Ratio
Independent Variable		
Cash Flow	$CF = \frac{\text{Operating Cash Flow}}{\text{Total Assets}}$	Ratio
Board Independence	$BIND = \frac{\text{Total Independent Commissioners}}{\text{Total Commissioners}}$	Ratio
Company Size	SIZE = Ln(Total Assets)	Ratio

Source: Prior Researches (Processed), 2022

RESULTS

Descriptive Statistics

The objective of descriptive statistics is to see the general information about minimum, maximum, mean, and standard deviation. From the data analysis, it is concluded that the minimum of financial distress is -5.046 which indicates that the company is not in a good zone, while the maximum of financial distress is 14.822. This maximum value indicates that the company performed very well and it is in a safe zone. If the Altman score is more than 3.0, it means that the company is safe from the bankruptcy whereas if the Altman score is lower than 1.81, it means that the opportunity to be bankrupt is high (Wahlen *et al.*, 2018). Cash flow has a minimum value of -2.63. This shows that the company's cash out is bigger than cash in. The maximum value of cash flow is 0.242 which indicates the cash in of a company is bigger than the cash out. It also shows that the company still has cash 24% of total assets. The descriptive statistics of board independence show that the average value (0.41650) is bigger than the standard deviation (0.137884). This means that the data is not heterogeny. Company size

has a minimum value of 24.596 while the maximum value of 32.651 The output also shows that the average value (27.45665) is bigger than the standard deviation (1.970614), meaning that the data is not heterogeny.

Classical Assumption Test

Table 2: Normality Test

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		72
Normal Parameters[a,b]	Mean	.0000000
	Std. Deviation	3.14032163
Most Extreme Differences	Absolute	.103
	Positive	.103
	Negative	-.078
Test Statistic		.103
Asymp. Sig. (2-tailed)		.055[c]
a. Test distribution is Normal.		
b. Calculated from data.		
c. Lilliefors Significance Correction.		

Source: Data Processed by SPSS, 2022

Based on the results above (table 2), it can be seen that the significant value of One-Sample Kolmogorov-Smirnov test is greater than 0.05 (0.055 > 0.05). Therefore, the data is normally distributed.

Table 3: Multicollinearity Test

Coefficients[a]			
Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	CF	.993	1.007
	BIND	.986	1.014
	SIZE	.986	1.014
a. Dependent Variable: FD			

Source: Data Processed by SPSS, 2022

Based on the results above (table 3), it can be seen that the data is free from multicollinearity because there is no tolerance value below 0.1 and VIF value exceeds 10.

Table 4: Heteroscedasticity Test

Correlations			
			Unstandardized Residual
Spearman's rho	CF	Correlation Coefficient	-.031
		Sig. (2-tailed)	.796
		N	72
	BIND	Correlation Coefficient	-.086
		Sig. (2-tailed)	.474
		N	72
	SIZE	Correlation Coefficient	.095
		Sig. (2-tailed)	.428
		N	72
	Unstandardized Residual	Correlation Coefficient	1.000
		Sig. (2-tailed)	.
		N	72
*. Correlation is significant at the 0.05 level (2-tailed).			

Source: Data Processed by SPSS, 2022

Based on the results of Spearman's rho test (table 4), it can be seen that the significant value of the correlation between variables exceeds 0.05 which indicates that the data is free from heteroscedasticity.

Table 5: Autocorrelation Test

Model Summary[b]	
Model	Durbin-Watson
1	.386
a. Predictors: (Constant), SIZE, CF, BIND	
b. Dependent Variable: FD	

Source: Data Processed by SPSS, 2022

If the Durbin Watson value is in the equation -2 < DW < +2, it can be concluded that the data is free from autocorrelation. The results of the test above (table 5) states that there is no autocorrelation because it has fulfilled the specified conditions, namely -2 < 0.386 < +2.

Table 6: Adjusted R^2

Model Summary[b]				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.446[a]	.199	.164	3.209
a. Predictors: (Constant), SIZE, CF, BIND				
b. Dependent Variable: FD				

Source: Data Processed by SPSS, 2022

Based on the results of adjusted R-square test (table 6), the combination or variation of the independent variables is able to explain the dependent variable by 16.4% whereas the remaining 83.6% is explained by other variables which are not examined in this research.

Table 7: Goodness of Fit Test

ANOVA[a]			
Model		F	Sig.
1	Regression	5.628	.002[b]
	Residual		
	Total		
a. Dependent Variable: FD			
b. Predictors: (Constant), SIZE, CF, BIND			

Source: Data Processed by SPSS, 2022

Based on the results of goodness of fit test (table 7), the significant value is 0.002 < 0.05 indicates that the research model is feasible and able to predict the dependent variable.

Table 8: Hypothesis Test

Coefficients[a]						
Model		**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
		B	Std. Error	Beta		
1	(Constant)	7.591	5.613		1.352	.181
	CF	13.677	4.669	.319	2.929	.005
	BIND	5.254	2.781	.206	1.889	.063
	SIZE	-.316	.195	-.178	-1.625	.109
a. Dependent Variable: FD						

Regression model:

FD = 7.591 + 13.677CF + 5.254BIND – 0.316SIZE

Where;

FD : Financial Distress
CF : Cash Flow
BIND : Board Independence
SIZE : Company Size

DISCUSSION

The Effect of Cash Flow on Financial Distress

Based on the hypothesis testing (table 8), the significant value of cash flow variable is 0.005 < 0.05. This indicates that the first hypothesis (H_1) is accepted and the null hypothesis (H0) is rejected, so that cash flow has a significant effect on financial distress. This result indicates that the higher cash flow ratio, the higher financial distress occurs. Although the cash flow is good, companies with inability of managing it can still experience financial difficulties. Cash's changes can give significant effects to the financial conditions. Therefore, if the companies generate low cash flow, the companies will be unable to fulfill their operating costs including interests and debts (Bachtiar & Handayani, 2022). This result is in line with the previous research

conducted by (Christine *et al.*, 2019), (Bachtiar & Handayani, 2022), (Harto & Napisah, 2020), (Ramadhani & Nisa, 2019), and (Nailufar *et al.*, 2018) which showed that cash flow had an effect on financial distress.

The Effect of Board Independence on Financial Distress

Based on the hypothesis testing (table 8), the significant value of board independence variable is 0.063 > 0.05. This indicates that the second hypothesis (H_2) is rejected and the null hypothesis (H0) is accepted, so that board independence does not have a significant effect on financial distress. Based on the regulation, companies must have at least thirty percent composition of board independence from the total of commissioners. This result also tells that how many commissioners in the company, there is still probability to experience the financial distress (Dirman, 2020). The existence of board independence in the company is only for obeying the regulations and unable to enhance the monitoring effectivity (Pratama, 2020). Previous research conducted by (Dirman, 2020), (Pratama, 2020) and (Annisa *et al.*, 2022) supported the result of this research that the board independence had no an effect on financial distress.

The Effect on Company Size of Financial Distress

Based on the hypothesis testing (table 8), the significant value of company size variable is 0.109 > 0.05. This indicates that the third hypothesis (H_3) is rejected and the null hypothesis (H0) is accepted, so that company size does not have a significant effect on financial distress. This is because company size is not the main factor which triggers the company to experience financial distress. Companies with small, medium, or big size can still be threatened by the financial distress. Assets ownership does not directly determine the failure of the company because every company has different total assets (Mahera & Hartono, 2022). This result is in line with the previous research conducted by (Mahera & Hartono, 2022), (Pancawitri & Dillak, 2022) and (Faldiansyah *et al.*, 2020) which showed that company size had no an effect of financial distress.

CONCLUSION

Based on the results from the outputs of data analysis or hypothesis test, the conclusions of this research are cash flow has a significant effect on financial distress, board independence does not have a significant effect on financial distress, company size does not have a significant effect on financial distress.

SUGGESTION

During this research, there are still limitations that the researchers faced. For further researchers, it is recommended to add more or other independent variables since board independence and company size are proven to not affect the financial distress. Further researchers are also suggested to use the other object research because this research only took the transportation and logistics as the main objects to observe, so that the information about financial distress research could be better and wider.

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