THE EFFECT OF BUSINESS RISK, LIQUIDITY, SOLVENCY AND CASH CONVERSION CYCLE ON PROFITABILITY

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ABSTRACT

The core objective of this research is to determine the effect of business risk, liquidity, solvency and cash conversion cycle on the profitability of companies in the consumer goods industry. The study variables measured were: business risk, liquidity, solvency and cash conversion cycle. The source of the data collected from this study is secondary data which is in the form of financial statements of companies listed on the IDX for the 2014-2020 period. The research sampling method used purposive sampling which was processed using the SPSS version. The results of the study found that business risk, liquidity, solvency and cash conversion cycle have a simultaneous effect on company profitability. The results of the hypothesis test found that business risk has no positive effect on profitability, liquidity has no positive effect on profitability, solvency has a positive effect on profitability and the cash conversion cycle has a positive effect on profitability. Thus this study is able to provide positive and relevant information for stakeholders in predicting profitability through independent variables as predictors.
Keywords: Business Risk; Liquidity; Solvability; Cash Conversion Cycle; Profitability

1. Introduction.

The impact of COVID-19 is still being felt today and has had a significant impact on the economies of all countries, including Indonesia. The impact of the occurrence of COVID-19 affected all aspects, one of which was the aspect that had a major impact, namely the economic condition of all countries including Indonesia experienced a slowdown in growth, even reaching -5.32%. This resulted in a decrease in the source of revenue from the tax budget which is used as the main source of the financial performance of various businesses. The government's initial step in saving the affected economy in the real sector for implementing tax incentives is to absorb labor. This sector can survive the COVID-19 period in the midst of an economic crisis. Rescue efforts by the government did not terminate employees' employment, which resulted in difficulties in the company's finances resulting in an increase in unemployment (Jetter, 2020). Total sales have decreased drastically, having a major impact on the company's finances, so that several companies had to liquidate due to financial difficulties (Bintang, 2019).

According to the World Health Organization (WHO) that this virus can be transmitted between humans which attacks the respiratory tract from flu or mild symptoms of COVID-19 (Mukharom and Aravik, 2020). The Coronavirus virus appeared in Wuhan, China and spread to other countries (Hadiwardoyo, 2020). When implementing this policy, the Indonesian people disobeyed the policy so that the number of COVID-19 has continued to increase to this day. The impact of this policy has caused a drastic economic downturn including the consumer goods sector (Misno, 2020). According to Iskandar's research (2020). , all activities are temporarily closed which may not operate so that social distancing has an impact on the overall economic impact.

The company's main and core goal is to increase value. Profit is one of the main indicators of financial value. Comparison between profits and capital from the profitability obtained by the company can produce profits in certain periods. For companies, profitability is very important because it makes the basis as a determinant of value in the condition of the company. The profitability scale depicts the company's performance in terms of the

company's profits obtained so that it can find out whether the company can form stable performance prospects in the future. This study uses a profitability proxy, namely return on assets, which illustrates how profits are obtained by companies from total sales so that they can be utilized in the next period. On the other hand, Return on Assets can evaluate the efficiency of assets owned. Factors that can affect profitability make empirical debates that focus on business risk, liquidity, solvency, and the cash conversion cycle can increase profitability (Zheng, 2017).

The company operates to generate profits so that the company's value is expected to increase. This will trigger a positive attraction for investors. Companies that achieve large profits will try to grow by increasing their investment. However, in line with this step the risks faced will also increase. Risk is one of the things that interferes with the company in achieving the desired profit. This is faced by every business person, without exception. Thus, company management besides wanting to make a profit, must also seriously look for alternatives to manage risk which is uncertainty in funding its business.

In addition to understanding business risk, companies should understand the problem of the ability to pay short-term obligations, which is called the liquidity ratio. This ratio is an indication of the company's ability to pay its short-term obligations on time. Current assets are said to be liquid, but if the amount is too small, it will cause the company to be illiquid. Conversely, if the amount of current assets is too large where the funds obtained are not used productively, the result is that the company's performance is not effective and efficient. A company that can fulfill its short-term obligations is said to be liquid. This is indicated by the current assets are greater than current liabilities. This must also be adjusted in proportion because it depends on the type of industry (services, trade, or manufacturing) and also the speed of the cash cycle.

Apart from the liquidity variable, an important thing that needs to be considered by company management is solvency issues. Solvency means how much the company is funded by liabilities (Luthfiana, 2019). Obligations or liabilities are expected to increase company profits. The use of liabilities will reduce the tax burden due to the interest factor as a deduction from profit before tax. However, the negative impact is that liabilities disrupt liquidity. Under these conditions, company management must wisely manage business processes. According to Hwee et al (2019), if the company can pay off the company's debt, the dividend is smaller.

Companies need to implement the right strategy to maintain the smooth turnover of their assets. In this case, one of the things that needs to be controlled is the cash conversion cycle (CCC). CCC is a measure of how long the cash cycle is during one period. Management competence in managing CCC will be reflected in the company's ability to maintain liquidity and solvency so that the company is profitable and avoids the risk of loss, especially bankruptcy.

The problem is that the results of previous research show results that are controversial or inconsistent. This encourages efforts to continue research. To prove this statement here disclosed the occurrence of controversy over research results. Previous research conducted by Surasmi et al (2019) said that the influence of business risk has a positive effect on profitability. However, on the other hand, it was found that the research by Bhawa and Dewi (2015) suggested the effect of risk

Factors that can determine the success or failure of a company can be seen from its profitability where the needs match the needs as a provision for how the company can face risks in paying off short-term obligations. Based on research by Septy Wulan Sari (2017), liquidity has a positive effect on profitability. On the other hand, the results of

Felicia Rumondang Sinurat's research (2017) state that liquidity has a negative effect on profitability.

Besides the liquidity factor, there is a solvency variable. Research conducted by Kridasusila and Rachmawati (2016) found solvency results had a positive effect on profitability. However, on the other hand, the research by Alexandre and Wiksuana (2018) found that solvency has a negative effect on profitability. Below, research forms the development of hypotheses, namely:

One of the measurements used for working capital in this study is the Cash Conversion Cycle (CCC) to convert cash into investments as a company's operational activities. Management measurements contained in working capital use the CCC cycle which aims to determine cash disbursements and cash receipts. Research conducted by Rahmi et al (2015) shows a negative effect on the cash conversion cycle on profitability. However, research by Ponsian et al (2015) shows the results of a positive effect on cash conversion cycle on profitability.

Based on the background above, the researcher is interested in conducting research and determines the title "The Influence of Business Risk, Liquidity, Solvability and Cash Conversion Cycle on Profitability." To simplify understanding, the following problems are formulated: 1) Does business risk affect profitability; 2) Does liquidity affect profitability; 3) Does solvency affect profitability?; 4) Does the cash conversion cycle affect profitability? The purpose of this study was to analyze the effect of risk, liquidity, and solvency, and the cash conversion cycle has an effect on profitability.

2. Literature review and hypothesis development

2.1. Basic Concept Definitions

2.1.1.Agency Theory (Agency Theory)

Agency theory shows the exposure in agency relations to principals and agents. The relationship between shareholder contracts can give management authority by giving trust to agents by making the best decisions. Agency theory assumes that each individual can be motivated by interests, causing conflict between principals and agents. Agency theory explains solving problems between business relationships with agents, but if agency problems arise, they can delegate authority to agents (Sulastri, 2018). Thus, agents manipulate reports regarding the company to principal submissions. This data causes a manager to need high economics to maximize compensation with earnings management practices. Agency theory can lead to relationships with owners and managers by avoiding relationships from the concept of corporate value (Putri, 2017). The relationship from agency theory forms income smoothing by explaining that between agents and principals there are different interests. This research can link company value with agency theory so that agency costs are high, so shareholders and managers can reduce investors' valuation of cash. Reducing agency costs can reduce the risk of monitoring companies (Bena et al, 2017). On the other hand, the reduction also affects the taking over of ownership in foreign institutions (Huang and Zhu, 2015; Loncan, 2019).

The concept of agency theory that underlies the problem when a company is separated from ownership that gives participants to make contributions to minimize long-term returns. Agency theory relates to both parties, the owner and the agent. This theory states that being able to run a company over problems to try to maximize the utility function with the development of the company the greater the conflict. There is dissimilarity between management and principal so that this emergence occurs, so you have to avoid risks. Agency theory occurs that a company can build a cooperation contract including an agreement by explaining that this relationship must work optimally by producing

satisfaction values with high profits. Generally, management tasks are different from those of shareholders who have different goals. Differences in interests that occur can cause agency conflict by producing a low percentage. Therefore, managers who have decided on agreements that have no effect on shareholders. In agency relationships, a manager is one of the parties who has complete information within the company to work on future company prospects. But the information that is in the company is not fully disclosed with investors. This requires strong supervision and control to reduce and ensure that what is done is according to company regulations. The purpose of the agency cost that finances this activity is not to offend the manager's behavior.

2.1.2. Signaling Theory

Based on this theory states that the company gives a signal to the financial statements. The concept taken from the company can provide direction for an investor to know the views of management according to the company's prospects. In addition, conveying is done by depicting the company better than other companies. According to Pertiwi (2018), managers form confidence in carrying out company prospects and increasing stock prices so that they can discuss well with investors. Companies need outside information to find out more about the company's future prospects and provide low prices for shares (Tambunan, 2019). Signaling theory affects the value of the company by knowing the condition of the company from financial and non-financial reports. Signaling theory is related to signals that influence management policies, one of which is company value. Based on policies that signal an investor makes a company's prospects to find out utilization as a consideration in the investment decision-making process (Karasek and Bryant, 2015). This theory can determine the value of the company more accurately without an investor knowing and maximizing profits.

This theory is based on the assumption that information has been received from other parties. This theory relates to information on company management that has a financial interest. A manager has the right to know who has an interest in issuing the company's financial statements. In building this theory based on management and shareholder information. Formation of signaling theory from the bottom line of thinking to get the right information according to the increase in firm value. However, sometimes investors do not trust this information to managers. The company also decided to find a high value on signaling with a company's financial policy that is not the same as the company's. Signaling is a process that can cost money to build confidence in investors about a company's value. If the signal is good, it cannot imitate other companies with a cost factor due to low value. The impact of signaling theory on financial markets has been researched as a high theoretical foundation by explaining investment decisions (Alsos and Ljunggren, 2017).

Signaling theory discusses how the success and failure of a company's management is shown by the owner. This information itself is given in the company's financial statements. A manager also provides information on the application of accounting policies to generate earnings in a quality manner. This policy is one of the prevention principles of companies with actions that increase profits and helps in the use of reports to present profits and assets. This theory discusses the ups and downs of stock prices in the capital market which can affect investment decisions. Therefore, the views of investors by responding to positive and negative signals that affect market conditions. Signaling theory can be applied to increasing corporate leverage which can encourage high leverage. This states that it cannot be followed in small companies that cause bankruptcy.

2.1.3. Profitability

The company forms the performance of an achievement activity or program to realize the goals that have been set according to the planning strategy of the organization. The capabilities realized by the organization can manage resource empowerment in different ways so as to form a more competitive advantage. In general, there are two types of performance, namely financial and non-financial performance (Almajali, 2019). The measurement of this ratio looks at the success of the company's journey by creating profits. The performance of companies conducting research is measured by profitability. This measurement can determine the increase in profits for companies with high success in profitability and shows the value of the effectiveness of company management.

The company's performance, as measured by financial performance, obtains profits and market value obtained from the company. Research conducted by measuring company performance can be realized from profitability, namely return on assets. The profitability ratio is the ratio of earning profit from total sales. In addition, knowing how effectively the company operates to generate company profits that focus on company performance. The ability acquired by the company aims to predict future financial conditions. Companies cannot withdraw capital from outside profits, so management can maximize profits with market income (Githam, 2015).

2.1.4. Business Risk

The company has a risk which is interpreted as an event that is experienced to cause losses. Risk indicates the possibility of a monetary outcome obtained from irregularities. This risk can also be high-scale if it can strengthen the profitability obtained for a decrease in the amount paid by shareholders. According to Mnune & Purbawangsa (2019), business risk results from a decrease in company performance from financial discomfort and difficulties in operating the company. If a company uses debt on a small scale, the company faces a low risk with stable product demand so that the company can adjust prices according to increasing costs as a variable. The measurement in this study used the business ratio is the degree of operating leverage. Business risk can be faced from the company's operational activities which affect business continuity to pay off debt with the risks the company faces, so it is influenced by the company's ability to generate funds. The risk of a high value company is concerned with internal use of funds rather than investment.

2.1.5. Liquidity

The company's ability to pay financial obligations in the short term by using its assets, one of the indicators used is the liquidity ratio. This ratio is not related to the company's finances but changes in current assets. Liquidity shows the results of the company's ability to pay off obligations efficiently. The ratio can use current ratio measurements which show a comparison between current assets and current liabilities (Hery, 2015). Companies can fulfill financial obligations according to the ability to obtain from liquidity. This ratio can show the goals and benefits of the parties concerned, namely the company owner and management, to evaluate the company's performance. The liquidity ratio can be used as a measurement tool for the future relationship between cash and debt.

2.1.6. Solvability

The solvency ratio can be used to evaluate the company's ability to pay off obligations in the short or long term in accordance with the guarantee of assets acquired by the company or liquidated. Solvency is one way to make debt payments by measuring the comparison of the value of assets and debts, which is a requirement for the company to fulfill the obligations it has acquired. If the company is in ideal condition, the company has fulfilled its long and short term obligations. The purpose of the solvency ratio is to ascertain

whether the wealth acquired by the company can support the company's performance activities. This ratio can perform exposure to the amount of assets held by shareholders. If a company's assets are held a lot, then the value of leverage can decrease, but if a creditor has optimal assets, a large level of leverage will appear. The solvency ratio makes it easier for management to understand the risks of companies that have recorded financial statements.

2.1.7. Cash Conversion Cycle

Operational conditions that screen the company's performance according to working capital. Turnover that starts from cash to invest in the form of a working capital component. Each company has a goal by way of financing the company's operations to minimize working capital can accelerate the sale of inventory during cash spending. This can measure the cash conversion cycle (CCC) and can reduce debt suspension by converting inventory according to the description of the company's sources. The cash conversion cycle is one of the cycles that can make payments when cash flow receipts are used as a company that can pay suppliers to pay off sales to consumers. This cycle can find out the journey of cash issued until it returns.

2.2. Research Framework

The research was conducted using the independent variables used are business risk, liquidity, solvency and cash conversion cycle. While the control variable in this study was 1, namely firm age. As well as the dependent variable used is profitability.

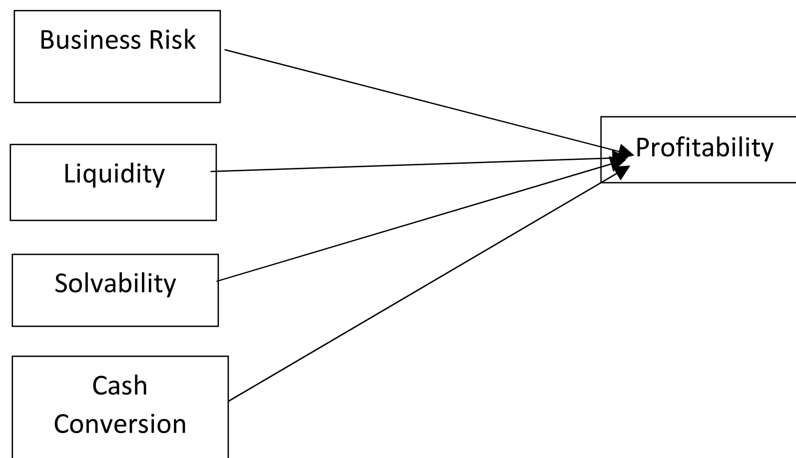

Figure 1 : Research Framework

2.3. Hypothesis Development

2.3.1. Business Risk and Profitability

Companies that obtain debt with a high value scale rather than their own capital can cause an increase in the company's debt ratio which requires a reasonable limit as a reference, one of which is an indicator of business risk. This risk can indicate the risk of a company having fixed operational costs by using the degree operating leverage (DOL) indicator. The degree of operational leverage ratio can have a high or low impact on the business risk that the company receives. Companies that get high DOL scores have high business risks, so there is variability in the form of sales and production costs. Previous research conducted by Surasmi et al (2019) said that the influence of business risk has a positive effect on

profitability. However, on the other hand, it was found that the research by Bhawa and Dewi (2015) suggested that the effect of business risk has a negative effect on profitability.
H1 : Business risk has a positive effect on profitability.

2.3.2. Liquidity and Profitability

The effect of liquidity shows how much the company has paid off its liabilities in the short term by using the assets it has acquired. The company can show the level of liquidity value to avoid bankruptcy or the risk of failure to pay off short-term liabilities. Companies that get a high liquidity scale can affect the profit earned by a company. On the other hand, the company can increase the distribution of dividends in the form of cash so that it can have a large linkage with investment. The level carried out by the company by means of the capital obtained to emphasize paying debts according to the interest expense that must be carried out in repayment policies is getting lower where the profits obtained are also large but the tax payments are also high. Factors that can determine success or not can be seen from profitability where needs match needs as a provision for how companies can face risks in paying off short-term obligations. Based on research by Septy Wulan Sari (2017), liquidity has a positive effect on profitability. The results of Felicia Rumondang Sinurat's research (2017) state that liquidity has a negative effect on profitability.
H2 : Liquidity has a positive effect on profitability.

2.3.3. Solvency and Profitability

The relationship between solvency and profitability can be strengthened by improving the company's prospects so that it is stronger in obtaining company profits. According to the Pecking Order Theory, it shows that the value of leverage indicates a company that is required to pay off interest costs in full so that it can affect the company's profitability level to decrease. The results of the research are in accordance with those stated by Kridasusila and Rachmawati (2016), companies can show that sales in assets are low, meaning the company is more effective and the acquisition level of investment is low. If the company is more effective with low use of assets, the level of profitability will also increase. Research conducted by Kridasusila and Rachmawati (2016) found that solvency results have a positive effect on profitability. Furthermore, Alexandre and Wiksuana's research (2018) suggests that solvency has a negative effect on profitability. Below, research forms the development of hypotheses, namely:
H3 : Solvability has a positive effect on profitability.

2.3.4. Cash Conversion Cycle and Profitability

One important indicator for companies to maintain competitive environmental competitiveness is profit (Shosa, 2015). Profitability establishes a relationship between revenue and costs that obtains more efficient use of company assets with more productive company operations. Based on research, a company can increase profits which generate income and reduce expenses (Gitman & Zutter, 2015). The results obtained from a high profitability ratio require management to have optimal company performance so as to maximize the value of profitability. One of the measurements used for working capital in this study is the Cash Conversion Cycle (CCC) to convert cash into investments as a company's operational activities. Management measurements contained in working capital use the CCC cycle which aims to determine cash disbursements and cash receipts. Research conducted by Rahmi et al (2015) shows a negative effect on the cash conversion cycle on profitability. However, research by Ponsian et al (2015) shows the results of a positive effect on cash conversion cycle on profitability.
H4 : Cash conversion cycle has a positive effect on profitability.

3. Research methods

3.1. Population, Sample and Data Source

Population, samples and data sources are components of conducting research because without these three components one cannot measure, research and test in more detail.

3.1.1. Population

According to Kusnadi and Mustaroh (2016), the population is formed from the total number of individuals and groups studied with the formation of the same characteristics. The population can refer to the object or subject based on the characteristics studied so that conclusions can be drawn. This research formed the population of the consumer goods sector listed on the Indonesia Stock Exchange from 2014 to 2020. Based on the population elements of the study, there were 58 consumer goods companies.

3.1.2. Sample.

Siyoto (2015) states that the sample is from the number and characteristics obtained by the population for study. Based on the methods and approaches, the sample is the entire population that includes the research. The method in this study uses 2 categories, namely probability and non-probability sampling. Based on probability sampling, the population has the same probability so that it is selected from the simple random sampling alternative which is more effective and efficient. Meanwhile, non-probability sampling refers to sampling that collects information using a purposive sampling method based on a particular group. Therefore, the research conducted sampling using purposive sampling which included non-probability sampling. The method shows that the population does not get the probability of the sample (Sekaran & Bougie, 2016). The purposive sampling method is divided into 2 categories, namely judgment sampling and quota sampling. This study was carried out by means of judgment sampling which stated that sampling was based on subjects who could provide the information needed and the benefits of this could make it easier to obtain relevant data. In addition, the sample must carry out the test in accordance with the provisions stipulated as follows:

a. Consumer goods companies have been listed on the IDX for the 2014-2020 period. If a company that is not registered or has just made an IPO cannot be used as a sample in this study.

b. Companies that did not experience delisting in 2014-2020

c. Complete and publicly accessible company financial reports.

3.1.3 Data Source

Sources obtained in research from data subjects are divided into two categories as follows:

1. Primary Data

Data obtained through directly from the main source. Examples of primary data are the results of interviews and survey results from questionnaires.

2. Secondary Data

Data derived from sources that are already contained in the financial statements. An example of secondary data is research that has a relationship with company conditions and company performance in financial reports.

The data source used in this research is secondary data obtained through the Indonesian Stock Exchange website and the S&P Global Market Intelligence website. The data is taken from the financial reports of consumer goods sector companies listed on the IDX for the 2014-2020 period.

3.2 Definition of Operational Variables

3.2.1 Dependent Variable (Y)

According to Sugiyono (2016), the dependent variable is a variable that can be influenced by the result or occurrence of independent variables. This study uses a variable, namely profitability, which can determine profits according to a certain period. The main focus of the company's performance appraisal is to generate profits from operating activities. Measuring profitability using Return on Assets (ROA). This ratio can determine the ratio of net income earned to shareholders. If the ROA value is high, the company's performance prospects are good so that the return on investment is also more efficient provided by the company (Wild Subramanyam and Halsey, 2018).

$$Return\ On\ Asset = \frac{Net\ Income}{Sales} x \frac{Sales}{Total\ Asset}$$

3.2.2 Independent Variable (X)

Research by Sekaran and Bougie (2016), the independent variable is a variable that can affect the causes of changes in the dependent variable. The variables used in this research are business risk, liquidity, solvency, and cash conversion cycle.

3.2.2.1 Business Risk

The business risk variable shows the risk depiction of the company's failure to obtain results within the company (Gitosudarno, 2018). Risk is defined as the result of differences in returns faced by the company. This can cause difficulties in conducting external funding according to the theory that has a positive effect on business risk. The measurement of business risk is the degree of operating leverage. This ratio shows the effect of the fixed operating costs incurred by the company. Analysis of the degree of operating leverage to determine changes in sales results obtained so that losses do not occur.

$$DOL = \frac{persentase\ perubahan\ EBIT}{persentase\ perubahan\ Sales}$$

3.2.2.2 Liquidity

Liquidity is a ratio that can determine liabilities in the short term. The liquidity ratio used to analyze the financial statements listed from the solvency of the company is able to pay bills according to maturity which has shown problems in business failure. Measurement of liquidity uses the current ratio. Based on research by Gitman (2015), the current ratio is one of the financial ratios that are required to make payments with current assets.

$$Current\ Ratio = \frac{Current\ Asset}{Current\ Liabilities}$$

3.2.2.3 Solvability

Companies that show high solvency ratios can have a large financial risk, but on the other hand have the opportunity to earn high profits. When there is a big financial risk, the company is obliged to bear the burden of making interest payments. However, if the loan funds are used effectively in purchasing certain assets to finance the company's expansion. Conversely, a company that obtains a small solvency scale score, the financial risk experienced is low. Research on the solvency ratio is proxied by the debt to equity ratio. This ratio is a comparison between the amount of debt and equity used in the company's operations by adjusting the financial position.

$$Debt\ to\ Equity\ Ratio = \frac{Total\ Debt}{Total\ Equity}$$

3.2.2.4 Cash Conversion Cycle

Cash turnover can be done with the cash conversion cycle by knowing the company's progress in converting money to accounts payable inventory (Anjum and Malik, 2018). The cash conversion cycle shows the results of the production process tied to the sale of operations with the acquisition of profit as a requirement for payment from creditors. The measurement used in the cash conversion cycle is the number of periods that convert inventory plus the period of addition minus the suspension of debt.

$Cash\ Conversion\ Cycle = DIO + DSO - DPO$

Information:

Outstanding Inventory Days : $\frac{Average\ Inventory}{COGS/Period}$

Days Sales Outstanding : $\frac{Account\ Receivable}{Total\ Credit\ Sales}\ x\ Days\ the\ Period$

Outstanding Days Payables : $\frac{Account\ Payable}{COGS}\ x\ Number\ of\ Days$

3.2.3.1 Firm Age

A company was established from a predetermined age, so you can find out how long it took from the time it was founded to when the company was still in existence (Paramitha and Rohman, 2020). Companies that have been established for a long time usually form a more in-depth experience than companies that have just been established because they have learned how to maintain business existence and maintain product quality so that companies provide innovations that use more sophisticated technology. Based on research byYameen et al (2019) it states that the age of a company can be measured by the difference in the year the research was conducted and the year the company was founded.

3.3 Empirical Research Model

In order to test the hypothesis, an empirical model can be formed which will be examined as follows:

$$PROF = \alpha + \beta_1 RB + \beta_2 LIQ + \beta_3 SOLVA + \beta_4 CCC + \beta_5 FA + \varepsilon$$

Description:

PROF	= Profitability
α	= Constant
$\beta_1 - \beta_5$	= Coefficient of parametric
RB	= Business Risk
LIQ	= Liquidity
$SOLVA$	= Solvability
CCC	= *Cash Conversion Cycle*
FA	= Firm Age
ε	= Error term

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