

Does COVID-19 Pandemic Impact on Financial Difficulties in Indonesian Tourism Sector Companies?

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Abstract

President of the Republic of Indonesia, Joko Widodo has determined the strategic role of tourism as a leading sector in national development in his two leadership periods. However, since the emergence of the Covid-19 outbreak in early 2020, the tourism industry and its related sectors, including hotels, food and beverage establishments, cleaning services, local tour guides, and transportation, have experienced considerable setbacks. The performance of the tourism industry amid the Covid-19 outbreak has received significant attention. The Covid-19 outbreak, which began in 2020, has restricted people's mobility, particularly impacting the travel of international tourists to Indonesia. Companies operating in the tourism sector, such as those in the hotel, resort, and cruise line industries, now face various risks, such as decreasing revenue and operating income. This decline will undoubtedly result in financial hardships. This study examines the differences in financial distress and litigation risk of hotel, resort, and cruise line sub-industry companies prior to and following the onset of the pandemic. The Paired Sample T-test is utilized for hypothesis testing, contingent upon fulfilling the normality test requirement. However, if the normality test results indicate the non-normal distribution of residuals, non-parametric statistical methods, such as the McNemar test and Wilcoxon test, will be utilized for data analysis. The study presents findings that demonstrate differences in financial distress and litigation risk within the Hotel, Resort, and Cruise Line Sub-Industry companies prior to and following the pandemic.

Keywords: COVID-19; Financial Distress; Litigation Risk; Tourism Sector; Indonesia

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1. Introduction

Tourism is the backbone of Indonesia's economy and one of the main contributors to the country's foreign exchange earnings. According to the Organization for Economic Cooperation and Development (OECD) in its report *Tourism Trends and Policies 2020*, the tourism sector contributed up to 536.8 trillion rupiahs or 4.1% of Indonesia's total Gross Domestic Product (GDP) in 2017, and it increased to 6.1% in 2019. Strategically, the tourism sector provides employment for 12.7 million people or 10.5% of the total national workforce. The annual growth of Indonesia's tourism sector has also exceeded the average growth of other sectors in the national economy over the past 15 years (Dartiningsih, 2022)

However, this positive contribution was interrupted by the emergence of the COVID-19 pandemic, which initiated a health and global financial crisis (Azizah, Thalib, et al., 2022), (Azizah, Fredy, et al., 2022). Restriction of movement, strict lockdown measures, and limitations on international transportation have made the tourism sector sluggish. International tourist arrivals experienced a drastic decline after continuously showing positive trends for ten years until 2019, and the decline continued in 2020 and 2021.

The outbreak of COVID-19 has had a disruptive effect on both global and domestic supply chains (Azizah, 2021), (Azizah et al., 2021), resulting in fluctuations in financial markets, unexpected shifts in consumer demand, and detrimental consequences for significant sectors like travel and tourism. The COVID-19 pandemic evidently has had a far-reaching influence on every aspect of the tourism value chain.

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The number of foreign tourist visiting Indonesia from 2010 until 2019 continued to show growth. But in 2020, The number of foreign tourism visits only reached 4,05 milion, compared with 2019, reached more than 16 million visitors. Until 2021 the condition has not improved (Anggarini, 2021). One of the sub-industries in the tourism sector influenced by the COVID-19 outbreak is the Hotel, Resort, and Cruise Line industry, which relies heavily on tourism and recreation. Azizah et al. (2023) explain that the active mobilization of the population is crucial for this business. However, due to the spread of COVID-19, many countries have implemented restrictions on outdoor activities, foreign flight limitations, and even lockdowns, causing companies in this business to face significant challenges (Azizah, 2022).

Companies in the hotel, resort, and cruise line sectors are facing a drop in demand from tourists. This situation has resulted in financial difficulties for these companies. If this situation persists, companies may face financial distress and litigation risks. Financial distress refers to a sustained financial decline experienced by a company over several consecutive years, leading to bankruptcy (Liliani, 2021). Litigation risk is associated with the possibility of the company being involved in litigation by investors and creditors (Agata et al., 2021). Poor financial conditions for companies pose a significant problem for the companies and stakeholders (Putri et al., 2023; Widanengsih et al., 2022). Therefore, companies should conduct further analysis to anticipate worst-case scenarios, manage and control their financial conditions more effectively, and avoid financial failure.

2. Literature Review

2.1. COVID-19 Pandemic and Financial Distress

Badan Pusat Statistik (2021) recorded a cumulative decline in international tourist arrivals to Indonesia when the COVID-19 pandemic hit. Previously, the trend of tourist visits had been increasing from 2018 to 2019. The COVID-19 outbreak that started in 2020 limited the mobility of the population, especially restricting the movement of foreign tourists visiting Indonesia. Until 2021, the condition of the tourism sector has not improved, as reflected in the decrease in international tourist arrivals compared to pre-pandemic conditions (Rachmawati, 2022). In 2020, Indonesia witnessed a problematic situation as the influx of international tourists amounted to merely 4.052 million individuals. This number is highly alarming, accounting for only about a quarter of the total tourist arrivals recorded in 2019.

The decline in international tourist arrivals and the limited mobility of domestic tourists have inevitably decreased hotel occupancy rates. According to Firdaus et al., (2020), numerous companies expressed apprehension regarding their financial performance in 2020 owing to the economic downturn triggered by the COVID-19 outbreak. The pandemic had a significant impact on financial results in 2020, particularly in terms of lower corporate sales due to weakened consumer purchasing power. Similarly, in 2021, the COVID-19 pandemic has not subsided, and the mobility of the population remains limited.

An explains that the low population mobilization has overwhelmed companies operating in the tourism sector. The declining revenue but ongoing operational costs have put these companies in financial difficulty. This explanation is consistent with a study conducted by Budiyantri, et.al (2020), which suggests that the impact of the COVID-19 pandemic has caused many travel and aviation companies to suffer losses due to flight suspensions.

The financial difficulties faced by companies in the tourism sector have forced them to lay off employees. Based on data from BPS in 2020, approximately 409 thousand individuals employed in the tourism industry experienced unemployment due to the COVID-19 pandemic (Wicaksono, 2021). However, the tourism sector has been labor-intensive and employs many workers. The level of financial difficulty can be seen as the initial effects of organizational bankruptcy.

2.2. COVID-19 Pandemic and Litigation Risk

Litigation risk refers to the inherent risk faced by a company that may result in threats of litigation from stakeholders who feel aggrieved by the company. From the creditor's perspective, the threat of litigation arises when a company fails to fulfil its contractual obligations, such as the inability to repay agreed-upon debts. On the other hand, from the investor's perspective, the threat of litigation arises when the company's operations result in losses for the investors, as reflected in the movement of stock prices and volumes. Fluctuations in stock prices indicate the investor's response to the company's deteriorating condition (Agata et al., 2021)

Concerning the circumstances encountered by companies within the hotel, resort, and cruise line sub-industry, a sharp decline in tourist numbers has been observed since the onset of the COVID-19 pandemic. This decline has caused a significant influence on the companies' revenue, intensifying the pressure on them and potentially leading to challenges in debt repayment. Sambodo (2020) explains that the COVID-19 pandemic has resulted in liquidity difficulties for tourism sector companies, including defaults on investment loans and working capital.

According to a study by Khoiriah et al. (2020), there is a notable disparity in the Average Abnormal Return (AAR) for investors prior to and amidst the COVID-19 outbreak. The pandemic has influenced investors to make investment decisions, especially in the tourism sub-sectors such as hotels, restaurants, and tourism companies.

3. Research Method and Materials

The research was conducted on companies in the Hotel, Resort, and Cruise Line sub-industry enlisted on the Indonesia Stock Exchange from 2018 to 2021. The sample was selected through purposive sampling to obtain samples representing the predetermined criteria. The criteria set for sample selection were as follows:

- a. Companies consecutively enlisted on the Indonesia Stock Exchange in 2018 and 2021.
- b. Companies that publish audited financial reports.
- c. Companies with complete data required for this research.

The variables used in this research are financial distress and litigation risk. Financial distress refers to a condition where a company's financial health is compromised, resulting in financial difficulties. The assessment of financial distress in this research is done using the Revised Altman Model (Barry, 2019), commonly known as the Z-Score bankruptcy prediction model. Damayanti et al., (2019) conducted research with the title Analisis Perbandingan Model Prediksi Kebangkrutan Altman Z-Score dan Zmijewski di Bursa Efek Indonesia Periode 2011-2015, the results the Altman Z Score model is more accurate in predicting bankruptcy in the period leading up to bankruptcy, one or two years before the company was out from the stock exchange. The formula of Z-Score is as follows:

$$Z' = 6,56X1 + 3,62X2 + 6,72X3 + 1,05X4$$

with:

X1 = working capital/total assets

X2 = retained earnings/total assets

X3 = earnings before interest and taxes/total assets

X4 = Market value of equity/book value of debt

The calculated Z-score is then categorized into three categories based on the Z-score values as follows:

- a. If $Z > 2.99$, the company is estimated to be not bankrupt or in a healthy state (safe zone).
- b. If $1.22 < Z < 2.99$, the company's health or financial distress cannot be determined (grey area).
- c. If $Z < 1.22$, the company is predicted to be bankrupt (distress zone).

Financial distress in this research is represented by a dummy variable. It is coded as 1 for companies in the distress zone (bankrupt) and 0 for companies in the grey area (undetermined health or financial distress) and safe zone (not bankrupt).

Litigation risk refers to the risk inherent in a company that may lead to threats of litigation from stakeholders who feel aggrieved by the company. Litigation risk can be measured using various financial indicators that determine the likelihood of litigation. Based on Agata et al. (2021), the Debt to Equity Ratio (DER) is a suitable litigation risk measure. The higher the DER ratio, the greater the litigation risk the company faces, as the debt is much larger than the equity the company uses to cover its debt. Therefore, this research uses the Debt to Equity Ratio as a proxy for litigation risk.

$$DER = \frac{\text{Total Debt}}{\text{Total Equity}}$$

The pre-test period before COVID-19 includes 2018 and 2019, while the post-test period during the COVID-19 outbreak includes 2020 and 2021. The COVID-19 pandemic declared by the WHO on March 11, 2020 (WHO, 2020) is the basis for the period when the pandemic occurred, which falls within the year 2020.

The hypothesis testing is conducted using the Paired Sample T-test, with the requirement of normality assumption fulfillment. If the results of the normality test indicate a non-normal distribution of residuals, alternative statistical methods, such as the McNemar test and Wilcoxon test, non-parametric approach, will be employed to analyze the data.

4. Result and Discussion

The research sample comprises all companies operating in the Hotel, Resort, and Cruise Line sub-industry that are listed on the Indonesia Stock Exchange during the period from 2018 to 2021. This research includes a sample of 17 companies, selected based on predetermined criteria for sample selection.

After conducting the normality test, it was discovered that the data for both the financial distress and litigation risk variables do not follow a normal distribution. Consequently, non-parametric statistical techniques, particularly the Wilcoxon test and McNemar test are employed in this study (Ghozali, 2016). The findings of the hypothesis testing for the difference in financial distress using the McNemar test are outlined in Table 1.

Table 1. Results of Financial Distress Difference Testing

Test Statistics^a	
	Before Covid-19 Pandemic & During Covid-19 Pandemic
N	34
Exact Sig. (2-tailed)	.008 ^b

a. McNemar Test

b. Binomial distribution used

Referring to the provided McNemar test output table, it is evident that the Sig. value is $0.008 < 0.05$. Hence, it can be inferred that there is a difference in financial distress between the pre-test and post-test periods in the Hotel, Resort, and Cruise Line sub-industry.

Based on the Wilcoxon test output table 2, the Sig. value is $0.029 < 0.05$. Therefore, it can be concluded that there is a difference in litigation risk between the pre-test and post-test periods in the Hotel, Resort, and Cruise Line sub-industry.

Table 2. Results of Litigation Risk Difference Testing

Test Statistics^a	
	Before Covid-19 Pandemic & During Covid-19 Pandemic
Z	-2,180 ^b
Exact Sig. (2-tailed)	.029

a. Wilcoxon Signed Ranks Test

b. Based on negative ranks

The COVID-19 pandemic spread when the world was interconnected in economic, political, and socio-cultural interactions. This resulted in policies taken by one country affecting others. The pandemic forced governments to implement social restrictions and prohibit tourist visits from both domestic and international travelers. The tangible impact observed is the decreased income for workers in this sector. Considering the pandemic, companies have shifted their focus toward sustaining consistent sales effectiveness and mitigating the risk of bankruptcy. Consequently, since the pandemic outbreak, financial distress has threatened many companies, especially in Indonesia.

This research successfully proves differences in financial distress and litigation risk between the pre-pandemic period (2018 and 2019) and the pandemic period (2020 and 2021). The results of this research align with the data from the Ministry of Tourism and Creative Economy (2021), which states that the prolonged COVID-19 pandemic has caused a decline in the country's tourism and recreation industry's revenue by 20.7 billion. Since the instruction to maintain distance and engage in activities at home, the revenue of the tourism and recreation industry has significantly declined. The tourism and recreation industry's economy has been hit the hardest compared to other sectors.

Furthermore, this research also proves differences in litigation risk between the pre-pandemic period (2018 and 2019) and the pandemic period (2020 and 2021). During the pandemic, there was an increase in litigation risk. This was due to the pressure of the company's debt to cover operating costs, bringing about future obligations to repay the debt.

In regions where tourism plays a crucial role in generating income, concerns, and pessimism regarding the future of the tourism sector have emerged, particularly among areas heavily reliant on or aspiring to develop tourism. The uncertainty surrounding the duration of the COVID-19 pandemic has contributed to this unease. Sambodo (2020) asserts that the economic impact of the COVID-19 outbreak on the tourism sector includes: 1) Temporary closures of hotels, restaurants, and other tourism-related industries; 2) Workforce reduction through unpaid leave or termination of employment; 3) Challenges in maintaining liquidity, such as defaulting on investment and working capital loans; and 4) Permanent closure of businesses.

A substantial amount of corporate debt signifies heightened financial risks as companies face difficulties meeting their large debt obligations (Oktrivina & Azizah, 2022). Annual financial statements reflect this decline in performance, showcasing a growing number of unpaid debts that have reached their maturity dates.

5. Conclusion

In early 2020, the world faced the Covid-19 pandemic, which profoundly and widely impacted various aspects of human life. The Covid-19 pandemic has spread globally to no fewer than 218 countries, including Indonesia. In the National Medium-Term Development Plan (RPJMN) 2020-2024, Indonesia predicted that the risk of uncertainty would continue to significantly impact the development of Indonesia's economy and the world. The Covid-19 pandemic affected not only the social, education, and economic sectors but also the tourism sector. The massive social restrictions (PSBB) and the closure of recreational and entertainment venues aimed at curbing the spread of Covid-19 have decreased community mobility, which has caused a significant economic impact on the tourism sector.

The impact of Covid-19 on the tourism industry can be seen in the decline in foreign and domestic tourist arrivals. Entrepreneurs in the tourism industry have faced difficulties in financing their operations due to decreased income and losses caused by reduced business revenue. The increasing level of debt has further burdened these companies. This study has effectively demonstrated differences in financial distress and litigation risk between the periods prior to and following the pandemic within the Hotel, Resort, and Cruise Line sub-industry.

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