E-ISSN: 2986-5050, P-SSN: 2986-5336
DOI: https://doi.org/10.38035/gijea.v2i4
Received: December 04th, 2024, **Revised:** December 10th, 2024, **Publish:** December 16th, 2024

Effect of Capital Adequacy Ratio, Credit Policy, Liquidity Risk and Non-Performing Loan on Financial Distress

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Abstract: The purpose of this literature research is to build hypotheses regarding the influence between variables which can later be used for further research in financial management. The literature review research article on the effect of Capital Adequacy Ratio, Credit Policy, Liquidity Risk, and Non-Performing Loans on Financial Distress is a scientific literature article within the scope of financial management science. The approach used in this literature review research is descriptive qualitative. The data collection technique uses literature studies or reviews relevant previous articles. The data used in this descriptive qualitative approach comes from previous research that is relevant to this research and comes from academic online media such as Thomson Reuters Journals, Springer, Taylor & Francis, Scopus Emerald, Elsevier, Sage, Web of Science, Sinta Journals, DOAJ, EBSCO, Google Scholar and digital reference books. In previous studies, 1 relevant previous article was used to review each independent variable. The results of this literature review article are: 1) Capital Adequacy Ratio affects Financial Distress; 2) Credit Policy affects Financial Distress; 3) Liquidity Risk affects Financial Distress; and 4) Non-Performing Loan affects Financial Distress.

Keywords Financial Distress, Capital Adequacy Ratio, Credit Policy, Liquidity Risk, Non-Performing Loan

INTRODUCTION

An organization or company is an entity consisting of a group of people or resources that work in a structured and coordinated manner to achieve specific goals. Organizations usually have a vision, mission, and values that guide them in carrying out their activities, while a business is a special form of organization that engages in business with the primary

objective of making a profit. In addition to profit, the main goal of a company or organization is to achieve sustainability, with the end result of gaining a competitive advantage.

However, in achieving sustainability, a company or organization must be able to have resources that facilitate all its needs. The needs of the organization or company can be realized through the budget or costs provided directly by the company. But not all organizations or companies are able to meet these financial needs. This can be seen in previous research conducted by Hutauruk et al., (2021), related to financial distress experienced by several *food and beverage* sector companies listed on the Indonesia Stock Exchange for the 2015-2020 period. Where out of 3 companies, 1 company continues to experience continuous losses, and the value of its assets also continues to decline. Based on this, the company is said to be on the verge of bankruptcy, and will occur from a financial distress condition.

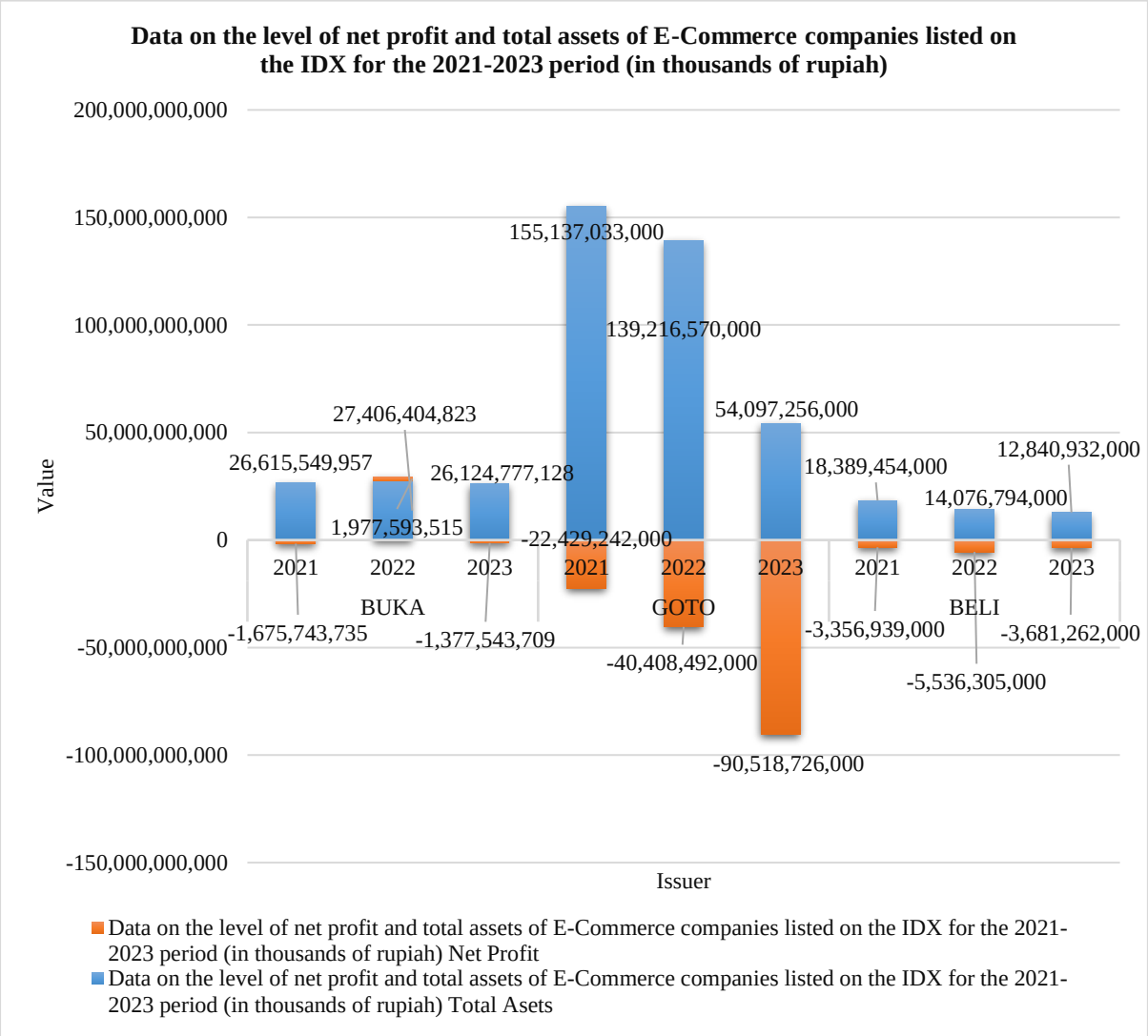

Figure 1. Data on the level of net profit and total assets of E-Commerce companies listed on the IDX for the 2021-2023 period (in thousands of rupiah)

Source: Secondary data processed (IDX 2024)

The results of the financial statements obtained from the Indonesia Stock Exchange in 2024, it is known that the report can provide an overview of the company's financial

predictions, especially in e-commerce companies in the future. Of the 3 samples of e-commerce companies, the difference in asset levels is quite significant. Judging by Total Assets, BUKA and GOTO are ranked higher than BUY. In terms of net profit, GOTO has experienced continuous losses in the last 3 years, and BUKA and BELI have experienced the same thing fluctuating. The presumption of the phenomenon of *financial distress* that occurs in these 3 e-commerce companies is supported by research conducted by Hutauruk et al., (2021), that there are facts in the cumulative data that are negative for a certain period of time in a row, experiencing losses to poor performance.

Financial distress is a critical condition that can threaten the survival of a company, particularly in the banking and financial sector. This situation is often caused by an imbalance between a company's revenues, expenses and liabilities, resulting in an inability to meet its financial obligations. In the banking sector, financial distress has a broader impact because it is directly related to the economic stability of a country. Banks, as financial intermediaries, are highly vulnerable to market dynamics influenced by various factors such as capital adequacy, credit policy, liquidity risk and non-performing loans. Therefore, the management of these factors becomes crucial to prevent financial distress.

Thus, research on the effect of capital adequacy ratio, credit policy, liquidity risk and non-performing loans on financial distress is highly relevant. This research not only helps to understand the relationship between these factors, but also provides practical insights for banks in designing effective mitigation strategies to prevent financial distress. Thus, the findings of this study are expected to contribute to strengthening the stability of the banking sector both nationally and internationally.

Problem Formulation

Based on the background of the problem above, the problem formulation is obtained to be used as a hypothesis for further research, among others: 1) Does Capital Adequacy Ratio affect Financial Distress?; 2) Does Credit Policy affect Financial Distress?; 3) Does Liquidity Risk affect Financial Distress?; and 4) Does Non Performing Loan affect Financial Distress.

METHOD

This research uses a descriptive qualitative approach. This method was chosen because it allows researchers to investigate and understand the phenomenon of financial distress thoroughly. Descriptive qualitative data collection and analysis allows researchers to customize their approach to the needs of the research and the characteristics of the subject under study.

The data used in this study comes from previous research on the topics of financial distress, CAR, Credit Policy, Liquidity Risk and Non Performing Loan for the period 2020-2024. Researchers will analyze existing literature to identify patterns and trends in financial distress, CAR, Credit Policy, Liquidity Risk and Non Performing Loan. By using previous research, researchers can develop stronger, evidence-based arguments and contribute to a broader understanding of the factors that influence financial distress, (Susanto et al., 2024).

Data was collected through a literature review. The literature review is an important step in this study as it allows researchers to identify and analyze various sources relevant to the topic at hand. The researcher will collect data from journal articles, books, and other relevant documents to gain insight into financial distress. The literature review also informs researchers about the latest developments in this field and identifies research gaps that need to be filled.

This research utilizes data from various reputable academic journals, including Thomson Reuters Journal, Springer, Taylor & Francis, Scopus, Emerald, Sage, WoS, Sinta

Journal, DOAJ, and EBSCO, as well as platforms such as Publish or Perish and Google Scholar. By using these sources, researchers can ensure that the data they collect is valid and accountable. The use of multiple sources also allows researchers to gain a more comprehensive understanding of financial distress, CAR, Credit Policy, Liquidity Risk and Non Performing Loan from various perspectives.

RESULTS AND DISCUSSION

Results

The following are the research findings by considering the context and problem formulation:

Financial Distress

Financial distress is the financial condition of a company that indicates an inability to meet short-term and long-term obligations. This situation often occurs when incoming cash flow is insufficient to pay debt interest, employee salaries or other operating expenses. Factors contributing to financial distress include declining sales, high debt levels and a lack of effective financial management. This condition can be the beginning of bankruptcy if the company cannot improve its financial structure. In the context of company analysis, financial distress is used as an indicator to assess the level of risk of bankruptcy or long-term losses (Sinambela & Marpaung, 2019).

Indicators or dimensions contained in the Financial Distress variable include: 1) Negative operating cash flow: Indicates that operating income is not sufficient to cover operating expenses or current liabilities; 2) High debt-to-equity ratio: Indicates the company's reliance on debt to finance its operations; 3) Net Income Performance: Low or negative net income is an early indicator of potential financial distress; 4) Decline in Asset Value: A significant decline in asset value indicates financial losses or poor asset management; 5) Bond Default Rate: The inability to pay interest or principal on bond loans is a clear sign of financial distress; and 6) Low Liquidity Ratio: The inability to convert assets into cash in a short period of time indicates liquidity weakness (M. F. A. Faisal, 2022).

Financial Distress variables are relevant to previous research that has been researched by: (Hutauruk et al., 2021), (Dewi et al., 2019), (Syuhada. Putri, 2020).

Capital Adequacy Ratio

Capital Adequacy Ratio (CAR) is a ratio that measures the adequacy of a bank's capital to bear the risk of loss on risky assets. This ratio is used to ensure that banks have sufficient capital to protect customer funds while maintaining financial stability. The CAR formula typically includes the ratio of Tier 1 and Tier 2 capital to risk-weighted assets (RWA). International regulations such as Basel III require a minimum CAR of around 8%. A high CAR indicates that the bank has a good financial capacity to deal with operational or credit risks. Conversely, a low CAR may indicate that the bank is vulnerable to financial disruption (Ichsan & Nasution, 2020).

Indicators or dimensions contained in the Capital Adequacy Ratio variable include: 1) Tier 1 Capital: Measures the bank's primary financial strength, including common equity and retained earnings; 2) Tier 2 capital: Additional capital, such as revaluation reserves or subordinated debt, to cover additional risks; 3) Risk-weighted assets: The value of assets adjusted for risk, such as risky loans or investments; 4) Minimum CAR ratio: The level of the CAR ratio set by the regulator as a minimum limit to be maintained; 5) Leverage Ratio: Measures the bank's total assets compared to its capital to see the level of dependence on debt; and 6) Basel III Compliance: Compliance with international standards that ensure the stability of bank capital (Budianto & Dewi, 2022).

The Capital Adequacy Ratio variable is relevant to previous research that has been researched by: (Suroso, 2022), (Anggari & Dana, 2020), (Dao, 2020).

Credit Policy

Credit policies are guidelines used by financial institutions or companies to govern lending to individuals or organizations. These policies include eligibility criteria, interest rates, repayment terms, and credit monitoring and control mechanisms. The main objective of a credit policy is to minimize the risk of non-performing loans (NPLs) while supporting the growth of the loan portfolio. Good policies help companies or banks manage cash flow more effectively and ensure regulatory compliance (Egga Pratiwi et al., 2024).

Indicators or dimensions contained in the Credit Policy variable include: 1) Lending Criteria: Eligibility standards for potential borrowers to reduce the risk of default; 2) Credit Ceiling Limit: The maximum amount of credit that can be extended to a borrower to maintain risk exposure; 3) Lending Rate: A competitive interest rate policy that takes into account credit risk; 4) Credit Assessment Process: Procedures for analyzing the eligibility and repayment ability of prospective borrowers; 5) Credit Monitoring Mechanism: Oversight measures to monitor loan performance throughout the life of the loan; and 6) Non-performing loan management: Resolution strategies to mitigate the impact of bad loans (Zulna, 2022).

Credit Policy variables are relevant to previous research that has been researched by: (Hartati et al., 2010), (Budiman & Supianto, 2020), (Hidayat et al., 2022).

Liquidity Risk

Liquidity risk is the risk that a company or financial institution is unable to meet its short-term financial obligations due to a shortage of liquid assets. For banks, this risk arises when there are insufficient funds to meet depositor withdrawal requests or maturing loan obligations. Liquidity risk can be exacerbated by a crisis of market confidence or poor cash management. It is therefore important for companies to have a liquidity management strategy that includes cash flow management, diversification of funding sources and asset allocation (Husain, 2021).

Indicators or dimensions contained in the Liquidity Risk variable include: 1) Liquidity Ratio: Measures the ability of a company or bank to meet short-term obligations; 2) Loan-to-Deposit Ratio (LDR): A comparison of total loans to total deposits to assess the bank's liquidity; 3) Liquid assets: The amount of assets that can be converted into cash immediately without loss of value; 4) Daily Cash Flow: Measures the stability and smoothness of cash inflows and outflows; 5) Emergency Credit Facility Availability: A source of additional funds to meet urgent needs; and 6) Asset Portfolio Management: Asset management strategies to ensure adequate liquidity (Dewi et al., 2019).

The Liquidity Risk variable is relevant to previous research that has been researched by: (Kristin et al., 2021), (A. Faisal et al., 2021), (Shidiq & Khairunnisa, 2019), (Amin et al., 2022).

Non Performing Loan

Non-performing loans (NPLs) are loans that fail to make their principal or interest payments within a specified period of time, usually more than 90 days. The NPL ratio is an important indicator of a bank's financial health, with a high ratio indicating an increased risk of non-performing loans. Factors that cause NPLs include poor economic conditions, debtors' inability to manage their finances, or inadequate credit risk assessment. To manage NPLs, banks typically implement strategies such as loan loss provisions, loan renegotiation or the sale of collateral assets (Ichsan & Nasution, 2020).

Indicators or dimensions contained in the Non Performing Loan variable include: 1) NPL to Total Loan Ratio: Measures the ratio of nonperforming loans to the total loan portfolio; 2) Nonperforming Loan Age: The length of time that a loan is past due on principal or interest, typically more than 90 days; 3) Allowance for Loan Losses: The amount of funds allocated to cover potential losses due to NPLs; 4) Effective Collection Process: The effectiveness of collection mechanisms to reduce the number of nonperforming loans; 5) Loan Restructuring: Efforts to modify loan terms to help debtors repay their debts; and 6) Debtor Profile Quality: An assessment of a borrower's risk based on their credit history, income, and assets (Towhid et al., 2019).

The Non Performing Loan variable is relevant to previous research that has been researched by: (Ningsih & Dewi, 2020), (Yusuf et al., 2022), (Soekapdjo, 2020).

Previous Research

Based on the findings above and previous studies, the following research discussion is formulated:

Table 1. Relevant Previous Research Results

No	Author (Year)	Research Results	Similarities With This Article	Differences With This Article
1	(Putri, 2021)	-The Capital Adequacy Ratio variable affects Financial Distress at Islamic Commercial Banks for the period 2017-2019 -The variable Return on Equity has an effect on Financial Distress at Islamic Commercial Banks for the period 2017-2019 -The Return on Assets variable has an effect on Financial Distress at Islamic Commercial Banks for the period 2017-2019	This article has in common that it examines the Capital Adequacy Ratio variable in the independent variable, and examines the Financial Distress variable in the dependent variable.	-The difference with previous research is that the research subject is the financial statements of Islamic commercial banks for the 2017-2019 period. -Another difference is that there are differences in the ROE and ROA variables as other independent variables
2	(Citra Wulandari et al., 2022)	-The variables of Credit Policy, Leverage, Average Collection Period, Sales Growth, Profitability have an effect on Financial Distress	This article has in common that it examines the Credit Policy variable in the independent variable, and examines the Financial Distress variable in the dependent variable.	Another difference is that there are differences in the variables of Leverage, Average Collection Period, Sales Growth and Profitability as other independent variables.
3	(Gunawan Aji et al., 2023)	-The Liquidity Ratio variable affects Financial Distress -Credit Risk variable has an effect on Financial Distress -Good Corporate Governance variable affects Financial Distress -Leverage variable has an effect on Financial Distress	This article has in common that it examines the Liquidity Ratio variable in the independent variable, and examines the Financial Distress variable in the dependent variable.	The difference with previous research is in the variables of Credit Risk, GCG and Leverage as other independent variables.
4	(Suhartant	-The Non Performing Loan	This article has in	-The difference with

o et al., 2022)	variable affects Financial Distress at BUMN Banks in Indonesia for the period 2014-2021 -The Loan to Deposit Ratio variable has an effect on Financial Distress at BUMN Banks in Indonesia for the period 2014-2021 -The variable Return on Asset affects Financial Distress at BUMN Banks in Indonesia for the period 2014-2021 -The Capital Adequacy Ratio variable has an effect on Financial Distress at BUMN Banks in Indonesia for the period 2014-2021	common that it examines the Non Performing Loan variable in the independent variable, and examines the Financial Distress variable in the dependent variable.	previous research is that the research subject is the financial statements of BUMN Banks in Indonesia for the 2014-2021 period. -Other differences are that there are differences in the variables Loan to Deposit Ratio, ROA and CAR as other independent variables

Discussion

This literature review will be discussed based on the history of the topic, research objectives, problem formulation, indicators or dimensions, and related previous research:

Effect of Capital Adequacy Ratio on Financial Distress

Capital Adequacy Ratio (CAR) plays an important role in mitigating the risk of financial distress, which is characterized by indicators such as negative operating cash flow, high leverage, and asset impairment. Tier 1 capital, a key component of CAR, provides a stable financial foundation for financial institutions. Strong Tier 1 capital allows banks to cover operating losses without disrupting normal operations. This can reduce pressure on operating cash flows, which is often one of the first signs of financial distress. With sufficient Tier 1 capital, banks have the ability to remain liquid even in the midst of difficult economic conditions.

In addition to Tier 1 capital, Tier 2 capital also contributes to risk management. Tier 1 capital provides additional protection against unexpected losses. In the event of financial distress, Tier 1 capital can be used to absorb losses on risky assets, thereby reducing pressure on the leverage ratio. This ratio is critical to maintaining investor and creditor confidence, as excessive leverage is often the primary trigger for bankruptcy or default. A balanced capital structure between Tier 1 and Tier 2 capital helps banks maintain financial stability.

Risk-weighted assets also play a key role in the CAR. Assessing the risk of assets allows banks to prioritize the allocation of capital to riskier assets in order to anticipate future losses. This has implications for the management of net income performance, as well-managed risky assets can generate optimal returns without incurring significant losses. Failure to manage risky assets appropriately can lead to a decline in asset value, which has a direct impact on financial distress.

The Capital Adequacy Ratio (CAR) is a key regulatory indicator of a bank's financial health. CAR compliance ensures that banks have sufficient capital reserves to cover their risk exposures. In the context of bond default rates, maintaining a CAR can increase market confidence in the bank's ability to meet its debt obligations. This is important to prevent financial instability that could trigger a spiral of financial distress.

The leverage ratio is also an important component of the CAR that affects liquidity risk. This ratio ensures that the bank does not rely excessively on debt to fund its operations. Excessive reliance on debt can lead to liquidity problems, particularly in the event of market disruptions or large depositor withdrawals. By maintaining a healthy leverage ratio, a bank can ensure that it has sufficient liquidity to meet its short-term obligations.

Finally, Basel III compliance is an overarching factor in CAR management. This standard not only regulates minimum capital requirements, but also emphasizes the importance of liquidity risk management and financial transparency. In the context of financial distress, Basel III compliance ensures that banks have a robust risk management system in place that includes proactive risk assessment and implementation of mitigation strategies. Basel III also requires banks to have recovery plans in place for emergency situations, which can help prevent financial distress from escalating into insolvency.

Thus, the capital adequacy ratio, through its components such as Tier 1 capital, Tier 2 capital, risk-weighted assets, CAR, leverage ratio, and Basel III compliance, collectively helps manage the various aspects that contribute to financial distress. Good management of CAR not only prevents distress, but also enhances stakeholder confidence, maintains financial stability, and ensures operational sustainability amidst economic challenges.

Effect of Credit Policy on Financial Distress

Credit policy is one of the most important tools for preventing and managing financial distress, which is characterized by conditions such as negative operating cash flow, high leverage, asset impairment and low liquidity. Lending criteria are the first step in determining the quality of the loan portfolio. By applying strict criteria, such as business viability analysis and risk assessment of prospective borrowers, banks can ensure that credit is only extended to borrowers with sufficient ability to pay. This prevents defaults that could potentially reduce the bank's operating cash flow.

The credit limit is also an important factor. Setting the maximum amount of credit that can be extended to a particular borrower or sector aims to spread risk more evenly. If credit limits are not properly managed, banks risk having a high concentration of credit in vulnerable sectors. If such sectors experience economic pressures, this could lead to a decline in asset values and threaten the financial stability of the bank. Therefore, careful management of credit limits can mitigate the adverse impact on the overall credit portfolio.

In addition, lending rates play an important role in attracting potential borrowers while maintaining the financial health of the bank. Setting interest rates that are competitive but still commensurate with the risk level of the borrower can lead to an increase in interest income, which directly contributes to net income performance. However, rates that are too low without regard to risk can reduce a bank's profit margin, while rates that are too high risk increasing default rates and contributing to a high leverage ratio due to bad debt.

Credit underwriting is the next critical step in credit policy. A comprehensive assessment includes analysis of repayment capacity, market conditions, and industry risk. This process ensures that only loans with an acceptable level of risk are approved. If this process is weak or rushed, the risk of loan losses increases, which can ultimately lead to an increase in bond default rates. Efficiency and rigor in credit assessment are therefore critical to maintaining financial stability.

Credit monitoring is the next step in monitoring the performance of loans after they have been disbursed. Through regular monitoring, banks can detect problems early, such as a decline in the debtor's ability to pay. This allows the bank to take proactive measures, such as loan restructuring, before the problem affects the bank's liquidity. If this mechanism is not effective, low liquidity ratios may be one of the consequences, as delayed loan repayments reduce the bank's ability to meet its short-term obligations.

Finally, the management of non-performing loans is an important element of credit policy that is directly related to the management of financial distress. When non-performing loans occur, approaches such as negotiation, restructuring, or even the sale of the debtor's assets can be used to minimize losses. Effective management of non-performing loans helps

prevent further losses that could lead to asset impairment or even jeopardize the sustainability of the bank's operations.

Overall, credit policies, which include lending criteria, lending limits, lending rates, credit underwriting procedures, credit monitoring mechanisms, and the management of non-performing loans, play an integral role in maintaining the financial health of banks. When well implemented, these policies can minimize the risk of financial distress through more prudent credit management, protection of the asset portfolio, and increased stakeholder confidence in the stability of the bank. The wise implementation of credit policies ensures that banks are not only able to survive difficult economic situations, but also remain competitive in the long run.

The Effect of Liquidity Risk on Financial Distress

Liquidity risk is a major challenge in maintaining a company's financial stability and preventing financial distress. A company's inability to meet its short-term obligations can result in negative cash flows from operations, further deteriorating its financial position. An important indicator of liquidity risk is the liquidity ratio, which reflects a company's ability to cover its current liabilities with current assets. A low ratio signals that the company does not have sufficient liquid assets to meet immediate obligations, which can accelerate the onset of financial stress and negatively affect net income performance.

The loan-to-deposit ratio is also a critical component of liquidity risk management. If this ratio is too high, the company is over-reliant on borrowing to fund its operations, which increases the likelihood of default if operating cash flows are disrupted. This imbalance worsens the debt-to-equity ratio, indicating further financial stress. Therefore, keeping the loan-to-deposit ratio within healthy limits is an important step in avoiding liquidity stress that could affect overall financial stability.

Liquid assets, such as cash or readily marketable assets, play a key role in liquidity risk management. The availability of these assets provides financial flexibility to meet immediate needs without having to sell strategic assets at a discount. A lack of liquid assets can force a company to sell its fixed assets, often resulting in a decline in asset value and exacerbating financial distress. Therefore, companies need to maintain adequate reserves of liquid assets to deal with unforeseen conditions.

In addition, stable daily cash flow is an important element in ensuring the smooth operation of the company. If daily cash flow is insufficient to cover operating expenses, companies may have to rely on short-term borrowing, which increases the debt burden and increases the risk of bond default. Reliance on external sources of financing for day-to-day needs can exacerbate financial stress, especially if borrowing costs increase due to tight market conditions or monetary policy.

In tight liquidity situations, the availability of emergency credit facilities becomes an important mitigating measure. Access to lines of credit or additional loans from financial institutions can help firms meet short-term obligations and prevent a greater impact on operations. However, if these facilities are unavailable or overused, this can impact low liquidity ratios and worsen the company's financial position in the long term. It is therefore important for companies to carefully plan the use of these credit facilities.

Finally, asset portfolio management is an important element of liquidity risk management. Asset diversification ensures that companies have a combination of assets that support liquidity flexibility and financial stability. If asset portfolios are overly concentrated in illiquid assets, companies may have difficulty meeting urgent liquidity needs, which can lead to further financial stress. Conversely, a balanced portfolio can help companies maintain liquidity flexibility without sacrificing profitability.

Overall, poorly managed liquidity risk has a direct impact on several dimensions of financial distress, such as negative operating cash flow, high leverage, and asset impairment. Indicators such as liquidity ratios, loan-to-deposit ratios, and daily cash flows provide important guidance for companies to assess their liquidity stability. By implementing mitigation measures such as maintaining liquid assets, judicious use of emergency credit facilities, and good asset portfolio management, companies can reduce the impact of liquidity risk and ensure their operational sustainability in dynamic market conditions.

The Effect of Non Performing Loan on Financial Distress

Non-performing loans (NPLs) have a significant impact on a company's potential for financial distress, particularly in the financial sector. One of the key dimensions of NPLs is the ratio of nonperforming loans to total loans, which reflects the proportion of loans that are not generating timely interest or principal payments. When this ratio increases, it indicates a decline in the quality of the company's loan portfolio, which in turn can reduce interest income, create negative operating cash flows, and affect short-term liquidity.

In addition, the age of non-performing loans is another important indicator. The longer a non-performing loan remains unresolved, the greater the impact on the company's financial stability. Lingering NPLs not only exacerbate high leverage ratios, but also increase the risk of asset impairment. This is because companies may need to revalue collateral assets, which often decline in value over time, exacerbating financial stress.

The allowance for loan losses, or provision for potential losses, also plays a large role in determining a company's ability to deal with nonperforming loans. If the allowance is inadequate, the company will have to bear the direct loss of the non-performing loans, which will negatively impact net income performance. Conversely, an adequate provision can protect against the direct impact, although it also reduces short-term profits due to the allocation of funds for provisioning.

An effective collection process is an important mitigation measure to reduce the impact of NPLs on the company's finances. Efficient collection helps increase the likelihood of recovering non-performing loans, thereby reducing the amount of bad debt. If collections are slow or inefficient, the risk of default increases because the company is unable to meet its obligations on time. In this context, proactive collections not only reduce risk, but also improve disrupted operating cash flow.

When the collection process does not produce the expected results, loan restructuring is often an alternative solution. Restructuring allows companies and debtors to renegotiate credit terms, such as extending payment terms or lowering interest rates, thereby improving debtors' ability to repay their obligations. This step can help mitigate the negative impact of NPLs on low liquidity ratios, while extending the recovery period of non-performing assets so that they do not immediately burden the financial statements. However, poorly planned restructurings can delay the problem without providing a long-term solution.

The quality of the debtor profile is also a fundamental factor in managing NPLs and preventing financial distress. Selecting debtors with a good credit history, stable income, and a high willingness to pay can minimize the potential for nonperforming loans. Conversely, a poor debtor profile increases the risk of default, thereby increasing the likelihood of financial distress for the company. Therefore, proactive management of debtor profiles and careful credit selection can help companies maintain financial stability.

Overall, non-performing loans are closely related to several dimensions of financial distress, such as negative operating cash flow, asset impairment, and bond default rates. A high ratio of non-performing loans to total loans, weak collection processes, and poor debtor profile quality can worsen a company's financial condition. To mitigate the impact, strategic measures such as allowance for credit losses, loan restructuring and effective collection must

be consistently implemented. With good management, the company can maintain its financial stability and mitigate the negative impact of non-performing loans on its financial condition.

Conceptual Framework

The conceptual framework is determined based on the formulation of the problem, research objectives and previous studies that are relevant to the discussion of this literature research:

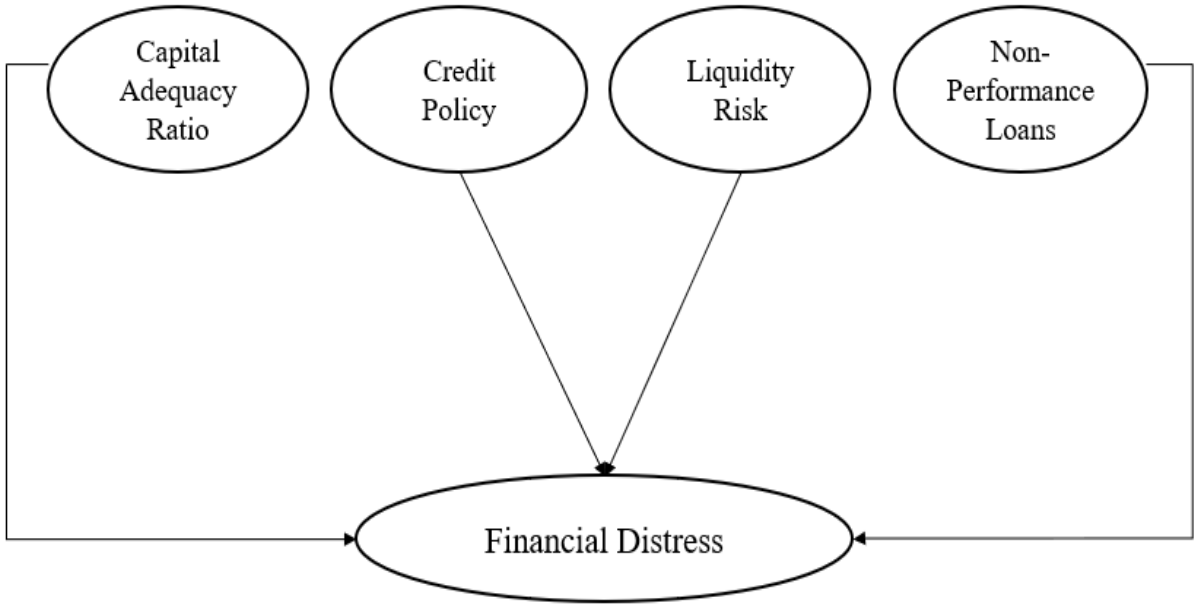

Figure 2. Conceptual Framework

Based on Figure 2 above, capital adequacy ratio, credit policy, liquidity risk and Non Performing Loan affect financial distress. However, in addition to the variables of capital adequacy ratio, credit policy, liquidity risk and Non Performing Loan that affect financial distress, there are other variables that influence, among others:

1) Profitability: (Romadhani et al., 2020), (Mardianti & Ardini, 2020), (Fadhila & Haryanti, 2020), (Sholahuddin et al., 2020).
2) Capital Structure: (Zainal et al., 2019), (Sari, 2019), (Tanjung et al., 2021), (Miswanto et al., 2022).
3) Sales: (Firdaus & Rohdiyarti, 2021), (Saputra & Mahaputra, 2022), (Thi Mai Nguyen et al., 2023).

CONCLUSION

Based on the problem formulation, results and discussion above, the conclusions of this study are:

1) Capital Adequacy Ratio affects Financial Distress;
2) Credit Policy affects Financial Distress;
3) Liquidity Risk affects Financial Distress; and
4) Non Performing Loan affect Financial Distress.

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