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The Role of the Altman Z-Score Method in Predicting Corporate Bankruptcy

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ABSTRACT

The bankruptcy of a company can occurs due to various factors, one of which is the company's financial inability to pay its debts to creditors. With the assistance of predictive analytical models designed by several experts, including well-known methods like the Altman Z-Score analysis, the potential for bankruptcy can be detected earlier. This analytical model aims to provide early warnings regarding possible financial issues a company might face. The objective of this research is to analyze the role of the Altman Z-Score in predicting bankruptcy in a company. The research methodology employed includes literature review and library studies. The results of this research demonstrate the significant role of the Altman Z-Score analysis method in predicting the financial condition of a company based on its financial statement ratios.

Keywords: *Altman Z-score, Bankruptcy, Financial Statement*

INTRODUCTION

The increase in economic development in Indonesia is marked by the increasing number of companies. Each company has a target to make a profit, which is then used to expand its operations to become larger and wider. To maintain the sustainability of the company, good corporate management is essential (Yusri Kusumayuda, et al., 2022). However, Indonesia is currently experiencing economic changes, from conditions affected by the pandemic to economic turmoil due to rising inflation due to supply disruptions. This condition has led to monetary tightening, which threatens the economy with a long-term recession or decline. In an economic crisis, pressure on companies increases, and failures in internal financial control or deterioration in external factors can lead to financial distress (Alvira Almarsha Kurniawan, 2023).

Financial distress refers to the difficulty experienced by a company in maintaining cash flow or working capital. The company's financial position is an important consideration for investors who want to invest, because investments have varying risks, ranging from small to large. One common risk is the failure to return investment funds as expected, which can occur due to financial difficulties or financial distress leading to bankruptcy so that the company's obligations are not met (Yusri Kusumayuda et al., 2022).

Financial difficulties in a company can be identified through several indicators reflected in the financial statements. One method used to predict bankruptcy is the Altman Z-Score. This method uses a model involving several financial ratios that are considered to make a major contribution to predicting corporate bankruptcy (Melisa Octaviani Wijayanti and Suklimah Ratih, 2022). The financial ratios used in the Altman Z-Score include liquidity, solvency, activity, and profitability. Based on the resulting score, the company can be categorized as healthy, in the gray zone, or experiencing major financial difficulties with a high risk of bankruptcy.

The preparation of accurate and relevant financial reports is the basis for assessing the financial health of a company. Good financial reports can provide a clear and reliable picture to stakeholders in evaluating the company's financial performance. The difference between sharia and conventional financial reports lies in the basic principles used. Sharia financial statements are prepared based on Islamic sharia principles, while conventional financial statements follow applicable accounting standards. Although different in some aspects, both aim to provide accurate and relevant information regarding the company's financial performance.

Bankruptcy is a situation where a company is no longer able to meet its long-term or short-term debt payment obligations due to lack of funds, which leads to difficulties in running the company's operations. Factors that cause bankruptcy include declining sales, increasing production costs, and increasingly fierce competition. Altman Z-Score analysis provides early warning of potential bankruptcy, so that management and stakeholders can take corrective action to prevent it.

This study aims to analyze the potential for corporate bankruptcy using the Altman Z-Score model. By knowing the company's Z-Score, it is expected to provide accurate and relevant information for stakeholders to make the right decisions in managing the company's finances, as well as preventing bankruptcy that can harm many parties.

METHOD

The research method used in writing this journal article is a research method that involves literature study. This method is a method that I use to collect various data and references through trusted library data with accreditation and credible evidence in accordance with the title taken for this discussion. Through various journals and books, I recorded the necessary data and then processed the results of the records into various references in this journal. The type of data used in this writing is secondary data that has been tested and obtained from journals or articles that have conducted previous research. The stages that have been passed are conducting research and writing articles through journals and books. My method of analysis starts by collecting various reading sources, then reading them carefully to explore the content or things related to our material, then in the end we summarize all the results so that what is conveyed is not missed or lost. The last step is to convert the quote into a paragraph outlined in this article.

RESULT AND DISCUSSION

The Role of Altman Z Score in Predicting Corporate Bankruptcy

The Altman Z-Score method is an analytical tool used to predict the potential bankruptcy of a company based on a number of ratios in financial statements. This method was developed by Professor Edward I. Altman in 1968 and has proven to be effective in predicting bankruptcy in companies. The Altman Z-Score method uses several financial ratios taken from a company's financial statements to generate a score that can indicate a company's potential for bankruptcy. Several studies have shown that the Altman Z-Score method has a high accuracy in predicting corporate bankruptcy. In the context of manufacturing companies, the consumer goods sector, cosmetics, household goods, and other industries, the Altman Z-Score method has been used to predict a company's financial condition and identify potential financial distress.

The Altman Z-Score method can provide benefits as a predictive tool that can assist stakeholders, such as investors, creditors, and company management, in identifying bankruptcy risks. By using this method, companies can take the necessary preventive or corrective measures to reduce the risk of bankruptcy. Altman Z Score is used to predict the likelihood of bankruptcy of a company in the future. By combining several financial ratios such as liquidity, profitability, leverage, and activity, this model provides an overview of a company's financial stability.

The Altman Z Score model functions as an early warning system that assists management and stakeholders in identifying potential financial problems that could lead to bankruptcy. This allows companies to take corrective action before the problem develops into more serious. The information provided by Altman Z Score can be used as a guide for management to make decisions related to financial strategy, debt restructuring, working capital management, or investment decision-making. By using this model, companies can increase the transparency of financial information to external parties such as investors, creditors, and regulators. This helps to build trust and reduce uncertainty regarding the company's financial stability.

In practice, the Altman Z Score is used as a tool to analyze the financial health of a company. While it cannot be considered a definitive forecast, it provides valuable guidance in recognizing potential financial risks that could lead to bankruptcy. However, it is important to remember that economic and industrial conditions also play a crucial role in the success or failure of a company. By using the information provided by Altman Z Score, the company's management and stakeholders can take proactive steps to reduce the risk of bankruptcy. As such, Altman Z Score's role is not only in identifying potential bankruptcies, but also in helping to take preventative and corrective measures to ensure healthy and sustainable business continuity.

Advantages and Disadvantages of the Altman Z Score Method

In the application of Altman Z-score to predict the bankruptcy of a company, there are advantages and disadvantages of this method. The advantage of this method is that in predicting and using the formula it is easy to use because it uses financial ratios that are already available in the company's financial statements. Altman Z-Score provides relatively quick results and can provide early warning of potential financial problems, allowing management to take preventive or corrective measures. In addition, it can make it easier for managers and investors to analyze the potential bankruptcy of a company to find out the company's financial condition in a healthy, *gray area*, or bankruptcy condition (Isnaini et al., 2022).

However, there is a drawback in predicting corporate bankruptcy using this method Altman Z-score is the lack of adjustment for market changes because the model bases its predictions on historical data that may not fully reflect changes in market conditions, regulations, or the new economic environment. In addition, this method tends to focus on financial ratios and may undertake non-financial risks that can also affect the company's condition, so there are limitations in taking into account non-financial ratios. Altman Z-Score tends to focus on internal company data and does not always consider external factors such as industry, political, or technological changes that greatly affect the bankruptcy of a company.

CONCLUSIONS

The conclusion of the study in this article is that Altman Z-Score, as an analytical method for predicting corporate bankruptcy, has proven to be effective in using financial ratios from financial statements to generate scores that provide early warning of potential financial problems. The advantages include ease of use, quick results, and providing valuable guidance in recognizing financial risks. While it provides significant benefits, there are drawbacks, such as a lack of adjustment to market changes and a focus on financial ratios, which can overlook non-financial risk factors. Nonetheless, Altman Z-Score remains a valuable tool for management and stakeholders, helping them take preventative or corrective action, and increasing the transparency of a company's financial information to ensure healthy and sustainable business continuity.

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