

The Effect of Profitability Towards Financial Distress

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Abstract

This study investigates the effect of profitability on financial distress in manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2017 to 2023, using a unique dataset from that period. From a population of 226 companies, 46 were selected through purposive sampling, resulting in 322 observation units. The analysis was conducted using multiple linear regression in SPSS. This research involves one dependent variable, one main independent variable, and four control variables. Financial distress, the dependent variable, is measured using the Altman Z-Score model. Profitability, the main independent variable, is calculated using return on assets (ROA). The control variables include leverage (measured by debt to asset ratio/DAR), liquidity (current ratio/CR), activity (assets turnover), and firm size (natural logarithm of total assets). The findings indicate that profitability and activity have a significant positive effect on financial distress, while leverage shows a significant negative effect. Liquidity and firm size do not have a significant impact on financial distress.

Keywords: Profitability, Financial Distress, Manufacture.

1. INTRODUCTION

Indonesia's manufacturing sector remains a vital contributor to national economic growth despite persistent global economic disruptions and the lingering effects of the COVID-19 pandemic. According to Badan Pusat Statistik (2024), the national Gross Domestic Product (GDP) increased by 5.03% and 4.94% year-over-year in the first and third quarters of 2023, respectively. The manufacturing sector, alongside trade and agriculture, played a key role in this growth. Micro and small-scale industries within the manufacturing sector demonstrated resilience and adaptability, achieving annual growth exceeding 5.43%, reflecting an ongoing recovery supported by government policies, productivity improvements, and rising domestic demand.

Nevertheless, many manufacturing companies remain vulnerable to financial instability. This is particularly concerning in a sector characterized by high capital intensity, fierce competition, and exposure to global market volatility. For instance, PT Krakatau Steel experienced financial distress in 2023 due to a heavy debt burden, declining domestic steel demand, and operational inefficiencies. The firm was forced to implement large-scale cost reductions and debt restructuring to avoid bankruptcy. This example highlights the importance of early detection and management of financial distress to ensure operational continuity, maintain shareholder value, and retain stakeholder confidence.

Financial distress is generally defined as a condition in which a company fails to meet its financial obligations due to inadequate revenue or liquidity constraints (Ekadjaja, 2019). Koh (2015) argues that firms in financial decline must make strategic decisions such as reducing dividends, limiting capital expenditure, or adjusting capital structures to survive. Financial statement analysis becomes essential in identifying early indicators of such conditions. The Altman Z-Score model, developed in 1968, is one of the most widely used tools for evaluating bankruptcy risk, especially in publicly listed manufacturing firms.

Profitability, typically measured by Return on Assets (ROA), is a key financial indicator used to assess a firm's efficiency in generating earnings from its asset base. In theory, firms with high profitability are less likely to experience financial distress. However, prior empirical findings have been mixed. Some studies report a significant negative association between profitability and financial distress, while others find the relationship to be insignificant or context dependent.

A preliminary analysis of three manufacturing firms listed on the Indonesia Stock Exchange (IDX)—PT Akasha Wira International (ADES), PT Alkasa Industrindo (ALKA), and PT Alkindo Naratama (ALDO)—between 2017 and 2023 reveals interesting dynamics. ADES posted high ROA values and elevated Z-Scores, yet its financial distress score remained relatively high, suggesting possible liquidity or leverage concerns. ALKA showed moderate profitability but persistent financial distress, while ALDO exhibited stable ROA and Z-Scores near the safety threshold, reflecting sounder financial management. This variation highlights the complexity of the relationship between profitability and financial distress, suggesting that profitability alone may not be a reliable predictor without considering additional influencing variables.

While previous research has examined the relationship between financial ratios and distress, many studies were limited by narrow sectoral focus (e.g., services, property), short observation periods (2–3 years), or reliance on logistic regression. In addition, prior studies frequently omitted key control variables such as firm size or asset activity. To address these gaps, this study applies a seven-year dataset (2017–2023) covering pre- and post-pandemic periods, focuses specifically on the manufacturing sector, and includes four control variables—leverage, liquidity, activity, and firm size—believed to affect financial distress.

In addition to its sectoral focus, this research introduces novelty by utilizing a unique and comprehensive dataset covering the period from 2017 to 2023. This time frame allows for analysis of both pre- and post-pandemic financial patterns. The dataset was rigorously curated using specific criteria: companies must be consistently listed on the IDX throughout the period, report in Indonesian Rupiah (IDR), publish complete annual reports, and record no net losses. From 226 listed manufacturing firms, only 46 met the criteria, resulting in a high-quality sample of 252 firm-year observations. This meticulous selection enhances the validity of the analysis and strengthens the study's contribution to understanding financial distress in Indonesian manufacturing.

Therefore, this study aims to fill the existing research gap by analyzing the effect of profitability on financial distress in manufacturing companies listed on the Indonesia Stock Exchange over the 2017–2023 period. It introduces novelty by extending the analysis over a longer observation window and integrating control variables such as leverage, liquidity, activity, and firm size, which are considered significant indicators of a firm's financial stability.

H₁: Profitability has a significant effect on financial distress.

The results of this research are expected to provide valuable insights for internal stakeholders, including corporate managers, creditors, and investors, to make informed decisions regarding risk management, resource allocation, and business continuity planning. Additionally, this study offers empirical evidence to enrich academic discourse in financial distress prediction and enhance understanding of the financial dynamics within Indonesia's manufacturing sector.

2. RESEARCH METHOD

This study uses a quantitative approach with a descriptive-causal research design aimed at analyzing the effect of profitability on financial distress in manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the period 2017–2023. The objective of this research is to empirically investigate whether firms with higher profitability—as measured by Return on Assets (ROA)—exhibit a lower risk of financial distress. The hypothesis posited is that profitability significantly influences financial distress, aligning with prior studies grounded in agency theory and financial performance analysis.

The population in this study consists of all manufacturing companies listed on the IDX within 2017–2023. The sample was determined using purposive sampling, a non-probability sampling method in which the researcher selects units based on specific characteristics or criteria that align with the research objectives. According to Sugiyono (2006), purposive sampling involves intentional selection of subjects who are most likely to provide relevant, reliable, and rich data for the study. This method is particularly appropriate in quantitative research where data quality and consistency over time are essential for longitudinal analysis.

Data must meet specific criteria to allow for accurate calculation of financial ratios and Altman Z-Scores, which form the foundation of the study's dependent variable (financial distress):

1. The company must be consistently listed on the IDX from 2017 to 2023
This is to ensure the availability of complete financial data and to avoid inconsistencies caused by mergers, or initial partway through the studied period.
2. The company must publish complete annual report in Indonesian Rupiah (IDR) from 2017-2023
Excluding company reporting in foreign currencies avoid discrepancies due to exchange rate fluctuation, which can distort the ratio analysis.
3. The company must report non-negative net income across all observed years.
Company with losses are excluded to reduce the bias in profitability (ROA) calculation and to maintain focus on company that have an ongoing operational performance

From an initial population of 226 companies, 180 firms were excluded for not meeting the criteria, resulting in a sample of 46 qualified manufacturing companies, each observed over a 7-year period. This yielded 322 firm-year observations. After outlier removal based on the Kolmogorov–Smirnov test and visual inspection of residuals, 252 valid observations remained for final analysis.

The sampling process ensures that the study focuses on homogeneous groups of financially active, stable and transparent manufacturing company.
This research includes one dependent variable, financial distress, which is measured using the Altman Z-Score model as follows:

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5 \quad (1)$$

Where:

X_1 is Working Capital / Total Assets. This ratio measures short-term financial health and liquidity.

X_2 is Retained Earnings / Total Assets. This shows the extent to which a company has reinvested its profit over time (reflects the company long-term profitability and financial sustainability)

X_3 is EBIT (Earnings Before Interest and Taxes) / Total Assets. This indicates how effectively a company generated operating profits from its assets.

X_4 is Market Capitalization / Total Liabilities. This is a measure of solvency. A higher ratio suggests the company has a strong equity position compared to its debt, making it less risky to investors and creditors.

X_5 = Net Sales / Total Asset. This ratio reflects how efficiently the company uses its assets to generate sales.

Z-Score interpretation based on:

$Z > 2.99$ as the Non-Distress Area (Safe Zone), $1.81 < Z < 2.99$ as the Grey Area, and $Z < 1.8$ as the Distress Zone

The independent variable is profitability, which is measured by Return on Assets (ROA), calculated as:

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}} \quad (2)$$

Control variables:

Leverage (Debt to Asset Ratio) = Total Liabilities / Total Assets, Liquidity (Current Ratio) = Current Assets / Current Liabilities, Activity (Asset Turnover) = Net Sales / Total Assets, Firm Size = Natural Logarithm of Total Assets

All data were analyzed using IBM SPSS version 27, starting with descriptive statistics to understand the distribution and characteristics of each variable. Next, a series of classical assumption tests were conducted, including tests for normality, multicollinearity, heteroscedasticity, and autocorrelation, ensuring that the regression model meets standard econometric criteria.

After the model passed all classical assumption requirements, a multiple linear regression analysis was performed to determine the influence of profitability (ROA) on financial distress, while controlling for leverage, liquidity, activity, and firm size.

The regression equation used is:

$$Y = \alpha + \beta_{151} + \beta_{252} + \beta_{353} + \beta_{454} + \beta_{555} + \epsilon \quad (3)$$

$$FD = \alpha + \beta_1 ROA + \beta_2 LEV + \beta_3 LIQ + \beta_4 ACT + \beta_5 FS + \epsilon \quad (4)$$

Financial Distress (FD) serves as the dependent variable, represents the company's financial condition whether it is stable, at risk or in distress.

Return on Assets (ROA) is the independent variable that measures a company's profitability and is expected to influence financial distress where higher ROA is generally associated with lower financial distress.

Leverage (LEV), *Liquidity (LIQ)*, *Activity (ACT)*, and *Firm Size (FS)* are included as control variables.

LEV is measured by debt-to-debt asset ratio that reflects the company's financial risks due to debt.

LIQ is measured by the current ratio, indicating the company's ability to pay short-term liabilities.

ACT is calculated by using the total assets turnover ratio that represents how efficiently the company uses its assets to generate sales.

FS is measured by the natural logarithm of total assets. Larger firms have lower financial risk.

α (alpha) denotes the constant term, representing the expected value of financial distress when all independent and control variables are equal to zero.

β_1 to β_5 represent the regression coefficients for each explanatory variable that shows the strength and direction of the relationship between each independent/control variable and FD.

ϵ (epsilon) is the error term that represents the other factors that is not included in the model that may affect financial distress

Multiple linear regression was chosen for its robustness in evaluating the linear relationship between multiple predictors and a single outcome. The selection of control variables—leverage, liquidity, activity, and firm size—is based on their established theoretical and empirical relevance in prior research concerning financial performance and distress prediction. These controls help isolate the specific effect of profitability on financial distress, ensuring the model's internal validity.

3. RESULTS AND DISCUSSION

The population in this study is all manufacturing companies' financial statements that are reported on the IDX between 2017–2023. Purposive sampling will be used to choose the sample. Criteria included companies consistently listed from 2017–2023, using IDR, not incurring losses, and reporting complete data. A total of 46 companies with 322 observations were selected.

The method used is multiple linear regression. The dependent variable is financial distress (Altman Z-Score), independent variable is profitability (ROA), and control variables are leverage (DAR), liquidity (CR), activity (Asset Turnover), and firm size (Ln Total Assets).

3.1. Descriptive Statistics

Table 1 presents the descriptive statistics for the 46 manufacturing companies sampled from the Indonesia Stock Exchange (IDX) between 2017 and 2023. The analyzed variables include Profitability (Return on Assets), Leverage (Debt to Equity Ratio), Liquidity (Current Ratio), Activity (Total Asset Turnover), and Firm Size (logarithm of total assets), and Financial Distress.

Table 1. Descriptive Statistics Output

	Descriptive Statistics				
	N	Minimum	Maximum	Mean	Std. Deviation
Profitability	322	.00	.53	.0975	.08505
Leverage	322	.01	1.19	.3475	.18312
Liquidity	322	.24	99.54	4.2551	8.37661
Activity	322	.00	22.40	1.1628	1.48626
Firm Size	322	23.35	32.86	28.9181	1.67404
Financial Distress	322	.70	604.84	18.0631	44.69450
Valid N (listwise)	322				

Source: Result of SPSS (2024)

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Profitability, as measured by Return on Assets (ROA), averaged 9.75%, indicating a moderate level of efficiency in asset utilization. This suggests that on average, manufacturing firms in Indonesia can generate a reasonable return from their asset base, although the wide range in profitability shows disparities in operational efficiency across firms.

Leverage, based on the Debt-to-Equity Ratio, averaged 34.75%, indicating a moderate reliance on debt financing. This level of leverage may reflect a balanced financial structure that avoids excessive risk while still utilizing debt to finance operations. However, firms with high leverage levels may be more vulnerable to economic shocks, especially in capital-intensive sectors of manufacturing.

Liquidity, reflected by the Current Ratio, showed substantial variability (ranging from 0.24 to 99.54), with a mean of 4.26. This high standard deviation suggests that some firms maintain excessive current assets relative to liabilities, possibly indicating inefficiencies in asset utilization or conservative cash management policies.

Activity, as measured by Total Asset Turnover, averaged 1.16, indicating that firms on average generate slightly more than one unit of sales for every unit of asset. However, the presence of firms with a very low turnover may reflect underutilized assets or inefficient operations within segments of the industry.

Firm Size, measured using the natural logarithm of total assets, showed a mean of 28.92, with relatively low dispersion. This implies that most sampled firms fall within a similar size range, which helps in maintaining comparability across the sample.

Financial Distress, assessed using the Altman Z-Score, also exhibited wide variability. Although the average Z-Score is 18.06—above the critical threshold of 1.81—the very high standard deviation (44.69) and a minimum value of 0.70 indicate that a number of firms were in a zone of severe financial distress. This finding raises concerns about the long-term viability of certain players in the Indonesian manufacturing sector and underscores the need for robust financial management and monitoring mechanisms in the industry.

3.2 Pearson Correlation Analysis

The correlation between Profitability (X1) and Financial Distress (Y) was analyzed using Pearson’s correlation coefficient.

Table 2. Pearson Correlation Analysis

Variable	Profitability	Financial Distress
Profitability	1	0.390 (p < 0.001)
Financial Distress	0.390 (p < 0.001)	1

A low positive correlation (0.390) exists between profitability and financial distress. The relationship is statistically significant (p < 0.01). This result is somewhat counterintuitive, as higher profitability is generally expected to reduce the likelihood of financial distress. However, in the context of Indonesian manufacturing companies, this finding may reflect unique industry dynamics—such as aggressive reinvestment strategies or high operational costs—that cause profitable firms to still face financial strain. This also may indicate that some profitable firms are taking on high-risk investments or expansion strategies that increase their exposure to financial vulnerability despite generating positive returns. In capital-intensive industries like manufacturing, firms often rely on both internal profits and external financing for growth, which could explain why higher profitability does not always equate to financial stability. Therefore, this correlation suggests that stakeholders should not assess financial health solely based on profitability metrics but also consider other financial ratios and indicators to get a holistic view of firm risk.

3.3 Classical Assumption Tests

To ensure the reliability of the multiple linear regression model, several classical assumption tests were performed:

3.3.1 Normality Test

The Kolmogorov-Smirnov (K-S) test was used to check data normality.

Table 3. Normality Test Results

Test Statistic	Asymp. Sig. (2-tailed)	Conclusion
0.048	0.200 (p > 0.05)	Normally Distributed

Interpretation: The residuals follow a normal distribution, fulfilling the regression assumption.

3.3.2 Multicollinearity Test

Multicollinearity was examined using Tolerance and Variance Inflation Factor (VIF). No variables had a VIF exceeding 10 or Tolerance below 0.1, indicating no multicollinearity

Table 4. Multicollinearity Test Results

Variable	Tolerance	VIF
Profitability	0.791	1.264
Leverage	0.706	1.415
Liquidity	0.707	1.414
Activity	0.910	1.099
Firm Size	0.942	1.062

3.3.3 Heteroscedasticity Test

The Glejser test revealed no heteroscedasticity, as all significance values were greater than 0.05.

Table 5. Heteroscedasticity Test Results

Variable	Sig.	Conclusion
Profitability	0.113 (p > 0.05)	No Heteroscedasticity
Leverage	0.081 (p > 0.05)	No Heteroscedasticity
Liquidity	0.745 (p > 0.05)	No Heteroscedasticity
Activity	0.820 (p > 0.05)	No Heteroscedasticity
Firm Size	0.979 (p > 0.05)	No Heteroscedasticity

3.3.4 Autocorrelation Test

The Run Test indicated randomness in the residuals with a p-value of 0.172, suggesting no autocorrelation.

Table 6. Autocorrelation Test Results

Test Statistic (Z)	Asymp. Sig. (2-tailed)	Conclusion
1.455	0.146 (p > 0.05)	No Autocorrelation

3.3.5 Multiple Linear Regression Analysis

The multiple regression analysis tested the combined and individual effects of the independent variables on financial distress. Regression Equation:

$$FD = -0.263 + 0.561(PROF) - 0.868(LEV) - 0.027(LIQ) + 0.151(ACT) + 0.843(FS) + \epsilon \quad (5)$$

Table 7. Regression Coefficients

Variable	Coefficient (β)	Std. Error	t-Statistic	Sig.	VIF
(Constant)	-0.263	2.180	-0.121	0.904	-
Profitability (X1)	0.561	0.047	11.854	0.000	1.264
Leverage (X2)	-0.868	0.072	-12.121	0.000	1.415
Liquidity (X3)	-0.027	0.053	-0.523	0.602	1.414
Activity (X4)	0.151	0.069	2.196	0.029	1.099
Firm Size (X4)	0.843	0.640	1.316	0.189	1.062

Profitability, measured by Return on Assets (ROA), has a positive and significant effect on financial distress ($\beta = 0.561$, $p < 0.05$). Leverage, measured by the Debt to Asset Ratio (DAR), shows a negative and significant effect ($\beta = -0.868$, $p < 0.05$). Activity, represented by Total Asset Turnover (TATO), also has a positive and significant effect on financial distress ($\beta = 0.151$, $p < 0.05$). In contrast, Liquidity (CR) and Firm Size have no significant effect ($p > 0.05$).

3.4 Hypothesis Testing

3.4.1 Partial Test (T-test)

The partial t-tests show that profitability and leverage significantly affect financial distress ($p < 0.05$). Activity also contributes significantly though to a lesser degree. Liquidity and firm size do not significantly influence financial distress.

The results of the hypothesis testing show that profitability has a significant effect on financial distress, with a t-value of 11.854 and a p-value < 0.05 , so the first hypothesis is accepted. Leverage also has a significant effect, but in a negative direction ($t = -12.121$, $p < 0.05$). Activity has a positive and significant effect on financial distress ($t = 2.196$, $p < 0.05$). However, liquidity and firm size do not have a significant effect, since their p-values > 0.05 , so their effects are rejected

3.4.2 Simultaneous Test (F-test)

Table 8. ANOVA Results

Source	Sum of Square	df	MS	F	Sig.
Regression	188.880	5	37.776	105.478	<0.001
Residual	88.103	246	0.358	-	-
Total	276.983	251	-	-	-

The F-statistics (105.478, $p < 0.001$) confirm that the model is significant.

3.4.3 Coefficient of Determination (R^2)

Table 9. Model Summary

R	R Square	Adjusted R Square	Std. Error
0.826	0.682	0.675	0.59845

This indicates that 68.2% of the variance in financial distress can be explained by the five independent variables.

3.5 Discussion

The findings of this study provide several nuanced insights into the complex relationship between financial indicators and financial distress within the Indonesian manufacturing sector during the 2017–2023 period. The analysis challenges some conventional assumptions while affirming the importance of contextual and behavioral factors in interpreting financial ratios.

One of the most notable findings is the significant positive relationship between profitability (ROA) and financial distress. This outcome is counterintuitive, as profitability is generally considered a safeguard against insolvency and an indicator of financial strength. However, in this case, the positive correlation suggests that higher profitability does not necessarily guarantee financial stability. A plausible explanation lies in the behavioral tendencies of firms with strong profit margins, particularly those operating in competitive or capital-intensive industries such as manufacturing. Profitable firms may be more likely to engage in aggressive reinvestment, rapid expansion, or even speculative projects in an attempt to maximize growth, market share, or shareholder value. These activities, while potentially lucrative, also expose the company to greater financial risk, particularly if not matched by effective risk management.

From the perspective of Agency Theory, such behavior may be driven by managerial incentives that prioritize short-term performance over long-term solvency. For instance, executives may pursue expansion strategies that boost sales and profits in the short run, thereby increasing their bonuses or status, without adequately considering the long-term financial implications. This can create a divergence between profitability and financial health, resulting in companies that appear strong on paper but are actually more vulnerable to liquidity constraints, market volatility, or rising debt obligations. In this light, the observed positive association between ROA and financial distress should not be viewed as an anomaly, but rather as a reflection of underlying governance and strategic issues that must be carefully monitored.

Equally compelling is the finding that leverage (debt to equity ratio) has a significant negative effect on financial distress. This contradicts the standard assumption that high debt levels increase the likelihood of financial default due to the burden of interest and principal repayments. Instead, the result suggests that within the sample, firms with higher (but still manageable) debt levels are less likely to experience distress. This can be understood through the lens of the disciplining role of debt, as suggested by Jensen (1986). Moderate levels of debt can act as an internal control mechanism, pressuring managers to avoid inefficient investments, reduce slack, and focus on productivity to meet debt obligations. In other words, debt may not always be a source of financial fragility; under certain circumstances, it can enhance operational discipline and encourage more responsible financial behavior.

In the Indonesian context, this finding may also reflect institutional and sector-specific factors. Manufacturing firms often require external funding to finance machinery, raw materials, and technology upgrades. Rather than being a symptom of financial weakness, leverage in this industry may signal investment readiness and creditworthiness, particularly if debt is sourced from reputable financial institutions under favorable terms. Moreover, firms with well-managed debt structures may benefit from tax advantages (due to interest deductibility), which further strengthens their financial position.

Another important result is the significant positive effect of the activity ratio (asset turnover) on financial distress. This suggests that higher levels of asset turnover—commonly interpreted as a sign of efficiency—are, in this case, associated with greater financial vulnerability. This paradox can be explained by the possibility of overtrading, a condition where firms push for high sales volumes without securing adequate profit margins. In industries with tight margins and long production cycles, such as manufacturing, firms that overemphasize sales performance may unintentionally overstretch their working capital, leading to cash flow problems and eventual distress.

High asset turnover may also indicate aggressive inventory or receivables management, where companies attempt to optimize resource usage at the cost of liquidity. For example, extended credit terms to customers may boost sales and turnover ratios, but delay cash inflows, creating a mismatch between revenue recognition and actual cash availability. This becomes particularly problematic in uncertain macroeconomic conditions, such as during the COVID-19 pandemic, when many firms faced supply chain disruptions and erratic demand patterns. Therefore, although asset turnover is a valuable efficiency metric, its positive association with distress highlights the need for balanced operational strategies that consider both revenue generation and margin preservation.

In contrast, the study finds that liquidity (current ratio) and firm size (log total assets) do not have a significant impact on financial distress. This is somewhat surprising, as both indicators are traditionally regarded as proxies for financial resilience. Liquidity, in particular, is expected to cushion firms against short-term obligations and unforeseen shocks, while larger firms are assumed to benefit from scale economies, market influence, and easier access to financing. However, during the 2017–2023 period, these assumptions may not have held due to unprecedented external challenges, including the COVID-19 pandemic, global inflationary pressures, and volatility in commodity prices.

Many firms, regardless of size or liquidity status, were affected by these shocks, which weakened the predictive power of such indicators. For instance, high liquidity may have resulted from hoarding cash due to uncertainty, rather than strategic planning. Similarly, large firms might have faced complex operational and supply chain issues, making them just as vulnerable—if not more so—than smaller, more agile firms. These findings imply that traditional metrics like current ratio and firm size must be interpreted with caution, especially in turbulent or transitional economic environments.

Taken together, the results of this study support a multifaceted understanding of financial distress, where ratios should not be viewed in isolation, but rather in combination with contextual, behavioral, and macroeconomic considerations. The use of the Altman Z-Score model in this research reinforces its relevance and robustness in capturing the multidimensional nature of corporate financial health. Its integration of liquidity, profitability, efficiency, and market value enables a more holistic assessment of risk, particularly for firms in capital-intensive sectors.

From a practical standpoint, the findings underscore the importance of maintaining financial balance rather than maximizing any single indicator. Managers should resist the temptation to over-leverage profitability for expansion and instead implement sound investment screening, debt

management, and operational planning. High turnover ratios should be monitored closely for signs of overtrading, and liquidity should be maintained at optimal levels—not too high to reduce asset productivity, and not too low to endanger short-term solvency. Moreover, analysts and investors are advised to go beyond surface-level profitability metrics and adopt a more integrated approach in evaluating financial distress, especially under volatile global conditions.

4. CONCLUSION

This study investigates the influence of profitability on financial distress in manufacturing companies listed on the Indonesia Stock Exchange (IDX) over the period 2017–2023. The research responds to an identified gap in the literature by reassessing the assumption that higher profitability inherently reduces the risk of financial distress. Through a quantitative approach using multiple linear regression, this study analyzes the role of Return on Assets (ROA) as the main independent variable, with leverage, liquidity, activity, and firm size as control variables.

The results show that profitability, measured by ROA, has a positive and significant effect on financial distress. This contradicts traditional financial theory, which suggests that higher profitability decreases the likelihood of distress. The findings imply that profitable firms may still be vulnerable if they engage in risky financial practices, such as over-leveraging or inefficient capital reinvestment. Conversely, leverage has a negative and significant effect on financial distress, suggesting that companies with well-managed debt levels may experience enhanced financial discipline and more efficient resource allocation, thereby reducing the likelihood of financial difficulty.

Furthermore, liquidity and firm size do not have significant effects on financial distress, indicating that high cash reserves or large asset bases alone are not sufficient indicators of financial stability. On the other hand, activity, as measured by asset turnover, has a positive and significant effect, suggesting that high turnover may indicate operational pressure or narrow margins, which could increase financial vulnerability.

Theoretically, this study contributes to the development of financial distress literature by providing empirical evidence that challenges the general assumption that profitability safeguards firms from financial risk. It highlights the complexity of financial management, particularly in emerging markets. Practically, the findings suggest that stakeholders—such as investors, management, and creditors—should interpret profitability alongside other financial indicators. Emphasis should be placed on prudent debt management and operational efficiency, rather than relying solely on earnings performance, when evaluating a firm's financial health.

This study is limited by its focus on manufacturing firms in Indonesia and its exclusion of companies with negative net income, which may restrict the generalizability of the results to other sectors or more distressed firms. Additionally, the analysis does not include qualitative factors such as governance quality or market dynamics that could influence financial distress.

Future research is encouraged to broaden the sample across different sectors and countries, incorporate qualitative assessments, or apply advanced econometric models such as panel data regression or structural equation modeling. Integrating macroeconomic variables could also enhance understanding of external influences on corporate financial stability.

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