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The Role of Profitability and Liquidity in Mitigating Financial Distress Risk

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Abstract: *This study examines the role of profitability and liquidity in mitigating financial distress risk. The sample consists of 26 State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period, selected through purposive sampling. Multiple linear regression analysis was employed to analyze the relationship between profitability, liquidity, and financial distress risk. The results indicate that the unique characteristics of SOEs, such as their strategic role in public service and national development, as well as government support in the form of state capital participation (PMN), debt restructuring, and other special policies, cause SOEs not to rely entirely on financial performance to maintain business continuity. In addition, accounting policies, government regulations, and political interests also influence the financial condition of SOEs, so financial ratios do not always reflect the actual distress condition. These findings suggest that SOEs have distinct characteristics that differ from private companies. Therefore, financial distress analysis in SOEs should consider not only financial indicators but also institutional, regulatory, and government support factors.*

Keywords: *Financial Distress; Financial Performance; Liquidity; Profitability; State-Owned Enterprises.*

1. INTRODUCTION

State Owned Enterprises (SOEs) are companies or institutions established by the government to provide public services, drive national development, and contribute to state revenue. Although they are owned by the state, many SOEs experience financial problems that ultimately lead to financial distress, which signals unfavorable conditions for the company.

Financial distress is a deteriorating financial condition in which a company is unable to generate sufficient profit to meet its financial obligations and serves as an early warning sign of potential bankruptcy, as well as a negative signal to related stakeholders (Jonnardi, 2023). Profitability is a ratio used to measure a company's ability to generate profits and serves as a primary indicator of long-term financial health and performance (Kasmir, 2018) (Harahap, 2018). High profitability sends a positive signal regarding a company's prospects, while low profitability may increase the risk of financial distress. Liquidity reflects a company's ability to meet its short-term obligations on time by utilizing its current assets, thereby indicating short-term financial stability and security (Munawir, 2010). A company's financial condition can be assessed through financial ratios such as liquidity and profitability, which reflect the company's ability to meet its obligations and generate profits. Therefore, these ratios serve as important indicators in evaluating a company's financial health (Heriyanto, H., Febriany, N., Engel, 2025).

In the first quarter of 2025, PT Garuda Indonesia (Persero) Tbk still recorded a loss of US$75.93 million. Meanwhile, PT Waskita Karya (Persero) Tbk reported a net loss of

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approximately IDR 2.14 trillion in the first semester of 2025, with negative operating cash flow amounting to IDR 1.26 trillion. Furthermore, based on the 2022 Accountability Paper of Commission VI of the House of Representatives of the Republic of Indonesia (Keahlian وآخ., 2022) entitled *"Financial Distress: Bringing PT Garuda Indonesia to the Brink,"* PT Garuda Indonesia (Persero) Tbk experienced severe financial distress and was described as being on the "brink." This condition was exacerbated by the COVID-19 pandemic, which intensified the liquidity crisis and increased the company's debt burden to approximately IDR 70 trillion. The report stated that the financial problems had actually occurred prior to the pandemic due to weak internal management and inefficient managerial decisions, including aircraft leasing contracts priced above market rates. Based on the background described above, the researcher is interested in conducting a study on the role of profitability and liquidity in mitigating financial distress risk.

2. LITERATURE REVIEW

Signalling Theory

Signaling theory explains that actions taken by management serve as signals regarding how management portrays the company's condition (Brigham, E. F., & Houston, 2019). When a company demonstrates high profitability and liquidity, it may convey a positive signal to the market. Conversely, low profitability or liquidity problems may send negative signals indicating the risk of financial distress.

Financial Distress

Financial distress refers to a deteriorating financial condition in which a company is unable to generate sufficient profits and consequently faces difficulties in meeting its financial obligations (Jonnardi, 2023). (Fahmi, 2018), financial distress is a condition of financial decline marked by a company's inability to generate profits and fulfill its financial commitments. From the perspective of signaling theory, financial distress constitutes a negative signal to investors, creditors, and stakeholders, as it reflects declining performance and an increased risk of bankruptcy. In contrast, strong profitability and liquidity provide positive signals that a company is financially sound and has a low risk of financial distress. Therefore, indicators such as Return on Assets (ROA) and the Current Ratio are important to examine as predictive tools for financial distress.

The analysis of financial distress is also relevant for State-Owned Enterprises (SOEs), as these companies manage substantial assets, hold public responsibilities, and play a strategic role in the national economy. Research on the influence of profitability and liquidity on

financial distress is expected to provide insights into the financial performance of SOEs as a signal for investors and the government in assessing corporate financial risk.

Profitability

Profitability ratios are measurement tools used to assess a company's ability to generate profits (Kasmir, 2018). (Harahap, 2018) further states that profitability is essential to analyze because it reflects long-term corporate success and serves as a primary indicator of financial health. Profitability can also signal company performance to external parties, thereby influencing investment and lending decisions. In relation to financial condition, high profitability sends a positive signal regarding favorable business prospects, whereas low profitability may signal potential financial distress.

Likuidity

(Munawir, 2010) states that liquidity reflects a company's ability to meet its short-term obligations. Similarly, (Hanafi, M. M., & Halim, 2016) define liquidity as a company's capacity to fulfill its short-term financial obligations using its current assets. Liquidity is a major concern for management, creditors, and investors because it reflects short-term financial stability and security.

Hypothesis Development

The Effect of Profitabily on Financial Distress

Profitability reflects a company's ability to generate profits from its assets. According to (Kasmir, 2018), higher profitability indicates efficient management performance in utilizing resources, thereby minimizing the risk of financial distress. Conversely, declining profitability may lead to financial difficulties due to the company's inability to generate sufficient earnings to cover short-term and long-term liabilities. Based on signaling theory, high profitability provides a positive signal to investors that the company performs well and is far from bankruptcy risk. Empirical studies by (Putri & Ardini, 2020) and (Indrawan & Sudarsi, 2023) show that profitability has a significant negative effect on financial distress.

H_1: Profitability has a negative effect on Financial Distress.

The Effect of Likuidity on *Financial Distress*

Liquidity reflects a company's ability to meet its short-term liabilities with its current assets. (Sartono, 2012), companies with high liquidity demonstrate better financial stability and are more capable of avoiding financial distress risk. From a signaling theory perspective, high liquidity provides a positive signal, while low liquidity signals potential financial difficulties Research by (Muntahanah, 2021) and (Fatikh 2020., وآخ) also supports that liquidity has a negative effect on financial distress.

H_2: Likuidity has a negative effect on *Financial Distress*.

3. RESEARCH METHOD

This study employs a non-probability sampling technique, specifically purposive sampling, to determine the research sample. The inclusion criteria are as follows: (1) State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period; (2) SOEs that publish complete financial and annual reports containing sufficient information for research purposes; and (3) SOEs that were not delisted during 2020–2024, ensuring data consistency and comparability across years. This study uses secondary data, including financial statements and annual reports collected from data sources, particularly the official IDX website (idx.co.id) and the respective company websites. The independent variables analyzed are profitability measured by Return on Assets (ROA) (X1) and liquidity measured by the Current Ratio (X2). The dependent variable (Y) is financial distress, measured using the Altman Z-Score model.

4. RESULTS AND DISCUSSION

Research Data Overview

Table 1. ***Research Data Description***

No	Sample Criteria	Total
1.	SOEs listed on the Indonesia Stock Exchange	27
2.	SOEs that did not publish annual and financial report	(1)
3.	SOEs that were delisted	0
Total Actual Observations (26 × 5 years)	130	
Total Actual Observations (26 × 5 years)	130	

(Source: Processed Secondary Data, 2025)

The data used in this study consist of 26 companies observed over five years (2020–2024), resulting in a total of 130 observations.

Descriptive Statistics

Tabel 2. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
ROA	130	-,95	,60	-,0029	,14938
CR	130	,05	2,54	1,1650	,49931
FD	130	-16,07	7,32	1,2211	3,05977

(Source: Processed Secondary Data, 2025)

The profitability variable (ROA) recorded a maximum value of 0.60 by PT GIAA Tbk. in 2022 and a minimum value of -0.95 by PT INAF Tbk. in 2023, with a standard deviation of 0.14938. The mean value of ROA is -0.0029, indicating that, on average, the SOEs in this study experienced losses. The liquidity variable (CR) recorded the highest value of 2.54 by PT PGAS Tbk. in 2021 and the lowest value of 0.05 by PT GIAA Tbk. in 2021, with a standard deviation of 0.49931. The mean liquidity value is 1.1650, indicating that, on average, SOEs in this study were able to meet their short-term obligations. The financial distress variable, measured using the Altman Z-Score model, shows a maximum value of 7.32 by PT ANTM Tbk. in 2024 and a minimum value of -16.07 by PT INAF Tbk. in 2024, with a standard deviation of 3.05977. The mean FD value is 1.2211 (grey zone), indicating that SOEs during this period were generally in a vulnerable financial position.

Financial Distress Frequency Distribution

Tabel 3. Financial Distress Frequency Distribution

Category	Frequency	Percentage
Safe Zone	32	24,6
Grey Zone	49	37,7
Distress Zone	49	37,7
Total	**130**	**100,0**

(Source: Processed Secondary Data, 2025)

Based on the Altman Z-Score classification, 24.6% (32 observations) fall within the safe zone. Meanwhile, 37.7% (49 observations) are categorized in the grey zone, and another 37.7% (49 observations) are classified in the distress zone.

Multiple Linear Regression Analysis

Tabel 4. Multiple Linear Regression Analysis

Variabel	**B**
(Constant)	-2.542
ROA	11.405
CR	3.268

(Source: Processed Secondary Data, 2025)

Regression Equation: Z-*Score* = -2,542 + 11,405ROA + 3,268CR

Tabel 5. Partial Test (t-test)

Model	**B**	**Sig. (2-tailed)**	**Conclusion**
(Constant)	-2,542	,001	
ROA	11,405	,001	H1 Rejected
CR	3,268	,001	H2 Rejected

(Source: Processed Secondary Data, 2025)

The results indicate that profitability and liquidity do not have a negative effect on financial distress; therefore, the hypotheses proposing a negative effect are rejected. These findings contradict previous studies suggesting that higher profitability and liquidity reduce the risk of financial distress. This outcome can be explained by the unique characteristics of SOEs, which differ from private companies. SOEs play a strategic role in providing public services and supporting national development. Therefore, even when experiencing financial difficulties or distress conditions, SOEs tend to continue operating. Government support such as state capital injections (PMN), debt restructuring, and special policy interventions means that SOEs do not rely solely on financial performance to sustain business continuity. Moreover, SOEs' financial conditions may be influenced by accounting policies, government regulations, and political interests. As a result, financial ratios may not fully reflect the actual distress condition. These findings also suggest that signaling theory is not entirely applicable in explaining financial distress within SOEs. Since SOEs are directly owned by the government and accountable to

the public, decision-making is not always based purely on financial considerations but may also involve political and policy factors.

5. CONCLUSION

Conclusion

Based on the research findings, it can be concluded that profitability and liquidity do not have a negative effect on financial distress in SOEs. Although profitability and liquidity reflect financial conditions, SOEs possess unique characteristics such as government support, public accountability, and political considerations. Consequently, financial distress in SOEs cannot be predicted solely based on financial indicators.

Limitations

This study has several limitations. The research data did not meet the assumption of normal distribution. In addition, the researcher did not sufficiently consider alternative measurement methods in selecting the variables.

Suggestions

Based on the findings, several recommendations are proposed for future research. Future researchers may consider using independent variables beyond financial aspects, given that financial distress is also measured using financial indicators. If financial variables are retained as independent variables, financial distress could be measured using a dummy variable approach. Researchers may also consider alternative financial measurement methods such as ROE, NPM, GPM, DAR, and DER. Furthermore, future studies may focus on specific sectors such as mining, manufacturing, and others, as well as extend the observation period to increase the sample size.

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