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**THE EFFECT OF PROFITABILITY, CASH FLOW, LEVERAGE, AND
FIRM GROWTH ON FINANCIAL DISTRESS**

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Abstract:

This study was conducted to examine the effects of profitability, cash flow, leverage, and firm growth on financial distress. The sampling technique used in this study was purposive sampling, resulting in a sample of 84 companies selected from the basic materials sector that were consistently listed on the Indonesia Stock Exchange (IDX) during the 2022-2024 period. The results of this study indicate that profitability has a negative and significant effect on financial distress. Cash flow has a positive and significant effect on financial distress. Leverage has a positive and significant effect on financial distress. Firm growth has no significant effect on financial distress.

Keywords:

Cash flow, financial distress, firm growth, leverage, profitability

BACKGROUND

As time progresses and development continues, competition in the economic environment has become increasingly intense, particularly in the era of globalization. This heightened competition has affected economic growth and development at both the national and international levels. Consequently, companies incur higher operating costs, which may adversely affect their financial condition. A company experiencing financial difficulties may enter a state of financial distress. Financial distress refers to a stage in which a company's financial condition deteriorates and may ultimately lead to bankruptcy (Sihombing & Angela, 2024). This condition generally arises due to declining revenues, increasing operating expenses, and unstable economic conditions that negatively affect a company's performance.

According to <https://www.kompas.id/> (published on January 19, 2024), Alessandro Gazzini, Managing Director of Alvarez & Marsal (A&M), a global strategy consulting firm, stated that the recovery of corporate financial health following the COVID-19 pandemic has been relatively slow. As a result, the number of companies experiencing prolonged financial difficulties, referred to as "zombie companies," has increased. These zombie companies are classified into three categories: (1) companies in a distressed condition characterized by weaknesses in their balance sheets and operational efficiency, (2) companies with weak balance sheet resilience, and (3) companies with weak balance sheets and income statements. The proportion of companies classified as distressed reached 19.4% during the first year of the pandemic in 2020. This figure declined to 13.3% in 2021, increased again to 15.3% in 2022, and decreased to 14.2% during the twelve months ending in June 2023.



Alessandro Gazzini further stated that companies operating in the metal mining and non-coal mining industries, which are included in the Basic Materials sector, experienced the highest level of financial distress. If financial distress can be identified at an early stage, companies may implement corrective and preventive measures to improve their financial condition and avoid more severe consequences, such as bankruptcy or business closure.

Various studies have employed both financial and non-financial indicators to analyze and predict the occurrence of financial distress. Commonly used financial ratios include profitability, liquidity, leverage, and activity ratios. In addition, several studies have incorporated non-financial variables, such as firm growth, corporate governance, and macroeconomic conditions, to predict the likelihood of financial distress.

The first factor influencing the prediction of financial distress is profitability. Profitability is a financial ratio used to measure a company's ability to generate earnings. Companies that consistently earn profits or maintain high and improving profitability ratios are less likely to experience financial distress. Conversely, lower profitability increases the likelihood of financial distress.

The second factor that may influence financial distress is cash flow information. Cash flow information assists companies in evaluating their financial condition. Strong cash flow generally indicates that a company has sufficient liquidity to meet its operational and financial obligations, thereby reducing the likelihood of financial distress.

The third factor affecting financial distress is leverage. According to Cahyana et al. (2025), leverage is a financial ratio used to measure the extent to which a company relies on debt financing. The higher the level of debt, the greater the risk that the company will experience financial distress.

The fourth factor influencing financial distress is firm growth. In this study, firm growth is proxied by sales growth, which reflects a company's ability to increase its sales from one period to the next. Higher sales growth can improve profitability and strengthen the company's financial performance, thereby reducing the risk of financial distress.

THEORETICAL FRAMEWORK

Agency Theory

Agency theory was first introduced by Jensen and Meckling in 1976. According to Putri and Tumirin (2025), agency theory explains the contractual relationship between one or more individuals acting as principals (shareholders) and agents (parties responsible for managing the company). The principal delegates authority and provides direction to the agent. In turn, the agent is responsible for managing the company's operations in accordance with the principal's directives and is accountable for carrying out those responsibilities.

Financial Distress



Financial distress is a condition in which a company's financial performance deteriorates significantly, resulting in an unhealthy financial position. Financial distress refers to a situation in which a company is at risk of failing to fulfill its financial obligations to various stakeholders. This condition is also a major concern for management, or the agent, as it indicates a decline in the company's financial performance that may threaten its business continuity.

Profitability

Profitability is a financial ratio used to measure a company's ability to generate profits from the utilization of its total assets over a given period. It is one of the key indicators used to assess a company's efficiency in generating earnings from its sales activities during a specific period. A company that consistently generates profits demonstrates that the agent has effectively managed the company in accordance with the principal's interests and possesses the ability to sustain its business operations in the future. Conversely, a company that continuously incurs losses or experiences declining profits is more likely to encounter financial difficulties or financial distress.

Cash Flow

Cash flow is one of the essential components of a company's financial statements, as it reflects the cash inflows and cash outflows that occur during a specific accounting period. The statement of cash flows provides management with information to evaluate the company's operating performance and serves as a basis for planning investment and financing activities. Cash flow also plays an important role for investors and creditors. For investors, cash flow serves as an indicator of a company's ability to generate cash that can be used to pay dividends or reinvest in the business to enhance firm value. For creditors, cash flow provides information regarding the company's ability to meet its debt obligations, including the payment of principal and interest.

Leverage

Leverage is a financial ratio used to measure the extent to which a company utilizes debt to finance its assets and operational activities. Leverage is an important component of a company's financial structure because it has a dual effect, creating both opportunities and risks. When managed efficiently, leverage can enhance a company's ability to generate profits. However, if leverage is not managed optimally and reaches a high level, it may increase the company's difficulty in meeting its financial obligations.



Firm Growth

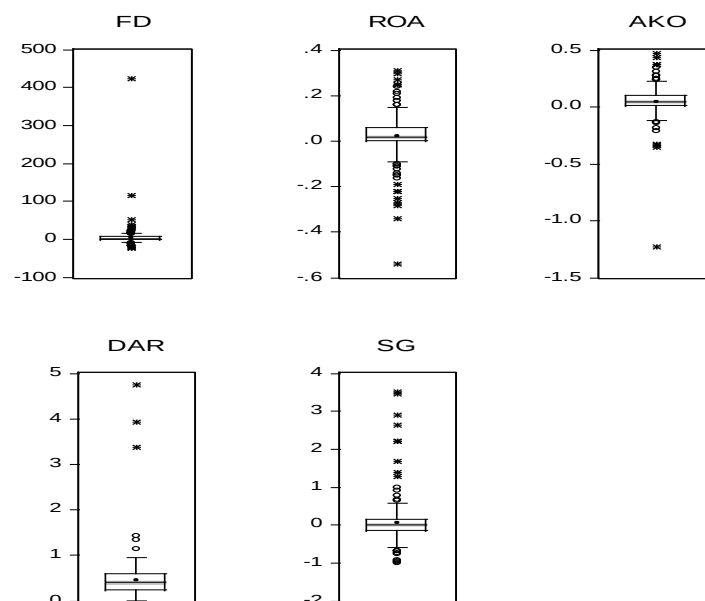
Firm growth refers to a company's ability to improve and maintain its economic position within the economy and the industry in which it operates. Such growth is driven by an increase in business volume. Rapid firm growth may create substantial financial pressure, requiring the company to manage its financial resources effectively and efficiently. Conversely, a decline in firm growth may indicate problems in the company's financial performance, thereby increasing the likelihood of financial distress.

METHOD

The unit of analysis in this study consists of companies in the Basic Materials sector listed on the Indonesia Stock Exchange (IDX). The sampling technique employed in this study is non-probability sampling. The data are analyzed using EViews version 14, and the analytical method applied is panel data regression analysis.

RESULT

The population of this study consists of 108 companies in the Basic Materials sector that were consistently listed on the Indonesia Stock Exchange (IDX). Of these, 24 companies did not consistently publish their financial statements on the Indonesia Stock Exchange (IDX) during the 2022–2024 period. As a result, the study comprises 252 observations. Subsequently, the researcher conducted an outlier test using a boxplot, as several companies exhibited extreme values.



Gambar Boxplot sebelum outlier



The results of the boxplot method indicated that 25 companies exhibited extreme values. Therefore, these 25 companies were excluded from the study.

Analisis Statistik Deskriptif

	N	Minimum	Maximum	Mean	Std. Dev.
<i>Financial Distress</i>	252	-21,51	426,91	7,2659	28,7793
Profitabilitas	252	-0,54	0,31	0,0241	0,0941
Arus Kas	252	-1,23	0,47	0,0517	0,1317
<i>Leverage</i>	252	0,00	4,76	0,4643	0,4694
Pertumbuhan Perusahaan	252	-0,98	3,51	0,0688	0,5511

The financial distress (FD) variable has a minimum value of -21,51 and a maximum value of 426,91. The mean value of financial distress is 7,2659, which is lower than its standard deviation of 28,7793. The profitability variable has a minimum value of -0,54 and a maximum value of 0,31. The mean value of profitability is 0,0241, while its standard deviation is 0,0941. The cash flow variable has a minimum value of -1,23 and a maximum value of 0,47. The mean value of cash flow is 0,0517, with a standard deviation of 0,1317. The leverage variable has a minimum value of 0,00 and a maximum value of 4,76. The mean value of leverage is 0,4643, while its standard deviation is 0,4694. The firm growth variable has a minimum value of -0.98 and a maximum value of 3,51. The mean value of firm growth is 0,0688, with a standard deviation of 0,5511.

Panel Data Model Selection

Chow Test Results

<i>Effects Test</i>	Prob.
<i>Cross-section Chi-square</i>	0,000

Based on the table above, the probability value of the Cross-section Chi-square is $0,000 < 0,05$. Therefore, the Fixed Effect Model (FEM) is selected.

Hausman Test Results

<i>Test Summary</i>	Prob.
<i>Cross-section random</i>	0,135



Based on the table above it can be observed that the probability value of the Cross-section Random is $0,135 > 0,05$. Therefore, the Random Effect Model (FEM) is selected.

Lagrange Multiplier Test Results

	Prob.
<i>Breusch-Pagan</i>	0,000

Based on the table above it can be observed that the probability value of the Cross-section Random is $0,000 < 0,05$. Therefore, the Random Effect Model (FEM) is selected as the appropriate model for this study.

Classical Assumption Tests

Normality Test

<i>Jarque-Bera Probability</i>	Kesimpulan
0,000	Data tidak berdistribusi normal

The normality test results indicate that the Jarque–Bera probability value is $0.000 < 0.05$. Therefore, it can be concluded that the data are not normally distributed. To address this issue, the researcher applied the outlier technique.

Normality Test Results After Outlier

<i>Jarque-Bera Probability</i>	Kesimpulan
0,561	Data sudah berdistribusi normal

The normality test results after applying the outlier technique show that the Jarque–Bera probability value increased to 0,561, which is greater than 0,05. Therefore, it can be concluded that the data used in this study are normally distributed.

Multicollinearity Test

Multicollinearity Test Results

	Profitabilitas	Arus Kas	Leverage	Pertumbuhan Perusahaan
Profitabilitas	1,000	0,331	-0,461	0,231
Arus Kas	0,331	1,000	-0,044	0,035
Leverage	-0,461	-0,044	1,000	-0,171
Pertumbuhan Perusahaan	0,231	0,035	-0,171	1,000

It can be observed that the correlation coefficients among all variables $< 0,80$, indicating that there is no multicollinearity among the independent variables.



Heteroskedasticity Test

Heteroskedasticity Test Results

Variabel	Prob.	Kesimpulan
Profitabilitas	0,058	Bebas Heteroskedastisitas
Arus Kas	0,395	Bebas Heteroskedastisitas
Leverage	0,422	Bebas Heteroskedastisitas
Pertumbuhan Perusahaan	0,098	Bebas Heteroskedastisitas

Based on the table above, the probability values of all four variables are $> 0,05$. Therefore, it can be concluded that the regression model is free from heteroskedasticity, indicating that the assumption of homoskedasticity is satisfied.

Autocorelation Test

Autocorelation Test Results

Durbin Watson	Kesimpulan
1,655	Tidak terjadi autokorelasi

Based on the autocorrelation test results presented in the table, the Durbin Watson (DW) statistic is 1,655. This value falls within the acceptance region, where $-2 < DW < 2$ ($-2 < 1,655 < 2$). Therefore, it can be concluded that the regression model is free from autocorrelation, indicating that the autocorrelation assumption is satisfied.

Panel Data Regression Analysis Results

Variabel	Nilai Koefisien
C	10,678
Profitabilitas	13,406
Arus Kas	-1,935
Leverage	-15,707
Pertumbuhan Perusahaan	-0,010

The panel data regression analysis was conducted using the Random Effect Model (FEM). The estimated regression equation is as follows:

$$FD_{it} = 10,678 + 13,406ROA_{it} - 1,935OCF_{it} - 15,707DAR_{it} - 0,010SG_{it}$$

Based on the regression equation, the interpretations are as follows:

The constant value is 10,678, indicating that when profitability, cash flow, leverage, and firm growth are assumed to be constant or equal to zero, the Financial Distress value is 10,678. The coefficient of profitability is 13,406, indicating that a higher profitability decreases the risk of financial distress. The coefficient of cash flow is -1,935, indicating that a higher cash



flow increases the risk of financial distress. The coefficient of leverage is $-15,707$, indicating that a higher leverage increases the risk of financial distress. The coefficient of firm growth is $-0,010$, indicating that a higher firm growth increases the risk of financial distress.

Model Feasibility Test

<i>Prob(F-statistic)</i>	Kesimpulan
0,000	Model regresi layak digunakan

Based on the model feasibility test results presented in table, the probability value of the F-statistic is $< 0,05$. Therefore, it can be concluded that the regression model is statistically significant and appropriate for use in this study.

t-Test

t-Test Results

Variabel	Koefisien	Prob.	Kesimpulan
Profitabilitas	13,406	0,000	Hipotesis diterima
Arus Kas	-1,935	0,017	Hipotesis tidak diterima
<i>Leverage</i>	-15,707	0,000	Hipotesis diterima
Pertumbuhan Perusahaan	-0,010	0,947	Hipotesis tidak diterima

Based on the results of the t-test presented in the table, it can be concluded that the profitability variable has a probability value of 0,000, which is $< 0,05$, and a positive coefficient which is 13,406. Therefore, profitability has a negative and significant effect on financial distress. The positive sign of the coefficient indicates that an increase in profitability leads to an increase in the Altman Z-Score, implying a lower likelihood of financial distress. Thus, H1, which states that profitability has a negative effect on financial distress, is accepted. The cash flow variable has a probability value of 0,017 which is $< 0,05$, and a negative coefficient which is -1,935. Therefore, operating cash flow has a positive and significant effect on financial distress. Accordingly, H2, which states that cash flow has a negative effect on financial distress, is rejected. The leverage variable has a probability value of 0,000, which is $< 0,05$, and negative coefficient which is -15,707. Therefore, leverage has a positive and significant effect on financial distress. The negative sign of the coefficient indicates that an increase in leverage reduces the Altman Z-Score, implying a higher likelihood of financial distress. Thus, H3, which states that leverage has a positive effect on financial distress, is accepted. The firm growth variable has a probability value of 0,947, which is $> 0,05$, and a negative coefficient which is -0,010. Therefore, firm growth has no



significant effect on financial distress. Accordingly, H4, which states that firm growth has a negative effect on financial distress, is rejected.

Coefficient Determination (R^2 Test)

<i>R-squared</i>	<i>Adjusted R-squared</i>
0,810	0,806

Based on the coefficient of determination results presented in the table above, the Adjusted R-squared value is 0,806. This indicates that approximately 80,6% of the variation in financial distress is explained by profitability, cash flow, leverage and firm growth. The remaining 19,4% of the variation is explained by other factors not included in the regression model.

DISCUSSION

The Effect of Profitability on Financial Distress

The results of this study indicate that profitability, measured by Return on Assets (ROA), has a negative and significant effect on financial distress. Although the regression coefficient is positive, it indicates that higher profitability increases the Altman Z-Score. Since a higher Altman Z-Score reflects a lower likelihood of financial distress, an increase in profitability reduces the risk of financial distress.

These findings are consistent with the study conducted by Susanti, Rasyad, and Wardi (2022), which reported that profitability has a negative and significant effect on financial distress. However, the results differ from those of Yuanita and Priyadi (2023) and Khotimah and Gantino (2024), who found that profitability has a positive and significant effect on financial distress. In addition, the findings are inconsistent with those of Firmansyah (2024), who concluded that profitability does not have a significant effect on financial distress.

The Effect of Cash Flow on Financial Distress

The results of this study indicate that operating cash flow has a positive and significant effect on financial distress. These findings are consistent with the study conducted by Khotimah and Gantino (2024) and Anggraini (2024), who reported that cash flow has a positive and significant effect on financial distress. However, the results are inconsistent with the findings of Rahmawati and Setiawati (2022), who reported that cash flow does not have a significant effect on financial distress.

The Effect of Leverage on Financial Distress



The results of this study indicate that leverage has a positive and significant effect on financial distress. Although the regression coefficient is negative, it indicates that higher leverage reduces the Altman Z-Score. Since a lower Altman Z-Score reflects a greater likelihood of financial distress, an increase in leverage increases the risk of financial distress.

These findings are consistent with the studies conducted by Widhiastuti, Novitasari, and Narastuti (2023) and Anggraini (2024), which reported that leverage has a positive and significant effect on financial distress. However, the findings differ from those of Khotimah and Gantino (2024), Rahmawati and Setiawati (2022), and Mulyatiningsih and Atiningsih (2021), who concluded that leverage does not have a significant effect on financial distress.

The Effect of Firm Growth on Financial Distress

The results of this study indicate that firm growth, measured by sales growth, has no significant effect on financial distress. These findings are consistent with the studies conducted by Rahmawati and Setiawati (2022) and Oktaviani and Zaretta (2024), which concluded that firm growth does not have a significant effect on financial distress. However, the results are inconsistent with those of Apriliake et al. (2024) and Mulyatiningsih and Atiningsih (2021), who found that sales growth has a positive and significant effect on financial distress.

CONCLUSION

The results of this study indicate that profitability has a negative and significant effect on financial distress. Cash flow has a positive and significant effect on financial distress. Leverage has a positive and significant effect on financial distress. Finally, firm growth has no significant effect on financial distress.

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