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# Determinants of Financial Distress in Non-Financial State-Owned Enterprises in Indonesia

**Ikrana Shafa Maura, Mega Barokatul Fajri, Adi Lukman Hakim***

Faculty of Economic and Business, University Muhammadiah Lamongan, Lamongan, 62218, Indonesia

*Corresponding author e-mail: adilukmanhakim123@gmail.com

**ABSTRACT**

The study aims to assess how liquidity, profitability, leverage, capital structure, and the audit committee influence the financial challenges faced by State-Owned Enterprises (SOEs). The research employs a purposive sampling method based on specific criteria, with 20 companies included in the study. The multiple linear correlation test reveals a strong relationship between liquidity, profitability, and company size regarding financial challenges. Analysis conducted using SPSS software indicates a significance value for the F-test, suggesting that liquidity, profitability, leverage, capital structure, and the audit committee significantly impact the financial difficulties. Furthermore, the t-test results demonstrate that liquidity, profitability, leverage, and capital structure play a role in influencing the financial challenges, whereas the audit committee does not have a significant effect.

**Keywords:** Financial Distress; Financial Performance; Capital Structure; Audit Committee

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## INTRODUCTION

The development of infrastructure serves as a key driver of economic growth amidst the sluggish global economy due to the COVID-19 pandemic, as it can create job opportunities. The government's ongoing infrastructure development program emphasizes improving the welfare of the people and reducing regional disparities (Alam et al., 2024). The Ministry of Public Works and Public Housing has introduced the Cash-Intensive Labor-Intensive Program (PKT) and earmarked a budget of Rp 53.3 trillion in 2021 to bolster the national economic recovery. In 2021, Indonesia's economy began to grow again by 3.7% and continued to grow by 5.31% in 2022. The massive infrastructure development is expected to reduce logistics costs in Indonesia. One method of current government redistribution involves the development of the State Capital City (IKN), with the majority of projects being carried out by State-Owned Enterprises (SOEs).

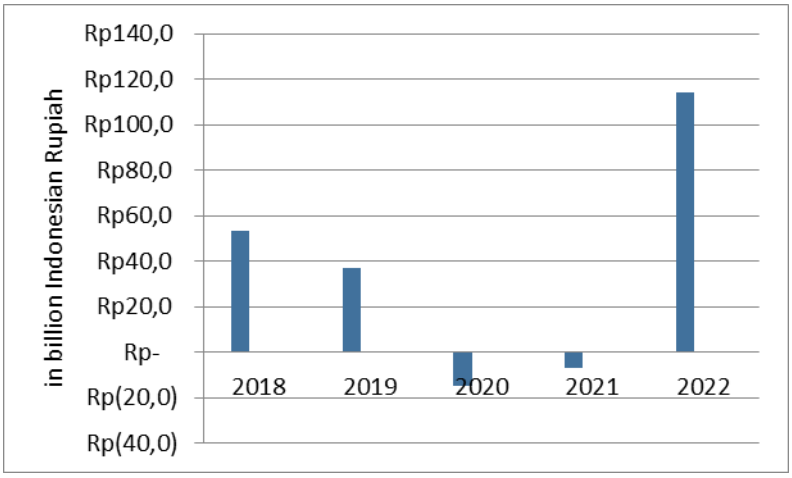


**Figure 1.** Total Net Profit (Loss) of State-Owned Enterprises (BUMN) for the Years 2018-2022

**Source:** authors (2024)

In 2018, non-financial SOEs earned a profit of Rp 53 trillion, but in 2019, it decreased by 30% or Rp 16 trillion, resulting in a profit of only Rp 36.85 trillion. The year 2020 was particularly challenging for non-financial SOEs as they incurred a loss of Rp 15.28 trillion, a 141% decrease from 2019. Companies such as PT Waskita Karya, PT Perusahaan Gas Negara, PT Garuda Indonesia, PT Waskita Beton Precast suffered losses exceeding Rp 1 trillion. Companies experiencing significant losses are indicative of being in a state of financial distress.

This study is based on previous research that found inconsistencies in the results, which would be more interesting to re-examine and use as supporting material for this study. Based on research conducted by Kournikova & Nurasik (2021) and Maximillian & Septina (2022), it was stated that liquidity and profitability have a significant positive effect on financial distress, while leverage has a negative effect on financial distress. This means that the higher the liquidity and profitability of a company, the greater the potential for the company to experience financial distress, but the higher the leverage of a company, the lower the potential for the company to experience financial distress. This differs from the results of research conducted by Adzroo & Suryaningrum (2023), which states that liquidity and profitability have a negative effect on financial distress, while leverage has a positive effect on financial distress. This means that the higher the company's liquidity and profitability, the lower the potential for the company to experience financial distress, but the higher the company's leverage, the greater the potential for the company to experience financial distress.

The primary research concern revolves around the predictive capability of financial ratios in forecasting financial distress and determining the significant ratios for this purpose. This study identifies variables that can accurately identify financial distress. To test the ability to predict future financial distress, financial ratios calculated from financial statements can be used to determine the strength of the relationship between these

ratios and economic phenomena. The research analysis aims to find a linear combination of financial ratios that can minimize the probability of misclassifying observations into their correct groups.

The objectives of this study are: (1) to test whether liquidity influences financial distress, (2) to test whether profitability affects financial distress, (3) to examine whether leverage influences financial distress, (4) to assess whether capital structure impacts financial distress, and (5) to investigate whether the size of the audit committee influences financial distress.

## LITERATURE REVIEW

### *Signaling Theory*

Signaling theory refers to the information potential of a company disclosed by management to investors. Additionally, the signal theory explains the effort to provide signals to stakeholders regarding the perspective of business opportunity management (Houston, 2006). Profitability provides crucial information to investors about the company's potential for profit generation.

The audit committee must provide effective oversight of management. An audit committee with integrity that exercises full oversight of financial reporting will minimise the possibility of fraud. Having sufficient members of the audit committee who are independent in their attitudes and opinions will make performance more effective.

### *Financial Distress*

Financial distress refers to a situation where financial deterioration occurs within a company before it faces bankruptcy (Fajri et al., 2023). This condition arises due to poor and unstructured financial management within the company. It starts with increased liquidity pressure and then a decrease in asset value, leading to difficulties in meeting financial obligations.

### *Liquidity*

Liquidity refers to a company's capability to meet short-term obligations (Kasmir, 2019:129). A company is deemed to have strong liquidity if it can settle its short-term obligations without any hindrances. The Quick Ratio (QR) serves as a metric to assess liquidity by analyzing the ratio of total current assets (excluding inventory) to current liabilities.

### *Profitability*

Profitability reflects the extent to which a company can generate profit through its productivity (Kasmir, 2019). Operational activities can influence profit generation, such as revenue growth and strict cost management in financing company operations. High

profitability levels can be an indicator of a company's achievement, as it reflects the potential to earn profits in a specific period with its revenue, assets, and shares. With high profitability, the company's performance will improve, leading to operational profit generation.

***Leverage***

The ratio is employed to assess the level of debt burden concerning the company's assets, showcasing the company's capacity to repay both short-term and long-term debts (Kasmir, 2019). This ratio offers valuable insights into the significant impact of debt on the company's total assets.

***Capital Structure***

Capital structure evaluates how much debt can finance the company's assets and is calculated using the Debt to Equity Ratio (DER), which compares total debt to the company's equity. Capital structure plays a vital role in decision-making regarding financing through debt or equity for operational endeavors. Incorrect decisions in this regard could lead to losses, impeding profit generation.

***Audit Committee***

The Audit Committee is a professional body established by the board of commissioners, functioning independently. Its core duties include supervising audit-related matters, overseeing the enforcement of corporate governance, managing risks, and monitoring financial reporting by the board of commissioners or supervisory board.

**Hypothesis Development**

***Relation Between Liquidity, Profitability, Leverage, Capital Structure, Audit Committee, and Financial Distress***

Based on signal theory, liquidity, which is one of a company's financial ratios, can be used as a signal for companies to provide information to external parties regarding the financial condition of the company concerned. Disclosure of financial information in terms of liquidity ratios can be used by external parties to make decisions regarding capital investment in the company. According to the research conducted by Septiani et al. (2021), liquidity has a favorable influence on financial distress. This is due to the fact that liquidity illustrates a company's ability to settle its imminent short-term debts by utilizing its current assets. By effectively managing its short-term debt obligations, a company can reduce the likelihood of experiencing financial distress.

H1a: Liquidity has a positive impact on financial distress

This is in line with research conducted by Rodifah & Hendrawaty (2023), and Adzroo & Suryaningrum (2023), which found that profitability has a negative and significant effect

on financial distress. This means that the higher a company's profitability ratio, the lower the potential for that company to experience financial distress. This condition is due to the fact that a good level of profitability indicates that an entity can maximise its assets to generate profits or earnings. The research results by Arya et al. (2025), suggest that a robust profitability situation empowers an entity to efficiently utilize its assets to generate earnings. Through these earnings, a company can meet its operational expenses and settle all debts, consequently lowering the risk of financial distress. These outcomes align with the signaling theory, which proposes that elevated levels of profitability in a company's financial reports send a favorable message to external stakeholders like shareholders to consider investing in the company.

H1b : Profitability has a positive impact on financial distress.

The leverage ratio is a ratio used to measure a company's ability to pay all its debts, both long-term and short-term (Kasmir, 2019). Leverage in signaling theory states that the higher the level of debt in a company, the greater the risk borne by the company. In research by Rodifah & Hendrawaty (2023), companies benefit from using debt through tax savings, as the interest expense from debt can reduce the taxes a company must pay. The cost incurred from debt utilization is interest, which can lower the tax burden on the company. Therefore, using debt as a funding source is more cost-effective than financing from equity. The decision to use debt in companies, in general, can enhance the company's profitability, leading to an increase in the company's stock price. Indirectly, this will boost the welfare of shareholders and create significant growth potential for the company, thereby reducing the likelihood of financial distress.

H1c : Leverage has a positive impact on financial distress.

In a study Amaliyah & Nurcholisah (2023) indicates that the capital structure has a negative impact on financial distress, meaning that the higher the value of the capital structure, the more likely the financial distress (reflected in reduced ICR) experienced by the company. This is because as the level of debt or obligations undertaken by the company increases, so does the burden on the company in terms of interest expenses and principal obligations. This implies that the risk associated with meeting the company's obligations grows, elevating the potential for financial distress.

H1d : Capital Structure has a negative impact on financial distress.

Previous research by Masak & Noviyanti (2019) The larger the size of the audit committee, the tighter the supervision related to financial reports, enabling early detection of financial issues and proactive measures to reduce the potential for financial distress.

H1e: Audit Committee has a positive impact on financial distress.

If a company's financial performance improves and its audit committee consists of at least three members in accordance with government regulations, the company will be protected from financial distress indicated by a high ICR value. This is because a company with strong performance can generate significant profits to repay its debts, both short-term and long-term (Sitompul et al., 2025).

H1f : Liquidity, Profitability, Leverage, Capital Structure, and Audit Committee has a positive impact on financial distress.

**Hypotheses of the research**

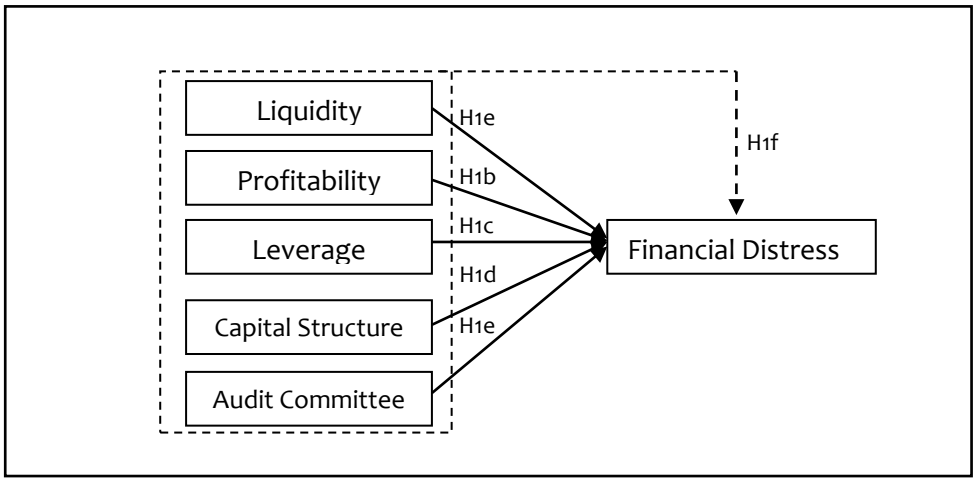


**Figure 2.** Hypotheses of the Research
**Source:** authors (2024)

**METHODOLOGY**

The researcher adopted a quantitative approach and accessed secondary data for the study. The research concentrated on 20 non-financial State-Owned Enterprises (BUMN) listed on the Indonesia Stock Exchange from 2018 to 2022 serve as the study population. Purposive sampling was employed, choosing firms that consistently disclosed financial information throughout the research timeframe, leading to a sample size of 20 companies. Data were extracted from the financial statements of these companies spanning a 5-year duration, resulting in a total of 100 data points.

The dependent variable, financial distress, was assessed using the interest coverage ratio (ICR), which assesses the company's ability to withstand a decline in income without facing difficulty in paying its annual interest expenses. For the independent variables, liquidity was evaluated through the Quick Ratio (QR), comparing current assets to current liabilities excluding inventory. Profitability was determined using Return on Assets (ROA), which compares net income after tax to total assets. Leverage was using the Debt to Asset Ratio (DAR), which compares debt to assets, while capital structure was approximated by the Debt to Equity Ratio (DER), dividing total debt by total equity of the company. The audit committee variable was indicated by the number of members in each company's audit committee.

## RESULTS

### Classic Assumption Test

**Table 1.** Kolmogorov-Smirnov

| | | Understandartized Residual |
|---|---|---|
| **N** | | **53** |
| Normal Parameters[a,b] | Mean | .000000 |
| | Std. Deviation | .91412921 |
| Most Extreme Differences | Absolute | .117 |
| | Positive | .117 |
| | Negative | -.107 |
| Test Statistic | | .117 |
| Asymp. Sig. (2-talled) | | .069 |

**Source:** authors (2024)

The analysis yielded an Asymptotic Significance (Asymp Sig.) value of 0.069 for the One-Sample Kolmogorov-Smirnov test. A value higher than 0.05 suggests that the research data adheres to a normal distribution.

**Table 2.** Test of Multicollinearity

| | | Collinearity Statistic | |
|---|---|---|---|
| **Model** | | **Tolerance** | **VIF** |
| **1** | **(Constant)** | | |
| | Likuiditas | .783 | 1.278 |
| | Profitabilitas | .808 | 1.237 |
| | Leverage | .262 | 3.814 |
| | Struktur Modal | .309 | 3.237 |
| | Audit Committee | .924 | 1.082 |

**Source:** authors (2024)

The testing outcomes revealed tolerance values for liquidity at 0.783, profitability at 0.808, leverage at 0.262, capital structure at 0.309, and audit committee at 0.924. This implies that the tolerance values are below 0.10. Additionally, the VIF values for liquidity, profitability, leverage, capital structure, and audit committee are 1.278, 1.237, 3.814, 3.237, and 1.082, respectively. Consequently, the conclusion drawn from this assessment is that there is no multicollinearity concern as the VIF values are < 10.

**Table 3.** Test of Autocorrelation

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin Waston |
|---|---|---|---|---|---|
| 1 | .786[a] | .617 | .576 | .96152 | 2.068 |

**Source:** authors (2024)

In the regression model, the absence of autocorrelation is indicated when du < dw < (4-du). The test results displayed a dw value of 2.068. Within this regression equation, the du value is 1.7685, and the 4-du value is 2.2315. This comparison reveals that the du value is less than the dw value, or in other words, 1.7685 (du) < 2.068 (dw) < 2.2315 (4-du). Hence, the data in this study is devoid of autocorrelation.

**Table 4**. Test of Heteroskedasticity

| Model | t | Sig. |
|---|---|---|
| (Constant) | .921 | .362 |
| Likuiditas | .199 | .843 |
| Profitabilitas | .570 | .572 |
| Leverage | -.215 | .830 |
| Struktur modal | -.007 | .994 |
| Audit Committee | -.228 | .812 |

**Source:** authors (2024)

The results of heteroskedasticity indicate Sig. values for liquidity at 0.362, profitability at 0.843, leverage at 0.572, capital structure at 0.830, and audit committee at 0.994. Based on these findings, the regression model is free from heteroskedasticity as all independent variables exhibit significance values > 0.05.

**Coefficient of Determination**

**Table 5.** Coefficient of Determination

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .786[a] | .617 | .576 | |

**Source:** authors (2024)

The test results indicated an Adjusted $R^2$ value of 0.576, indicating that 57.6% of the variance in financial distress is accounted for by liquidity, profitability, leverage, capital structure, and the audit committee, with the remaining 42.4% influenced by factors not addressed in this study.

**Result of Hypothesis Testing**

**Table 6**. F-test

| Model | | Sum of Square | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 70.013 | 5 | 14.003 | 15.146 | .000[b] |
| | Residual | 43.453 | 47 | .925 | | |
| | total | 113.466 | 52 | | | |

**Source:** authors (2024)

The F-test results show a significant relationship between the independent variables (liquidity, profitability, leverage, capital structure, and audit committee) and the dependent variable (financial distress). The calculated F-value (15.146) is much larger than the critical F-value (2.41), with a p-value of 0.000, indicating that these factors collectively have a strong influence on financial distress.

**Table 7.** T-test

| | Model | t | Sig. |
|---|---|---|---|
| 1 | (Constant) | -1.276 | .208 |
| | Likuiditas | 2.223 | .031 |
| | Profitabilitas | 7.364 | .000 |
| | Leverage | 2.190 | .033 |
| | Struktur modal | -2.176 | .035 |
| | Audit Committee | .763 | .449 |

**Source:** authors (2024)

The regression analysis reveals that the t-test shows positive coefficients for the liquidity, profitability, leverage, and audit committee variables, while the capital structure variable has a negative coefficient. This analysis leads to the following formulation:

Financial Distress (Y) = -1,647 (α) + 0,924 (*QR*) + 47,416 (ROA) + 3,5621 (DAR) – 0,385 (DER) – 0,142 (AC) + ϵ

## DISCUSSION

### *The Effect of Liquidity on Financial Distress*

Based on the research findings, a t-value of 2.263 was obtained with a significance level of 0.028, below the critical level of 0.05. This indicates that the liquidity ratio positively influences the interest coverage ratio (ICR). Liquidity is crucial for assessing a company's ability to fulfill short-term commitments. Companies with strong liquidity are usually more stable and liquid, demonstrating their capability to meet short-term obligations and diminish the risk of financial distress (higher ICR). In contrast, low liquidity may lead to difficulties in repaying short-term debts, indicating inadequate liquidity to cover current liabilities, potentially triggering financial distress (lower ICR). The liquidity ratio of state-owned enterprises is still considered liquid because their current assets are still higher than their current liabilities. In order to avoid financial distress, companies must have sufficient current assets to pay off maturing debts. If companies do not have sufficient current assets, such as cash, they will default on their short-term debts and experience financial distress.

These results align with signaling theory, suggesting that liquidity, as a financial ratio, signals the company's financial health to investors. Higher liquidity values attract investors for capital investment as companies can meet current obligations with current

assets, reducing the likelihood of financial issues and mitigating financial distress. Numerous studies Kournikova & Nurasik (2021), Maximillian & Septina (2022), Sitompul et al. (2025), Fikri et al. (2025), Septiani et al. (2021), Wijaya (2023), dan Kawakibi & Kurniawan (2025), also support the positive correlation between liquidity and financial distress.

***The Effect of Profitability on Financial Distress***

The analysis unveils a t-value of 7.296 with a significance value of 0.000, surpassing the threshold significance level of 0.05. This indicates that the profitability ratio positively impacts the interest coverage ratio (ICR). Profitability, as measured by Return on Asset (ROA), exhibits a positive correlation with financial distress, suggesting that higher profitability leads to an increase in financial distress (ICR) values. Conversely, a decline in profitability results in lower financial distress levels measured by ICR. As seen above, in 2020 and 2021, state-owned enterprises suffered losses, one of the causes of which was the COVID-19 pandemic. The smaller the net profit generated, the smaller the profitability value and the ICR value. This means that the potential for companies to experience financial distress is increasing because the ICR value is getting closer to 1. Aligned with signaling theory, profitability serves as a signal of the company's financial standing to external stakeholders. Enhanced profitability attracts investors for financial investment owing to the company's ability to generate profits, thereby decreasing the likelihood of financial challenges. Prior studies Giovanni et al. (2020), Arya et al. (2025), Kournikova & Nurasik (2021), Maximillian & Septina (2022), Muntahanah (2021), Fikri et al. (2025), Sitompul et al. (2025), Septiani et al. (2021), Arif et al. (2023), also corroborate the favorable association between profitability and financial distress.

***The Effect of Leverage on Financial Distress***

The study reveals a t-value of 2.219 with a significance value of 0.031, falling below the significance level of 0.05. This implies that the leverage ratio positively impacts financial distress. Elevated leverage, quantified by the Debt To Asset Ratio (DAR), signifies higher financial distress gauged by the proxy of ICR, reflecting a sound financial standing for the issuer. The utilization of debt by companies typically enhances company profitability, leading to higher stock prices. It can be seen that the average total assets owned by state-owned enterprises in 2018-2022 have a greater value compared to their total assets, meaning that the companies have the ability to pay off their debts. Companies can also benefit from debt in the form of tax savings, as the interest expense on debt can reduce the taxes that companies have to pay. Therefore, using debt as a source of funding is cheaper than funding from other sources. The decision to use debt in companies can generally increase company profitability, thereby increasing the company's share price.

This improvement augments shareholder value and potential company expansion, reducing the risk of financial distress, as demonstrated by the increase in ICR value. This finding Adzroo & Suryaningrum (2023), Muntahanah (2021), Septiani et al. (2021b), dan Jessie & Tania (2024) supports the beneficial influence of leverage on financial distress.

***The Effect of Capital Structure on Financial Distress***

The analysis discloses a t-value of -2.141 with a significance level of 0.038, falling below the critical threshold of 0.05. This suggests that the capital structure variable adversely impacts financial distress. A high Debt To Equity Ratio (DER) diminishes financial distress (ICR), indicating proximity to potential financial distress for firms with a debt-centric capital structure. Companies with elevated DER values encounter heightened risks of financial distress owing to a debt-heavy capital framework, manifested in reduced ICR values. Increased debt levels elevate the susceptibility to financial distress, heightening the likelihood of default. This result Amaliyah & Nurcholisah (2023), Lee & Manual (2019), Hananiyah & Jaya (2023) dan Mercyana (2022), supports the adverse influence of capital structure on financial distress.

***The Effect of Audit Committee on Financial Distress***

The study reveals a t-value of 0.763 with a significance level of 0.449, surpassing the critical significance level of 0.05. This suggests that the audit committee does not impact financial distress. The hypothesis suggesting a positive association between the audit committee and financial distress cannot be confirmed or rejected. The number of audit committee members does not affect financial distress. In numerous cases, the audit committees of organizations may not effectively discharge their responsibilities. They often exist to comply with governmental regulations mandating the presence of an audit committee in public companies, with the expectation of enhancing company performance. Hence, the audit committee variable does not significantly impact the likelihood of financial distress, aligning with prior research Arya et al. (2025), Masak & Noviyanti (2019), Lestari & Wahyudin (2021), Alexandra (2021), Rodifah & Hendrawaty (2023) dan Nadjib (2016), that reveals no substantial influence of the audit committee on financial distress

***The Effect of Liquidity, Profitability, Leverage, Capital Structure, and Audit Committee on Financial Distress***

The sixth hypothesis states that liquidity, profitability, leverage, capital structure, and the audit committee have a positive impact on financial distress. The research results yielded an F-value of 15.146, exceeding the critical F-value of 2.41 at a significance level of 0.05. Therefore, it can be concluded that liquidity, profitability, leverage, capital structure, and the audit committee positively influence financial distress. This means that the sixth hypothesis is accepted. When a company's financial performance improves, aligned with the presence of an audit committee meeting the government regulations of at least three members, the company can avoid financial distress indicated by a high ICR value. This is because a good company performance can generate significant profits to repay debts, both short-term and long-term. Additionally, the company will have sufficient capital for its operations, coupled with an adequate number of audit committee members ensuring effective supervision, reducing the potential for fraud and asymmetric information, thus protecting the company from

financial distress. This aligns with the signaling theory and trade-off theory. This is corroborated by studies conducted by Sitompul et al. (2025)

## CONCLUSIONS

The study was conducted by the researcher to examine internal factors within companies that may impact financial distress. The focus of this investigation was on state-owned enterprises (BUMN) that are listed on the Indonesia Stock Exchange between 2018 and 2022. Through data observation, hypothesis testing, and discussions, it was concluded that liquidity, profitability, leverage, and capital structure play a role in influencing financial distress, whereas the impact of the audit committee on financial distress was found to be negligible.

Based on the results of the study, it is known that several factors influence corporate financial distress. It can be concluded that financial ratios have a significant influence on the financial distress of a company. The managerial policy implications that arise from the results of this study are that investors must always pay close attention to developments in the internal conditions of the company without ignoring external factors. Thus, the main objective of the company, which is to increase the prosperity of its owners or shareholders, can be achieved.

### *Limitations and recommendations*

Recommendations for this study involve enhancing liquidity, profitability, prudent management of leverage, and paying attention to the capital structure of state-owned enterprises. Future research should consider expanding the scope of variables, extending the duration of the study, utilizing diverse analytical approaches, and examining the effects of government policies. Despite the lack of significance of the audit committee in this study, it is crucial to reinforce its functions. Improving transparency, accountability, and investor trust is also essential in the management of state-owned enterprises.

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