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ABSTRACT

Financial distress is a condition that occurs before a company goes bankrupt and can be experienced by companies that are under pressure due to the impact of the COVID-19 pandemic. The purpose of this research is to determine the existence of institutional ownership as a moderating of the influence of financial ratio on financial distress in infrastructure, trading, service, and investment companies listed on the Indonesia Stock Exchange for the period 2020-2021 through logistic regression and moderated regression analysis. This type of research is quantitative by using a sample of 125 companies determined through a purposive sampling technique. The results showed that the profitability and liquidity ratio had a significant and negative impact on financial distress. While institutional ownership is not able to moderate the effect of profitability and liquidity of the firms toward better financial distress, because institutional ownership is centralized and owned by foreigners. This causes management control to be not optimal so that the decisions taken by management are not always in line with the interests of shareholders. Implications in this study are considering the profitability and liquidity ratio in predicting financial distress that can be used by companies, potential investors, and future researchers.

Keywords: Financial distress; Financial ratio; Profitability; Liquidity; Institutional ownership

Introduction

The occurrence of the Covid-19 Pandemic has put significant pressure on various aspects of most companies. The company's efforts to suppress the spread of the Covid-19 virus by stopping their business activities and government regulations to limit community activities certainly affect the economic sector in Indonesia and the company's financial performance and cause serious financial problems if not handled properly (CPA, 2020; Hanoatubun, 2020).

The sectors most affected by the Covid-19 pandemic are the infrastructure, trade, services and investment sectors which showed worse performance year after year than other sectors showing fluctuating movements, even better. If the company cannot improve its deteriorating performance and survive in this pandemic situation, then the
Financial difficulties are caused by various factors, one of which is improper decision making and several weaknesses that are interconnected and have a direct or indirect impact on management and lack of efforts to monitor financial conditions so that the use of money is not in accordance with needs (E. Brigham & Daves, 2007). One indicator of companies experiencing financial distress is companies that have had negative Earnings Per Share (EPS) for several periods. Negative EPS indicates that the company's profit prospects and performance have decreased and this will have an impact on decreasing shareholder interest in including its capital in the company (Hu & Zheng, 2015; Kasmir, 2008:207; Miglani et al., 2015; Sunarwijaya, 2017). The condition of financial distress that occurs in a company can be known through financial ratio analysis which aims to determine the financial condition of a company and at the same time aims to assist the company in identifying strengths and weaknesses in its financial condition (Kasmir, 2008:68; Sujarweni, 2017:59). There are two ratios that are considered the most effectively used to predict the condition of financial difficulties in a company, namely profitability and liquidity ratios (Mohamed, 2020).

Profitability is one of the ratios that can show the efficiency and effectiveness of the company in using its assets and measure the company's ability to generate profit based on the use of assets (Arini et al., 2021). Research conducted by Chairunesia (2021) on manufacturing sector companies in Indonesia, shows that the profitability ratio had a significant negative influence on the possibility of companies experiencing financial distress. High profitability shows that the company can generate profits that can be used to fund the company’s operations or pay its obligations so as to make the company survive and avoid the threat of financial distress (Carolina et al., 2018; Indriaty et al., 2019). However, the results of research conducted by Destriwanti et al., (2022) and Laksmiwati et al., (2021) provide different results, where the level of profitability ratio will be followed by an increasing threat of companies experiencing financial distress. The two research results that showed differences in the influence of profitability were also contrary to research conducted by Setyobudi et al., (2017), which found that the level of profitability ratios had no influence on the possibility of financial distress.

Analysis of financial distress through liquidity ratios is used to measure the liquidity capabilities of a company. A good level of liquidity indicates that the company has a good ability to meet its short-term obligations at maturity (Kasmir, 2008). Conversely, when the company has a low liquidity ratio, it means that the company's finances are in a bad state and are said to be in an illiquid position (Laksmiwati et al., 2021). A result study conducted by Hastiarto (2021) in manufacturing companies in Indonesia showed that companies would experience lower risks if they had a high percentage level of liquidity, this result is also in line
with research by Mesak (2019) and Susdaryo et al., (2021) which showed that liquidity ratios have a significant negative influence on financial distress. However, there are studies that show different results, where the level of liquidity will not affect the risk of companies experiencing financial distress (Arini et al., 2021; Destriwanti et al., 2022; Dirman, 2020). Meanwhile, a study conducted by Indriaty et al., (2019) and Adiyanto (2021) found results stating that the higher the liquidity ratio will affect the level of financial distress risk which is getting higher as well.

The only use of financial ratios as a tool to predict financial distress is considered less effective so that it requires non-financial variables to increase accuracy in predicting financial distress, namely through the ownership structure (Balasubramanian et al., 2019). One component of the ownership structure that can be used to predict financial distress is institutional ownership, because institutional shareholders can increase supervision of managerial decisions through their role in a company, namely as a controlling agent (Fathonah, 2017). Studies that have been conducted by previous researchers also support the statement that institutional ownership has a negative influence on financial distress (Destriwanti et al., 2022; Hu & Zheng, 2015; Khan & Kong, 2022). Meanwhile, a study conducted by Md-Rus et al., (2013) explained that a high level of institutional ownership in a company can increase the risk of financial distress. In addition, different results also explain that institutional ownership has no influence on the degree of possible financial distress (Donker et al., 2009; Shahwan, 2015; Udin et al., 2016).

Generally, research in Indonesia uses financial and non-financial variables as independent variables to predict financial distress. However, it is still rare for research to use non-financial variables in the form of institutional ownership levels as moderating variables combined with financial variables in predicting financial distress. The reason for choosing the institutional ownership variable used in this study because in the results of previous research conducted by the author, it gives the result that institutional ownership is able to influence the condition of financial distress and is expected to be able to control management behavior that acts for personal interests as well as supervision of finances and management performance so that it is expected to influence the company's ability to produce profits and fulfill their obligations. Meanwhile, the reason for choosing financial variables in the form of profitability ratios proxied by ROA and liquidity proxied by CR was used in this study because both ratios have the highest level of accuracy among other financial ratios in predicting financial distress. In addition, the measurement of financial distress using the Modified Altman method combined with the profitability and liquidity ratios and institutional ownership as a moderation variable in 2020-2021, during which time there was a Covid-19 pandemic event, has also never been carried out by previous studies. So that the update of this study is the use of financial variables that have proven to be accurate and combined with institutional ownership variables as a
moderation to determine the impact of the Covid-19 pandemic on financial distress conditions measured using the Altman modified method.

Based on the background described above, this study aims to test: the existence of institutional ownership as a moderation variable for the influence of financial ratios on financial distress conditions in infrastructure, trade, service, and investment sector companies listed on the Indonesia Stock Exchange during the Covid-19 pandemic period.

Literature Review

Agency theory

Agency theory is a theory that describes the contractual relationship between the principal (shareholders) and the agent (manager) to perform services on behalf of the principal, which involves delegating decision-making authority to the agent. The relationship between shareholders and managers raises issues related to the separation of ownership and control. Agents will not always act in the best interests of the principal, so, the principal sets a number of incentives in the form of monitoring costs designed to limit the deviant attitude of agents referred to as agency costs (Jensen & Meckling, 1976). Agency theory serves as a way of applying various governance-related mechanisms for agency control in jointly owned companies (Panda & Leepsa, 2017).

Agency theory relates to the existence of shareholdings in a company which is expected to carry out and improve the function of important supervision of management behavior, in other words shareholders have sufficient opportunities to ensure an increase in company value and reduce agency problems, as well as participate in the recovery of the company's situation from financial difficulties (Manzaneque et al., 2016).

Signaling Theory

Signaling theory is a theory that states that managerial have an action to give instructions to shareholders on how management assesses the company's prospects. Management will strive to improve the company's performance which will later have an impact on increasing the profits that will be obtained by the company. Signaling theory will provide information to external parties and shareholders regarding the future condition of the company (Scott, 2015:503).

Signaling theory is related to the condition of financial distress in the company. Information that a company is about to enter a crisis phase can stimulate a quick response from managerial parties to take preventive measures and manage the
Financial Distress

Financial distress is a final stage of declining performance before the company enters the phase of bankruptcy, which is characterized by conditions of continuous financing difficulties in operational activities and obtaining loans from creditors (Fadrul & Ridawati, 2020; Platt & Platt, 2002). The condition of financial distress in companies is identified through the calculation method of Altman's Z-Score Modification (1995) which can be applied to predict the condition of financial distress in all types of companies both manufacturing and non-manufacturing. Determination of company categories through the Altman's Z-Score method, namely if the Z-Score value <1.1, the company is categorized into financial distress, while if the Z-Score value >1.1 then the company is free from financial distress conditions (Altman & Hotchkiss, 2006:267)

\[ Z - Score = 6.56 \times \frac{\text{working capital}}{\text{total asset}} + 3.26 \times \frac{\text{retained earning}}{\text{total asset}} + 6.72 \times \frac{\text{EBIT}}{\text{total asset}} + 1.05 \times \frac{\text{book value if equity}}{\text{book value of total debt}} \]  

(1)

Profitability Ratio

Profitability is a ratio that shows the company's ability to make a profit through all its capabilities and resources (Harahap, 2001:304). One type of profitability measurement is the Return on Assets (ROA). The ratio can show how much the asset contributes in generating net profit. ROA can be known by comparing the amount of net profit with the total assets owned by the company (Hery, 2016:193)

\[ \text{Return on Assets (ROA)} = \frac{\text{Net Income}}{\text{Total Assets}} \]  

(2)

Liquidity Ratio

Liquidity is a ratio that can show the company's ability to meet its maturing short-term obligations and to find out how liquid a company is (Kasmir, 2008:110). One type of liquidity ratio that can be used to measure a company's ability is through the Current Ratio (CR), or it can also be said to be a form of measuring the level of a company’s safety. CR calculation can be done through the comparison of total current assets with total current debt (Kasmir, 2008:134)

\[ \text{Current Ratio (CR)} = \frac{\text{current assets}}{\text{current liabilities}} \]  

(3)

Institutional Ownership

Institutional ownership is a share ownership owned by institutions, business entities, and organizations whose ownership is largely presented to the number of
company shares outstanding (Tarighi et al., 2022). The ability of the institutional investor shows the potential source of power that can be used in supporting management decisions and vice versa, so as to reduce agency costs (Nuresa & Hadiprajitno, 2015). Institutional ownership can be calculated by the percentage of shares owned by institutional against the total number of shares of the company (Manzaneque et al., 2016)

\[ \text{Institutional Ownership} = \frac{\text{number of institutional shares}}{\text{number of shares}} \] (4)

The level of profitability proxied through the Return on Assets (ROA) shows the company's ability to use all of its assets to generate its after-tax profit. The profitability ratio is also important for shareholders to show the level of effectiveness and efficiency of capital management carried out by the company's management (Sudana, 2015:25). With regard to signaling theory, when the ratio is high, it gives a good signal to shareholders and interested parties that the company has a good performance because it can generate high profits from its operational activities. When the company's profit is large, the company will reduce its debt level so that the percentage of financial distress will also decrease (Saputri & Asrori, 2019). This statement is in line with the results of research conducted by Chairunesia (2021) and Mesak (2019) which showed that profitability negatively affects the probability of financial distress.

H1: Profitability has a negative influence on financial distress

The level of liquidity indicates that the company has a good ability to fulfill its short-term obligations at maturity by using its current assets (Sudana, 2015:24). Liquidity ratio is also a form of responsibility from management to stakeholders through disclosure of financial condition in financial statements that can be used for decision making (Saputri & Asrori, 2019). This is related to signaling theory, where the disclosure of a high level of liquidity will give a good signal to stakeholders and indicates that the managerial party is effectively able to manage its business so that it is able to improve the company's performance and maintain financial condition in a good state. Thus, the probability of the company experiencing financial distress will also be smaller. Research conducted by Hastiaarto (2021) and Mesak (2019) showed the results that liquidity have a significant negative influence on financial distress conditions.

H2: Liquidity has a negative influence on financial distress

In addition to determine the company's ability to obtain profit, the profitability ratio can also show the level of managerial effectiveness of the company in increasing its sales and investments (Setyobudi et al., 2017). The increase in managerial effectiveness can be due to the monitoring function of institutional shareholders which
makes management performance better in using their assets as company resources. With the supervision of institutional ownership, management decisions become better, responsible, and in line with the interests of shareholders so that they can minimize errors in decision making that can have an impact on company losses (Sunarwijaya, 2017). This statement supports agency theory which states that the existence of an ownership structure by the institution is expected to reduce agency problems and improve management performance so as to increase company value and reduce the risk of financial distress (Manzaneque et al., 2016). This is also in accordance with the results of studies that show that institutional ownership can strengthen the effect of profitability on financial distress conditions (Setyobudi et al., 2017).

H3: Institutional ownership moderates the effect of profitability on financial distress

In addition to give a positive signal for shareholders, related to the company’s prospects, high liquidity ratio also illustrates the management’s ability to manage and make the right decisions for the sustainability of the company (Mesak, 2019). The good management skills can be influenced by the presence of institutional shareholders in a company. This is in accordance with agency theory which explains that agents must act in accordance with the interests of the principal and all decisions made are a form of their responsibility to shareholders (Saputri & Asrori, 2019). The existence of an institutional shareholder will improve managerial performance and make the company avoid of financial distress, because the institutional role is as a controlling agent and prevent manager behavior aimed at self-interest. This is in line with studies conducted by Setyobudi et al., (2017) showing that institutional ownership can increase the effect of liquidity on financial distress conditions.

H4: Institutional ownership moderates the effect of liquidity on financial distress

Conceptual Model

![Conceptual Model](image)

Method

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This research was a type of quantitative-causality research that used secondary data sourced from the company's financial and annual reports and obtained from the company's official website and the Indonesia Stock Exchange (IDX). The population in the study were companies in the infrastructure, trade, services, and investment sectors listed on the IDX in 2020-2021, with a sample of 125 companies determined using purposive sampling techniques, including criteria for (1) companies that publish annual and financial reports in the period 2020-2021 (2) EPS is negative for two periods (3) including complete information about the ownership structure, and financial instruments. Statistical analysis techniques using Logistic Regression. Before performing the regression test, it is necessary to carry out several tests, including the overall model fit, the goodness of fit test, the coefficient of determination, the classification matrix, and then hypothesis testing which can be done through the wald test and Moderated Regression Analysis (MRA).

\[
\ln \frac{p}{p-1} = \alpha + \beta 1 . ROA + \beta 2 . CR + \beta 3 . ROA\_INST + \beta 4 . CR\_INST + \epsilon
\]  

(5)

**Result and Discussion**

**Table 1. Result of Wald Test**

<table>
<thead>
<tr>
<th>Overall Model Fit</th>
<th>-2Log Likelihood</th>
<th>Block 0</th>
<th>191,073</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Block 1</td>
<td>39,787</td>
<td></td>
</tr>
</tbody>
</table>

Source: Data processed (2022)

**Overall Model Fit**

The overall model fit showed a decrease in the value of -2Log Likelihood of 151,286 (191,073-39,787) with df 3 (134-131), so it can be concluded that H0 was rejected and the addition of independent variables to the model was able to improve the fit model. This can also be known through the omnibus test of the model which has a significance value of 0.000 or less than the level of significance of 0.05 which indicates that the data is suitable for use.

**Table 2. Result of Estimation Eligibility of the Regression Model & Estimation Coefficient of Determination**

<table>
<thead>
<tr>
<th>Step</th>
<th>Chi-square</th>
<th>df</th>
<th>Sig.</th>
<th>Nagelkerke R Square</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2,756</td>
<td>8</td>
<td>0,949</td>
<td>0,888</td>
</tr>
</tbody>
</table>

Source: Data processed (2022)

**Hosmer and Lemeshow's Goodness of Fit Test**
The significance value of Hosmer and Lemeshow's Goodness of Fit Test in Table 2 is 0.949 > 0.05 which means that the model is acceptable and able to imply that the logistic regression analysis in this study is feasible to use because the observation value can be predicted by the model.

Nagelkerke R Square

Table 2 shows the value of nagelkerke R square used for the coefficient of determination test that the variability of the independent variable can explain 0.888 or 88.8% the variability of the dependent variable. This also means that 19.2% of the variability of independent variables outside the study can explain the variability of the financial distress variable.

Classification Matrix

Based on the output of the classification matrix shows that out of 62 companies, as many as 56 companies can be predicted with a percentage of 90.3%. Furthermore, of the 77 financial distress companies, 73 companies or 94.8% of regression models can be predicted precisely. Thus overall, the regression model was able to predict exactly 92.8%.

Parameter Estimation and Interpretation Test

Table 3. Result of Wald Test

<table>
<thead>
<tr>
<th></th>
<th>$\beta$</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>X1_ROA</td>
<td>-0.141</td>
<td>0.001</td>
</tr>
<tr>
<td>X2_CR</td>
<td>-0.073</td>
<td>0.000</td>
</tr>
<tr>
<td>Z_INST</td>
<td>-0.024</td>
<td>0.267</td>
</tr>
<tr>
<td>ROA_INST</td>
<td>-0.001</td>
<td>0.359</td>
</tr>
<tr>
<td>CR_INST</td>
<td>0.000</td>
<td>0.830</td>
</tr>
<tr>
<td>Constant</td>
<td>9.230</td>
<td>0.001</td>
</tr>
</tbody>
</table>

Source: Data processed (2022)

The equation model in this study is:

$$\ln \frac{p}{1-p} = 9.230 - 0.141 \text{ROA} - 0.073 \text{CR} - 0.001 \text{ROA}_{\text{INST}} + 0.000 \text{CR}_{\text{INST}} + \epsilon \quad (6)$$

Table 3 shows that profitability ratio measured using Return on Asset (ROA) has a significance value of 0.001 < 0.05 and a value of $\beta$ -0.141 which means that there is a negative and significant influence of profitability on financial distress conditions. In addition, the liquidity ratio through the Current Ratio (CR) measurement used to predict financial distress also has a significant negative influence. This can be seen
through the significance of the liquidity ratio of 0.000 < 0.005 with a value of β -0.073. The significant negative influence of the profitability and liquidity indicates that the higher the ratio owned by a company, the smaller the company will experience the risk of financial distress. The results of the logistic regression of institutional ownership variables obtained a significance value of 0.267 > 0.005 and β -0.024 which showed that institutional ownership could not affect the condition of financial distress. Meanwhile, the output of MRA showed that institutional ownership did not moderate the effect of profitability and liquidity on financial distress conditions. This is known through signification values of 0.359 and 0.830 which both have values greater than 0.05.

**Effect of Profitability Ratio to Financial Distress**

The output of logistic regression analysis shows that H1 is acceptable. This result means that there is a significant negative influence of the ratio of profitability to financial distress. Companies with a high profitability ratio have a good ability to obtain maximum targeted profits and have high productivity in all funds owned to finance their business and reduces the probability of financial distress (Kasmir, 2008:198). In addition, the amount of Return on Assets (ROA) as a measure of the company’s profitability ratio also shows that the use of company assets has been used efficiently by the company in order to generate greater profits so as to reduce the risk of the company experiencing financial distress (Sudana, 2015:25). The higher ROA indicates that the managerial party has made optimal efforts in managing the company through its assets so that the company obtains maximum profits so as to avoid financial difficulties (Hery, 2016:193). This finding is also in line with the signaling theory which states that the disclosure of information from management related to the level of profitability ratio indicates that the company is in good or bad performance towards the possibility of financial distress (E. F. Brigham & Houston, 2014:184). Furthermore, this finding also has a practical implication for stakeholders in assessing the company’s prospects in the future as a tool for consideration before carrying out investment activities or providing credit. Meanwhile, the management can be used as an evaluation tool to make maximum efforts in improving the ability to obtain profits in the next period which can be done by maximizing the assets owned to increase sales activities.

**Effect of Liquidity Ratio on Financial Distress**

Logistic regression analysis shows that H2 was received and there is a significant negative effect of liquidity on financial distress. The low liquidity ratio measured through the current ratio (CR) indicates that the company is in an illiquid condition and unable to meet short-term obligations that are already due due to the unavailability of current assets owned so this can increase the risk of the company experiencing financial distress (Kasmir, 2008:128; Sudana, 2015:24). The results of this
study also show the failure of the management who neglected to manage their business so that the company did not have sufficient current assets to fulfill its obligations. The theoretical implications of the results of this study are in line with the signaling theory which explains that the disclosure of the company's poor performance through its financial statements, can provide signals to various parties, where the company's financial condition and prospects have decreased which can have an impact on financial distress and even bankruptcy. In addition, the practical implementation of this study is that the management can analyze the liquidity ratio which aims to easily find out the condition and position of the company so that if a low liquidity ratio value is found, the company can make improvements by reducing the amount of its short-term debt and cooperating with investors to include its funds so that the company avoids financial distress.

**The role of Institutional Ownership in moderating the effect of Profitability Ratio to Financial Distress**

Moderated regression analysis in this study showed that institutional ownership variables do not moderate the effect of profitability to financial distress, which mean that H3 is unacceptable. One of the reasons this can happen is because the majority of institutional share ownership in companies in Indonesia tends to be centralized and not spread evenly so it has an impact on the inability of shareholders to control decision made by management (Kurniasanti & Musdholifah, 2018). In addition, another factor that makes the institution unable to moderate the effect of the profitability ratio is foreign institutions that have different locations and times so this can become an obstacle to the direct control and supervision function of institutional shareholders to management (Md-Rus et al., 2013). The absence of the role of institutional ownership in moderating the effect of the ratio of profitability to financial distress can cause management's attitude in managing the company to be not optimal. Management will make incorrect decisions and not make optimal use of its assets to obtain profits due to the absence of a control function of institutional shareholders. The theoretical implications of this study are not in line with agency theory which states that institutional ownership can minimize agency problems for its function as a controlling agent. So from this explanation, the practical implication for the company is to apply spread share ownership and prioritize domestic institutions to be used as company shareholders so that the monitoring and control functions can be carried out optimally so that management is able to produce the best decisions, especially in profit-making activities for the company.

**The role of Institutional Ownership in moderating the effect of liquidity ratios to financial distress**

The output of moderated regression analysis shows that H4 is unacceptable. This indicates that institutional ownership is unable to moderate the effect of liquidity
ratios on financial distress. The reason why institutional ownership cannot be used as a moderating variable because the institutional shareholders only focus on making investments that are solely aimed at obtaining profits and do not supervise managers in fulfilling short-term obligations and managing current assets owned by them. Thus, the existence of institutional ownership is unable to strengthen or weaken the effect of the liquidity ratio on financial distress (Komala & Triyani, 2020). The results of this study are not in line with agency theory which states that institutional ownership can suppress agency problems because of the control function of management attitudes that sometimes act inconsistently with the interests of shareholders. Meanwhile, the practical implication of this study is that institutional shareholders should carry out optimal supervision activities on companies that include funds so that management can manage the company properly, especially with matters related to company liquidity so that the company can avoid the threat of financial distress. In addition, companies can also strive to cooperate with other parties who are able to optimize the supervisory and control functions of their business to be free from the risk of lack of funds and the threat of financial distress.

Conclusion

The conclusion obtained based on the results of studies that have been carried out is that there is a significant negative influence on the ratio of profitability to financial distress conditions. The high profitability ratio owned by the company indicates that the company has a good ability to generate company profits through the utilization of its assets so that the company will avoid the risk of financial distress. The liquidity ratio has a significant positive influence on financial distress conditions. A high liquidity ratio indicates that the company has a good ability to fulfill its short-term obligations in accordance with predetermined deadlines and this shows that the company has the adequacy of current assets owned so that the condition of the company can reduce the risk of financial distress. The institutional ownership was unable to moderate the effect of profitability ratios and liquidity ratios to financial distress. The findings indicate that the level of institutional ownership cannot strengthen or weaken the effect of profitability and liquidity ratios on financial distress conditions because institutional ownership that is centralized and owned by foreign parties causes the control function of managerial parties not to be carried out optimally.

The implications resulting in this study for companies are to monitor the profitability ratio and liquidity ratio owned. Through several actions such as paying attention to the level of availability of assets, and short-term debt, as well as obtaining company profits, this can be used as a determinant of strategy and prevent the risk of financial distress. In addition, for investors, information related to the company's profitability and liquidity ratio can be used as a consideration before making an investment because the level of profitability and company profitability can be used to
find out the company's financial condition. As for subsequent studies, these findings can be used as a stimulant and reference in studies related to the topic of financial distress that use the profitability and liquidity ratio as predictor variables.

References


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