

CHAPTER I

INTRODUCTION

1.1 Background

The 2020-2025 period is an important period to examine financial distress in Indonesian non-financial State-Owned Enterprises (SOEs) because it covers the COVID-19 shock, the recovery period, inflationary pressure, and tighter financial conditions. These changes did not only affect firms through internal financial ratios, but also through the wider movement of the economy. When economic growth weakens, business demand, project completion, cash collection, and asset productivity may decline. When recovery begins, firms may obtain better revenue prospects, but debt pressure and liquidity problems may remain. Therefore, examining financial distress only through financial ratios may not fully describe the condition of SOEs during this period. In line with financial distress studies that combine firm-level and macroeconomic indicators, this study adds economic growth, measured by real GDP growth rate, to capture the external economic environment faced by firms (Abdilahi et al., 2026).

These pressures are more serious for SOEs because they operate under a dual mandate. SOEs are expected to pursue financial performance while also supporting public policy goals and national development programs. The Organisation for Economic Co-operation and Development (OECD) (2024) states that SOE governance should protect transparency, accountability, and efficiency because the state acts as owner on behalf of the public. In Indonesia, this dual mandate can create tension between commercial goals and public assignments. When SOEs finance public projects with debt or depend on state capital participation, profitability, liquidity, leverage, and macroeconomic conditions become central indicators of their financial resilience (Sayidah & Assagaf, 2020).

Corporate governance may also be closely associated with financial distress because governance quality determines how effectively managers are monitored,

how transparently financial risks are reported, and how prudently debt and investment decisions are made. In SOEs, weak board oversight or unclear accountability can intensify agency problems and allow inefficient asset use, liquidity deterioration, or excessive leverage to persist before corrective action is taken. Although corporate governance is not included as an empirical variable in this study, it remains a relevant institutional factor that may strengthen or weaken the effects of profitability, liquidity, and leverage on financial distress (Elloumi & Gueyié, 2001).

This study specifically focuses on non-financial State-Owned Enterprises (SOEs) because their financial distress can be examined more consistently through operating performance, liquidity position, debt structure, and asset-based financial indicators. Unlike financial SOEs, such as banks and insurance companies, non-financial SOEs operate mainly in the real sector, where financial health is reflected through the ability to generate profit from assets, manage current obligations, and control debt financing. This makes profitability, liquidity, leverage, and the Modified Altman Z-Score more suitable for explaining their financial condition. Sayidah and Assagaf (2020) also examined Indonesian SOEs in the non-financial sector and emphasized that SOE financial distress is important because dependence on government funding can create a burden on the state budget and reduce the financial independence of SOEs. Therefore, limiting the sample to non-financial SOEs helps this study avoid mixing companies with different balance sheet structures, regulatory requirements, and distress indicators.

The theoretical foundation of this study is strengthened by agency theory, signalling theory, and Minsky financial instability theory. Agency theory explains that weak monitoring and inefficient managerial decisions can increase agency costs, reduce asset efficiency, and create financial pressure in SOEs (Jensen & Meckling, 1976). Signalling theory explains that financial ratios and Z-Score provide information signals to investors, creditors, government, and the public about whether a firm is financially healthy or moving toward distress (Spence, 1973). Minsky financial instability theory adds a macroeconomic explanation.

Beshenov & Rozmainsky (2015) explain that this theory shows how an economy can become financially fragile from inside the system, especially when a period of growth encourages firms and lenders to take more risk. In Minsky logic, stable growth may encourage debt-financed expansion. If cash flows remain strong, firms can stay in a safe position. However, when growth slows, demand falls, or financing costs rise, firms with high debt and weak liquidity may move toward speculative or fragile financing positions. Therefore, this theory is relevant for this study because non-financial SOEs often operate large projects with high fixed costs and long-term debt.

Financial distress refers to a stage of financial decline that can appear before insolvency or bankruptcy. Platt and Platt (2002) describe it as a condition between financial difficulty and formal failure, while Altman (1968) shows that financial ratios can be combined to predict bankruptcy risk. This study uses the Modified Altman Z-Score as the measurement of financial distress for non-financial firms. The interpretation must remain consistent: a higher Z-Score shows a healthier financial condition and lower distress risk, while a lower Z-Score shows higher distress risk. Therefore, this study treats Z-Score as an inverse proxy of financial distress.

Table 1.1 Z-Score of Non-Financial SOEs (2020-2025)

No.	Code	2020	2021	2022	2023	2024	2025
1	ADHI	0.36	0.36	0.46	0.52	0.47	0.16
2	ANTM	2.97	3.69	4.58	4.22	4.21	4.35
3	ELSA	2.55	2.66	2.41	2.49	2.58	2.78
4	GIAA	-0.16	-0.50	-0.20	-0.17	-0.18	0.00
5	INAF	0.35	0.31	-0.01	-0.56	-0.71	-0.61
6	JSMR	0.87	1.03	1.29	1.22	1.35	1.34
7	KAEF	0.70	0.53	0.59	0.38	0.31	0.27
8	KRAS	0.17	0.21	0.24	0.24	0.16	0.34
9	MTEL	1.42	1.87	2.12	2.13	2.08	2.07

10	PGAS	2.47	3.24	3.55	3.12	3.76	3.87
11	PPRO	1.13	2.05	1.65	0.48	0.78	4.42
12	PTBA	6.45	7.89	7.93	5.03	4.16	3.24
13	PTPP	0.95	0.87	1.13	0.90	1.38	0.34
14	SMBR	2.76	2.79	2.86	3.09	3.39	4.25
15	SMGR	3.00	2.85	3.34	3.27	3.37	3.15
16	TINS	1.89	2.88	4.40	3.23	5.06	5.48
17	TLKM	3.17	3.10	3.36	3.34	3.13	2.96
18	WIKA	0.26	0.24	0.22	0.10	0.17	-0.02
19	WSBP	-0.10	-0.31	-0.28	-0.14	-0.33	-0.42
20	WSKT	0.03	0.11	0.11	0.06	0.04	-0.02
21	WTON	1.80	1.70	1.96	2.35	2.84	3.23
	Avg.	1.57	1.79	1.99	1.68	1.81	1.96

Source : Processed by Researcher, Indonesia Stock Exchange (IDX).

Table 1.1 presents the latest Modified Altman Z-Score results for 21 Indonesian non-financial SOEs during 2020–2025. A Z-Score below 1.10 indicates the distress zone, a score from 1.10 to 2.60 indicates the grey zone, and a score above 2.60 indicates a relatively healthy financial condition. The updated data show substantial heterogeneity across firms and years. The annual sample average was 1.57 in 2020, increased to 1.79 in 2021 and 1.99 in 2022, declined to 1.68 in 2023, and then improved to 1.81 in 2024 and 1.96 in 2025. Thus, the average company remained in the grey zone in every observation year rather than in the distress zone. At the firm-year level, the number of observations classified in the distress zone was 10 firms in 2020, 10 in 2021, 8 in 2022, 10 in 2023, 9 in 2024, and 9 in 2025. Meanwhile, the number of firms in the healthy zone increased to 10 firms in 2025. These results indicate that the overall financial condition of the sample improved compared with the pandemic period, but the persistence of nine distressed firms in 2025 shows that financial vulnerability remained material and uneven across SOEs.

A key financial measure indicating the financial health of a firm is

profitability. Firms with high profitability are more likely to have greater cash flow generation, stability of operation, less reliance on external finance. As such, profitability is one of the indicators used for financial distress prediction. Profitability is a fundamental indicator that reflects the effectiveness and efficiency of management in managing all assets owned to generate net income (Ross et al., 2019). In SOEs, profitability, which is proxied by Return on Assets (ROA), is the main benchmark in assessing the success of *Penyertaan Modal Negara (PMN)* in providing added value to the public (Pramono & Bustaman, 2025). However, the phenomenon in the 2020-2025 period shows that the contribution of SOEs to the national economy is still often hampered by stagnant performance and suboptimal operations, where low efficiency erodes profit margins and increases the probability of financial failure (Ferdiana & Sugiyarto, 2022). Firms with higher internal earnings can bypass expensive external debt, thereby insulating themselves from the rising interest rates and financing constraints observed globally in the 2023–2024 period (Liu et al., 2025). Theoretically, the greater the value of ROA, the smaller the chances of an enterprise experiencing financial distresses because of availability of adequate internal profits to finance operations (Platt & Platt, 2002). However, there are inconsistencies in previous research results, studies by Christine et al., (2019) and Fia Afriyani & Nurhayati (2023) state that profitability has a significant effect on financial distress, but these results contradict the findings of Mahaningrum & Merkusiwati (2020) and Nurhayati et al., (2021) which state that profitability has no effect on this condition. This difference in results indicates that the ability of profitability to signal agency risk and financial health still requires further testing, especially in the SOE sector, which has the characteristic of high fixed costs (Jensen & Meckling, 1976). ROA is selected over Return on Equity (ROE) because it measures asset-level efficiency independently of the capital structure, which is particularly important in the SOE context where leverage is often determined by government policy rather than market optimization (Pramono & Bustaman, 2025).

Liquidity is a ratio that measures a company's capacity to pay its short-term

obligations that become due and payable to both external and internal parties, companies with low liquidity are often unable to meet short-term obligations such as suppliers, loan interest and operational expenses (Ross et al., 2019). If this condition persists, it may lead to financial distress and eventually bankruptcy. In this study, liquidity is measured using the Current Ratio (CR) to show how much current assets are available to cover immediate liabilities (Mardiansyah et al., 2025). For SOEs, liquidity not only indicates technical financial health, but also operational capacity in carrying out government assignments without continuously relying on subsidies (Sayida & Assagaf, 2020). The phenomenon in SOEs shows that their contribution to the economy tends to stagnate when financial flexibility is hampered by low liquidity ratios, which limit their room for maneuver in maintaining strategic infrastructure (Ferdiana & Sugiyarto, 2022). There is a research gap in this variable, where previous studies have shown inconsistencies. Research by Erayanti (2019), Letiana & Hartono, (2023) and Saputri & Padnyawati (2021) shows that liquidity does not affect financial distress. Conversely, the results of studies Asfali (2019) and Hertina et al. (2022) actually state that liquidity has a significant effect on financial distress. These inconsistent findings suggest that the influence of liquidity may be context-dependent, particularly in SOEs that operate under high fixed costs, public service obligations, and government intervention. Therefore, re-examining the liquidity–financial distress relationship in non-financial SOEs during the 2020–2025 period is necessary to obtain more context-specific empirical evidence.

Leverage reflects the extent to which a company relies on debt financing in its asset structure. In this study, leverage is measured using the ratio of Total Debt to Total Assets (LEV), consistent with the leverage measurement applied by (Sayida & Assagaf, 2020). A higher ratio indicates that a larger proportion of the company's asset base is supported by debt financing, which increases fixed repayment commitments and may reduce financial flexibility when operating cash flows weaken. This proxy is particularly appropriate for the SOE sample because several firms experienced very low or negative equity during the observation

period, using equity as the denominator can generate extreme or discontinuous leverage values that complicate economic interpretation. Observations from the 2020-2025 period show that an increase in debt burden that is not accompanied by comparable revenue growth has narrowed the financial flexibility of SOEs, thereby increasing the probability of financial distress (Ferdiana & Sugiyarto, 2022). In the case of the Indonesian SOEs that participated in global supply chains, this risk constrained financing possibilities and immediately deteriorated their solvency ratios. A study by Asfali (2019) and Rissi & Herman (2021) indicated that leverage has a considerable impact on financial distress. On the other hand, a study by Erayanti (2019), Purwaningsih & Safitri (2022), Saputri & Padnyawati (2021) discovered that leverage does not affect this condition. The inconsistency of these results indicates that the impact of leverage might be influenced by a company's financial framework, the extent of government assistance, and its income stability. Within the unique environment of State-Owned Enterprises (SOEs) where debt is often utilized to fulfill public service mandates and fund extensive infrastructure development, the link between leverage and financial distress likely deviates from patterns observed in the private sector, especially in relation to the potential for agency conflicts between shareholders and creditors (Jensen & Meckling, 1976).

The inclusion of economic growth is also supported by previous empirical studies, although the findings are not fully uniform. Abdilahi et al. (2026) explain that economic growth is an important macroeconomic factor in financial stability because stable growth can improve creditworthiness, profitability, capital reserves, and resilience to shocks. Mahesh et al. (2025) also found that GDP growth significantly predicts firm financial health in an emerging market setting, where higher GDP growth reduces the likelihood of financial distress. However, Nadia et al., (2022), in a study of property, real estate, and building construction companies listed on the IDX, found that GDP had no significant effect on financial distress. These mixed findings create a research gap and make it relevant to test whether real GDP growth rate has an effect on financial distress in Indonesian non-financial SOEs.

Based on the phenomena and research gaps above, this study focuses on Indonesian non-financial SOEs listed on the Indonesia Stock Exchange during the 2020-2025 period. This period is relevant because it covers pandemic pressure, post-pandemic recovery, inflationary pressure, and tighter financing conditions. This study does not only describe financial distress, but also tests whether profitability, liquidity, leverage, and economic growth explain changes in the Modified Altman Z-Score. Based on this explanation, the revised title of this research is: **"THE IMPACT OF PROFITABILITY, LIQUIDITY, LEVERAGE, AND ECONOMIC GROWTH ON FINANCIAL DISTRESS (Case Study of Indonesian Non-Financial State-Owned Enterprises Listed on the Indonesia Stock Exchange in 2020-2025)."**

1.2 Problem Formulation

Guided by this background, our research addresses the following questions below:

1. Does profitability affect financial distress in non-financial SOEs listed on the Indonesia Stock Exchange during the 2020-2025 period?
2. Does liquidity affect financial distress in non-financial SOEs listed on the Indonesia Stock Exchange during the 2020-2025 period?
3. Does leverage affect financial distress in non-financial SOEs listed on the Indonesia Stock Exchange during the 2020-2025 period?
4. Does economic growth affect financial distress in non-financial SOEs listed on the Indonesia Stock Exchange during the 2020-2025 period?
5. Do profitability, liquidity, leverage, and economic growth simultaneously affect financial distress in non-financial SOEs listed on the Indonesia Stock Exchange during the 2020-2025 period?

1.3 Research Objectives

Regarding the problem statement above, here are several objectives of this research as follows:

1. To determine, examine, and analyze the impact of profitability on financial distress in non-financial state-owned enterprises (SOEs) listed on the Indonesia Stock Exchange for the period 2020-2025.
2. To determine, examine, and analyze the impact of liquidity on financial distress in non-financial state-owned enterprises (SOEs) listed on the Indonesia Stock Exchange for the period 2020-2025.
3. To determine, test, and analyze the impact of leverage on financial distress in non-financial state-owned enterprises (SOEs) listed on the Indonesia Stock Exchange for the period 2020-2025.
4. To determine, examine, and analyze the impact of economic growth, measured by real GDP growth rate, on financial distress in non-financial State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange for the 2020-2025 period.
5. To determine, examine, and analyze the simultaneous impact of profitability, liquidity, leverage, and economic growth on financial distress in non-financial State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange for the 2020-2025 period.

1.4 Research Benefits

Several contributions of this research are as follows:

1.4.1 Theoretical Contributions

This study is expected to enrich financial management literature, especially studies on financial distress in State-Owned Enterprises (SOEs). The study contributes by combining internal financial ratios, namely profitability, liquidity, and leverage, with a macroeconomic variable, namely economic growth measured by real GDP growth rate. This combination provides a broader explanation of financial distress because

SOEs are affected not only by managerial decisions and financial structure, but also by economic cycles and national business conditions. The study also strengthens the application of agency theory, signalling theory, and financial instability theory in the context of Indonesian non-financial SOEs in facing post-pandemic economic volatility.

1.4.2 Practical Contributions

a. For Companies

The results of this study are expected to help non-financial SOE management monitor financial health through profitability, liquidity, leverage, and macroeconomic movement. The findings can be used as an early warning input when companies prepare financing decisions, manage liquidity, and evaluate asset productivity during periods of economic slowdown or recovery.

b. For Government

As the majority shareholder and policy maker, the government can use the findings as input when evaluating SOE financial resilience, strategic assignments, and state capital participation. By considering economic growth together with financial ratios, government policies can be more careful in balancing development targets and SOE financial sustainability.

c. For Researchers

This study can become a reference for future researchers who want to develop financial distress models by combining firm-level financial ratios and macroeconomic variables. Future studies may extend the period, compare SOEs with private firms, or add other macroeconomic variables such as inflation, interest rate, or exchange rate.

d. For Academicians

This study is expected to provide academic reference and comparison material for studies on financial distress, SOE financial management, and the use of Modified Altman Z-Score in emerging market contexts.

