IMPACT OF LEVERAGE AND PROFITABILITY ON FIRM VALUE WITH FINANCIAL DISTRESS AS A MEDIATING VARIABLE

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ABSTRACT

The purpose of this study is to look at how profitability and leverage affect a company's value, as well as how financial crisis affects manufacturing enterprises that are listed on the Indonesia Stock Exchange. This study employs purposive sampling to choose samples from the manufacturing industry sector between 2019 and 2022, with a focus on the sector as a whole. The data collection comprises 67 firms' financial data. Empirical evidence indicates that leverage exerts a detrimental impact on financial distress, but profitability positively influences financial hardship. The value of a corporation is negatively impacted by financial challenges, profitability, and leverage. Leverage and Profitability Increase Company Value, with Financial Distress acting as a moderating element. By taking anticipated risks into account, this research attempts to use corporate value as a foundation for investing. It is envisaged that investors would make enormous returns from this venture. It is intended that the research results would serve as a resource and answer for anyone looking to fund a business. Additionally, a clearer comprehension of the connection between financial difficulty and firm valuation may be obtained from this research. Furthermore, these results might serve as a guide to comprehend the moderating influence of leverage and profitability on the valuation of companies.

Keywords: *Financial Distress, Profitability, Leverage, Firm Value, Manufacturing Enterprises*

1. Introduction

Indonesia, as a country experiencing growth, is trying to improve its economic sector. This is done through careful planning to overcome existing economic problems. One of the main strategies is to encourage the growth of the manufacturing sector as the main driving force. By advancing this sector, it is hoped that significant developments will occur not only in the industry itself, but also in other sectors such as services and agriculture. Indonesia has large market potential to support the expansion of the manufacturing sector, according to the Ministry of Industry. The Ministry of Industry is dedicated to increasing the productivity of the manufacturing sector to meet domestic demand and possibly expand into international markets.

Therefore, appropriate strategies need to be implemented, especially related to the availability of raw material and energy supplies (Susilowati & Fadlillah, 2019). Financial managers must be able to control and manage company finances effectively to maximize revenue. The value of a company, which is often related to changes in stock prices, represents investors' perceptions of a company. In effect, company value is a very important factor that requires increased focus from organizational management. This is due to the fact that the value of a company is an important determinant of its performance and goals in the future (Oktavian & Handoyo, 2023). In the industrial sector, each company is unique in its corporate values, where the corporate values reflect a company's integrity, innovation, quality, sustainability, diversity and inclusion, profitability, leadership and employee satisfaction.

An increased company value reflects stability and a better image, which makes new investors more likely to trust and care about the company. In effect, the company's attention shifts to the interests of shareholders. The value of the company increases as the value of the shares increases, and the wealth of the owner increases. Maximizing wealth is one of the company's goals, and this can be done through increasing revenue. Therefore, one of the main requirements for a company to become a public company is to achieve maximum share value (Prasetia et al., 2023).

Based on the background provided, this study will address a number of research questions, including the following: Does leverage impact financial distress?Does a company's profitability impact its financial difficulties?Does financial difficulties impact the company's worth?Does leverage impact a company's worth? Does a company's profitability impact its value?Does financial difficulty act as a mediator between leverage and firm value, and does profitability act as a mediator between the two?. A number of goals have been set for this study, including testing and evaluating the influence of leverage on financial difficulties in Indonesia; testing the relationship between a company's profitability and the degree of its financial difficulties; testing the effects of the economic downturn on company value; testing the influence of leverage on business value; investigating and evaluating the effect of profitability on the value of a business; and testing and evaluating the role that financial distress plays as a mediator in the relationship between financial distress and company value.Problem limits are established by the researcher in this study in an attempt to keep the discussion of the primary issue within reasonable bounds and prevent the problem from becoming out of control. Only financial difficulty, firm worth, profitability, and leverage are taken into account. Only manufacturing enterprises in the industrial sector that are listed on the Indonesia Stock Exchange for the 2019–2022 timeframe make up the population. The impact of profitability and leverage on company value, which is mediated by financial distress, is the sole topic of discussion in this study.

2. Literature Review

2.1 Agency Theory

Jensen & Meckling (1976) contend that agency theory is a contract that an owner and management enter into. According to this contract, in order for the business to run well, the owner must provide management the authority to make decisions. This perspective gives managers the authority to act in the owners' best interests. It is the managers' responsibility to report on their accomplishments in these circumstances, and they frequently do so by presenting financial data that demonstrates clear performance. According to some academics, agency theory works to protect management's and owners' interests in contracts to avoid circumstances in which there is a conflict of interest that would benefit one party over the other. Agency disputes are still common in practice because owners and agents have distinct interests. Others claim that the agency problem may be influenced by how it is interpreted as well as by the conflicting interests of management and shareholders. Conflicts may arise, for instance, if management of the company has extra money but does not utilize it to raise the value of the stock. Agency theory states that the ownership structure, which consists of liabilities and equity, lessens friction between the parties (Cung & Fajri, 2023).

2.2 Signalling Theory

According to Spence (2002), signaling theory explains how a business provides knowledgeable information that investors subsequently perceive. If the company sends out a positive signal, its expenditure will go down; if it sends out a negative signal, it will go up. Governments, as well as businesses and people, may use this information to start making decisions. This notion can be useful when making commercial and investment decisions. An organization's annual financial reports serve as its main communication tool. Managers have the ability to influence the organization's destiny and assess their own motivation levels to assist shareholders in fulfilling their responsibilities by utilizing the notion of signals. Signals are used by organizations to get information about other businesses. It is stated that a notion from signaling theory called information asymmetry defines how managers get useful information from investors. This affects capital structure, and data that produces reliable signals gives managers insights (Adaria et al., 2022).

2.3 Financial Ratios

2.3.1 Profitability Ratio

The potential gains that a company's assets, earnings, and stock ownership may provide are assessed by profitability. A company's capacity to make sizable profits in line with its goals indicates that its management is effective and will benefit shareholders. This profitability is calculated using Return on Assets (ROA) (Prasetia et al., 2023)

2.3.2 Company Size

The scale uses share value, total assets, total revenue, and other variables to categorize a company's size. A company's size reveals the total amount of assets it possesses. Companies with high total assets are thought to have bright future prospects since they have developed to have positive cash flow (Giarto & Fachrurrozie, 2020).

2.4 Firm Value

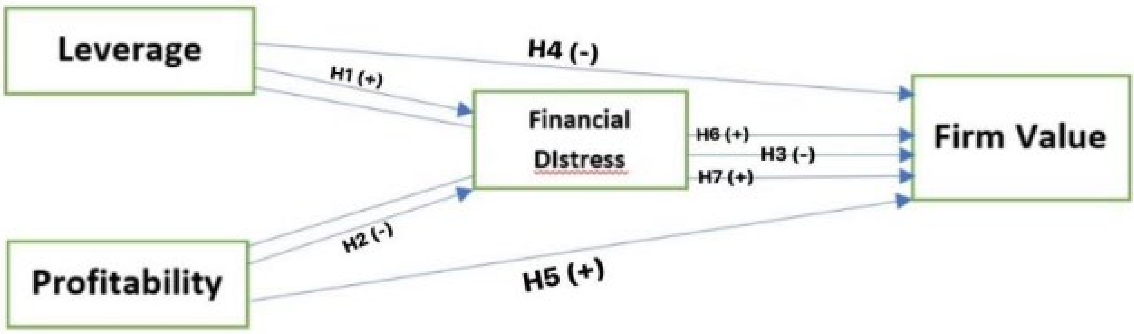
A firm may be evaluated from two angles: either its market value or its book value as represented by its equity. Understanding a company's worth becomes crucial for market participants like shareholders and investors, who need to keep a careful eye on the factors that might affect a company's share price. Investors may make better decisions when a company's stock price is in line with its fair market value. Consequently, a key consideration when deciding what to invest in is business value analysis (Wangsih et al., 2021). The public may view a company's value, which is a reflection of its state from the beginning to the end. The present value of any future earnings that the firm anticipates is also included in the definition of corporate value. Jensen & Meckling (1976) assert that rising share prices can help a corporation reach its objective of growing its value. In order to do this, management of the firm must make sure that business operations function smoothly, concentrate on innovation, and attain operational efficiency. By taking this move, the firm hopes to improve its reputation with the market and build long-term value. As a result, the company's worth represents more than just a figure on the balance sheet; it also speaks to the honesty, caliber, and prospects of the business. An additional measure of a company's worth is the well-being of its shareholders. In order to do this, shareholders frequently give outside specialists control over the company.

2.5 Financial Distress

When a firm performs worse than usual for a while before declaring bankruptcy, it is said to be in financial trouble. In this scenario, the company's insolvency may result in cash issues. Should the business be unable to pay its debts or find a speedy solution, bankruptcy will result. "Financial distress" refers to the time of declining financial stability before bankruptcy or liquidation. A company's earnings will be reduced even if its sales volume is strong if it has a heavy load to carry since its revenue must be used to pay for operating expenses. This might make the firm more vulnerable to financial difficulties. The three primary reasons of financial difficulties are losses, excessive debt and interest, and a lack of funds (Mahanani & Kartika, 2022).

2.6 Framework

The present study examines the moderating effect of dividend policy on the relationship between the dependent variable of business value and the independent components of firm size, profitability, and liquidity. The Indonesian Stock Exchange (Stock Exchange) requires yearly financial reports from companies that are listed. The data source for this study is a sample of manufacturing businesses in the industrial sector that are listed on the IDX, with a focus on the years 2019 and 2022. The goal of this study analysis is to find possible connections between the dependent variables, moderating variables, and independent factors in the research framework. By using this method, research aims to comprehend and assess the dynamics of variable interactions and how they affect the value of the organization within the industrial sector.



2.6 Hypothesis Development

2.6.1 The Effect of Leverage on Financial Distress

Researchers recommend that companies employ both debt and equity financing to boost earnings per share for their stockholders. A financial metric called leverage indicates how much of a company's assets have been added with the help of borrowed money. Excessive borrowing for operational assistance might raise the likelihood that the business will experience financial difficulties. A business that can weather financial hardships typically has a cheaper cost of equity. A high leverage ratio makes a business more susceptible to bad debt. While short- and long-term debt often has a negative effect on changes in operating profit of manufacturing businesses, the ratio of total debt to total assets and the debt to equity ratio have a favorable influence on changes in operating profit. Financial conditions are harsher for businesses with significant financial equity. Future payments may become challenging if the overall value of debt surpasses the whole value of assets. High debt levels are a sign that a firm has little cash on hand to sustain its assets, which might deter investors. Dealing with the firm may cause investors to become hesitant. The danger of financial troubles can be decreased with the use of leverage (Afgani et al., 2023; Wangsih et al., 2021). H1: Leverage has a positive influence on Financial Distress.

2.3.2 The Effect of Profitability on Financial Distress

The goal of any business is to maximize earnings from its activities. The profitability ratio shows how well a management controls a company's profit margin. Throughout the period, highly lucrative enterprises are viewed as successful because they exhibit efficient operations. Profitability is assessed in this study using Return on Assets (ROA), a financial statistic that accounts for the value of all assets. Stronger financial performance is indicated by a higher rate of return on investment (ROI) (Mahanani & Kartika, 2022). Large profit margins often indicate a lower likelihood of financial issues for a business. This is because companies that have a high return on assets (ROA) are able to make enough money to cover their operating costs and settle debt, which helps them stay out of financial trouble. Rahma (2020) also demonstrates how companies might stay out of bankruptcy by raising their profitability. H2: Profitability has a negative influence on Financial Distress.

2.3.3 The Effect of Financial Distress on Company Value

The company's worth is determined by estimating expected future earnings. Because of this, the corporation uses business prospects as a criteria for evaluation, and it has to have the advantages of having high standards for both asset and business management. A high rate of return on investment is typically demanded by investors, however this is only advantageous when the business is not having financial troubles. According to Hermuningsih et al. (2022), a company's worth is diminished when it faces financial troubles. Capital losses contribute to financial troubles by influencing a drop in financial performance, which lowers the company's worth. Even while capital losses H3: Financial Distress has a negative influence on company value.

2.3.4 The effect of leverage on company value

Considerable research has already yielded important conclusions on dividend schemes. Based on this data, we conclude that the significance levels for dividend policy are 0.034 (less than 0.05) and 0.387, respectively. In other words, a company's dividend policy has a big impact on its market value. Signal theory states that dividends are a positive indicator for stockholders. A company's worth rises in tandem with its share prices. The focus of signaling theory is on behaviors that send out good signals to all parties involved, particularly shareholders. A company's capacity and desire to provide dividends to shareholders is a reliable gauge of its performance and financial stability. Positive feedback between the two may cause a company's value and stock price to increase simultaneously. This reinforces the dividend policy's function as a useful instrument for informing shareholders about the company's financial stability and raising the enterprise value. H4: Leverage has a negative influence on company value.

2.3.5 The Effect of Profitability on Company Value

When a company does well, investors usually want to buy stock in it. Investors prioritize a company's profitability when assessing it. Because it draws in investors and raises the business's worth, profitability is crucial. A number of profitability theories have an impact on corporate value, and prior research has indicated that maximizing profits is crucial to achieving this goal. A company's worth will rise in response to its ability to generate greater profits through its financial performance (Budiarti, Moeldjadi, et al., 2023). A company's ability to produce high levels of profit signals that it is paying out dividends, which in turn drives up share prices as a good indication of the company's strength. Growing dividends are an indication of a company's financial stability, which motivates investors to raise the share price (Kanta et al., 2021). Numerous earlier research projects have determined how profitability affects a company's worth. Strong profitability will encourage investors to purchase the remaining shares, and as share prices climb, the business's worth will rise as well. H5: Profitability has a positive influence on Company Value.

2.3.6 The Effect of Leverage on Company Value as mediated by Financial Distress

The trade-off hypothesis, which contends that an excessive growth in debt might raise the probability of financial difficulties, is consistent with the research's findings. As the likelihood of financial troubles rises, so does the expense of declaring bankruptcy and the quantity of needless debt (Simamora, 2021). Empirical research supports the notion that leverage works well in financial crisis scenarios. According to some, employing excessive debt to finance a business would raise the likelihood that it may run into financial issues (Wangsih et al., 2021).H6: Leverage has a positive influence on Company Value with Financial Distress as a mediating variable.

2.3.7 The Effect of Profitability on Company Value mediated by Financial Distress

High-profit businesses are able to effectively manage and use their resources, which enables operations to go as planned and helps them stay out of potential financial trouble. On the other hand, businesses may run the danger of experiencing losses and negative cash flow as a result of poor asset management. A company's worth may decrease as a result of an unfavorable investment reaction and bankruptcy filing prompted by a poor financial position. Studies carried out by Afgani and colleagues (2023). H7: Profitability has a positive influence on Company Value with Financial Distress as a mediating variable.

3. Research Method

3.1 Population and Sample

3.1.1 Population

This study focuses on the manufacturing sector of the Indonesian Stock Exchange between 2019 and 2022. As a result, we collected data using a systematic random sample approach. The sample consisted of manufacturing sector businesses listed on the Indonesia Stock Exchange that did not record losses in their most recent financial reports. With these restrictions in place, the data processing for this study, which involved 67 firms, took 4 years and 268 hours.

3.1.2 Sample

Samples are individuals of the population chosen by researchers to examine the features of the population (Sekaran & Bougie, 2019). Purposive sampling was used to get samples, while non-probability sampling was used to identify the sample's composition depending on how many features it possessed. One of Indonesia's publicly traded manufacturing companies, a company engaged in the capital goods, transportation, or commercial and professional services sectors, the issuance of monetary notes denominated in rupiah, and a company that makes its financial reports fully available to the public are the criteria that were employed in the research. 2019–2022.

3.2 Data collection technique

Using four years' worth of secondary data from the Indonesia Stock Exchange (IDX), observations were obtained for this test. The Indonesia Stock Exchange (IDX) and the S&P Capital IQ website from 2019 to 2022 provided the secondary data for this observation.

4. Results and Discussion

4.1 Data analysis

4.1.1 Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
X1_LEV	268	0,01	370	64,3923	65,29004
X2_PRO	268	-12,19	35,8	4,0636	5,52429
X3_UP	268	10,78	19,84	14,5413	1,65688
X4_AGR	268	-51,98	73,8	4,7846	17,17059
X5_SG	268	-56,25	162,16	6,5933	34,94119
X6_AF	268	1	33	14,694	10,1599
Y_NP	268	0,28	34,9	2,3136	4,24103
Z_FD	268	-24,84	25,98	2,5028	4,82493
Valid N (listwise)	268				

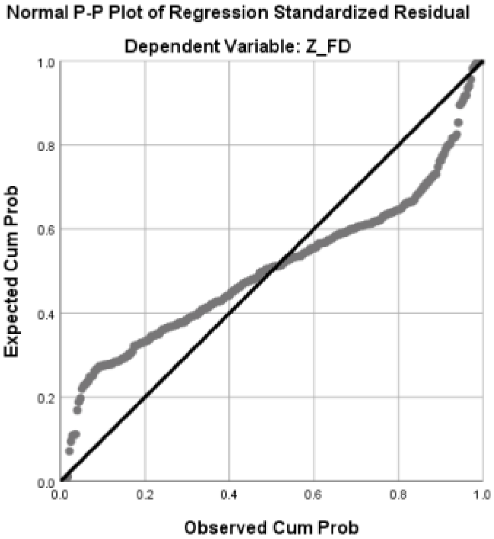
4.2 Correlation Test

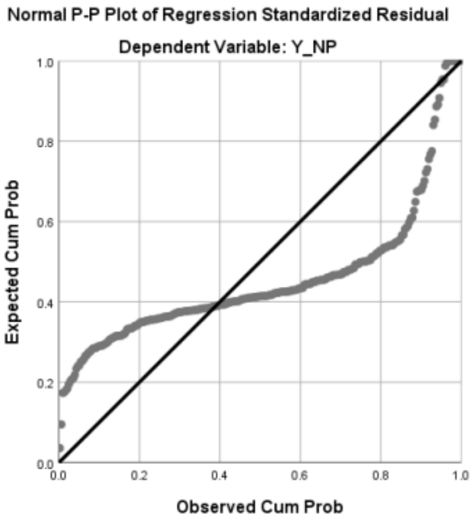
		X1_LEV	X2_PRO	X3_UP	X4_AGR	X5_SG	X6_AF	Y_NP	Z_FD
X1_LEV	Pearson Correlation	1	-0,211**	0,348**	0,041	-0,038	-0,054	-0,035	-0,271**
	Sig. (1-tailed)		0,000	0,000	0,251	0,269	0,188	0,282	0,000
	N	268	268	268	268	268	268	268	268
X2_PRO	Pearson Correlation	-0,211**	1	-0,010	0,451**	0,351**	0,065	0,180**	0,368**
	Sig. (1-tailed)	0,000		0,438	0,000	0,000	0,144	0,002	0,000
	N	268	268	268	268	268	268	268	268
X3_UP	Pearson Correlation	0,348**	-0,10	1	0,055	-0,002	0,24**	-0,11*	-0,151**
	Sig. (1-tailed)	0,000	0,438		0,184	0,489	0,000	0,036	0,007
	N	268	268	268	268	268	268	268	268
X4_AGR	Pearson Correlation	0,041	0,451**	0,055	1	0,456**	0,011	0,077	0,126*
	Sig. (1-tailed)	0,251	0,000	0,184		0,000	0,426	0,105	0,02
	N	268	268	268	268	268	268	268	268
X5_SG	Pearson Correlation	-0,038	0,351**	-0,002	0,456**	1	-0,004	0,022	0,073
	Sig. (1-tailed)	0,269	0,000	0,489	0,000		0,474	0,362	0,117
	N	268	268	268	268	268	268	268	268
X6_AF	Pearson Correlation	-0,054	0,065	0,24**	0,011	-0,004	1	-0,18**	-0,191**
	Sig. (1-tailed)	0,188	0,144	0,000	0,426	0,474		0,002	0,001
	N	268	268	268	268	268	268	268	268
Y_NP	Pearson Correlation	-0,35	0,18**	-0,11*	0,077	0,022	-0,18**	1	0,471**
	Sig. (1-tailed)	0,282	0,002	0,036	0,105	0,362	0,002		0,000
	N	268	268	268	268	268	268	268	268
Z_FD	Pearson Correlation	-0,271**	0,368**	-0,151**	0,126*	0,073	-0,191**	0,471**	1
	Sig. (1-tailed)	0,000	0,000	0,007	0,020	0,117	0,001	0,000	
	N	268	268	268	268	268	268	268	268

(**) *Correlationnya significant* pada level 0.01 (1-*tailed*)
(*) *Correlationnya significant* pada level 0.05 (1-*tailed*)

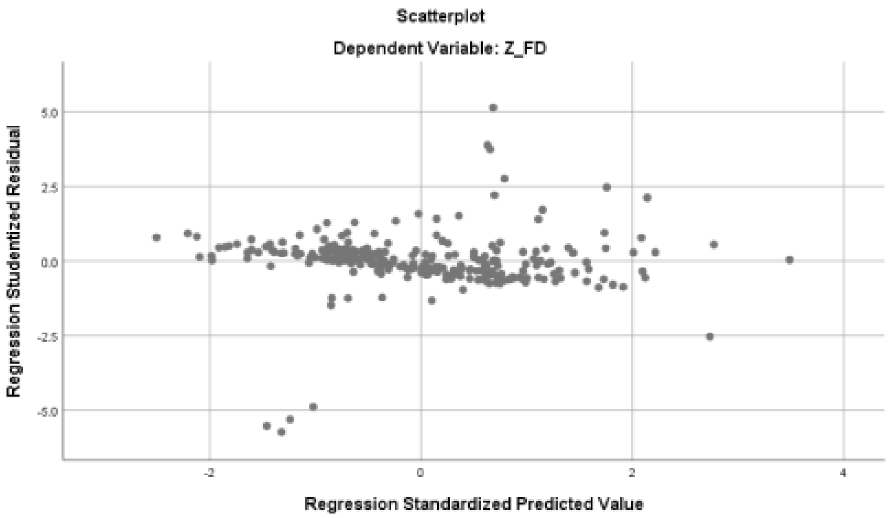
4.3 Classic assumption test

4.3.1 Normality test



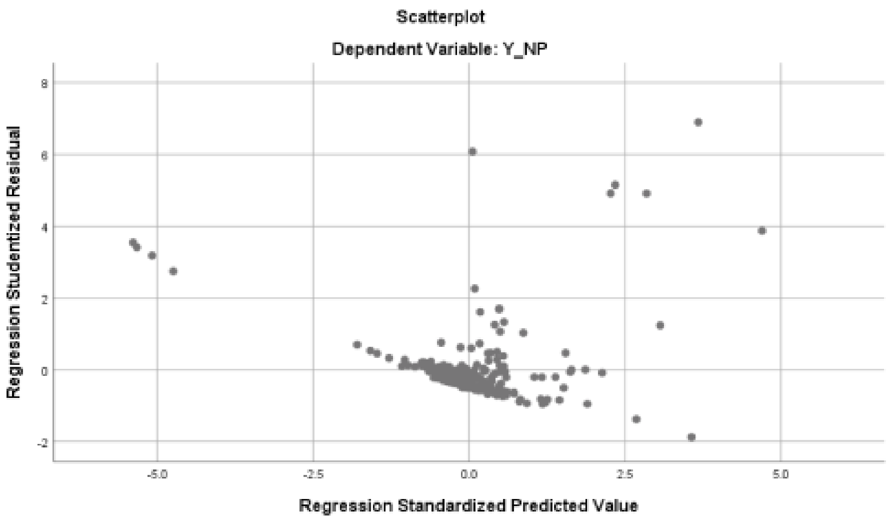


4.3.2 Uji Heteroskedastisitas



Gambar 4.0.3 Hasil Uji Heteroskedastisitas Model I

Sumber: Data diperoleh dari SPSSv25



Gambar 4.0.4 Hasil Uji Heteroskedastisitas Model II

Sumber: Data diperoleh dari SPSSv25

4.3.3 Uji Multikolinearitas

Coefficients[a]

Tabel 4.0.4 Hasil Uji Multikolinearitas Model I

Model		Tolerance	VIF
1	X1_LEV	0,803	1,245
	X2_PRO	0,717	1,394
	X3_UP	0,809	1,237
	X4_AGR	0,679	1,474
	X5_SG	0,764	1,308
	X6_AF	0,919	1,088

a. Dependent Variable: Z_FD

Sumber: Data diperoleh dari SPSSv25

Tabel 4.0.5 Hasil Uji Multikolinearitas Model II

Coefficients[a]

Model		Tolerance	VIF
1	X1_LEV	0,771	1,297
	X2_PRO	0,64	1,563
	X3_UP	0,808	1,238
	X4_AGR	0,679	1,474
	X5_SG	0,761	1,314
	X6_AF	0,869	1,151
	Z_FD	0,771	1,297

a. Dependent Variable: Y_NP

Sumber: Data diperoleh dari SPSSv25

4.4 Uji Hipotesis

4.4.1 Uji Koefisien Determinasi ($R2$)

Model Summary[b]

Model	R	R Square	Adjusted R Square	Standard Error of the Estimate	Durbin-Watson
1	0,478	0,229	0,211	4,28586	1,627

a. Predictors (0,478): (Constant), X6_AF, X5_SG, X1_LEV, X2_PRO, X3_UP, X4_AGR

b. Dependent Variable: Z_FD

Sumber: Data diperoleh dari SPSSv25

Model Summary[b]

Tabel 4.0.9 Hasil Uji Koefisien Determinasi (R2) Model II

Model	R	R Square	Adjusted R Square	Standard Error of the Estimate	Durbin-Watson
1	0,492	0,242	0,222	3,74113	2,072

a. Predictors: (Constant), Z_FD, X5_SG, X3_UP, X6_AF, X1_LEV, X4_AGR, X2_PRO

b. Dependent Variable: Y_NP

Sumber: Data diperoleh dari SPSSv25

4.4.2 Uji-F

ANOVA[a]

Tabel 4.0.10 Hasil Uji F Model I

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1421,542	6	236,924	12,898	0,000
	Residual	4794,203	261	18,369		
	Total	6215,745	267			

a. Dependent Variable: Z_FD

b. Predictors(0,000): (Constant), X6_AF, X5_SG, X1_LEV, X2_PRO, X3_UP, X4_AGR

Sumber: Data diperoleh dari SPSSv25

Tabel 4.10 Hasil Uji F Model I

ANOVA[a]

Tabel 4.0.11 Hasil Uji F Model II

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.163,367	7	166,195	11,874	,000[b]
	Residual	3.638,975	260	13,996		
	Total	4.802,341	267			

a. Dependent Variable: Y_NP

b. Predictors: (Constant), Z_FD, X5_SG, X3_UP, X6_AF, X1_LEV, X4_AGR, X2_PRO

Sumber: Data diperoleh dari SPSSv25

4.5 Uji-t

Coefficients[a]

Tabel 4.0.12 Hasil Uji T Model I

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	4.822	2.407		2.003	.046
	X1_LEV	-.015	.004	-.200	-3.302	.001
	X2_PRO	.315	.056	.361	5.618	.000
	X3_UP	-.073	.176	-.025	-.413	.680
	X4_AGR	.001	.019	.004	.065	.948
	X5_SG	-.009	.009	-.064	-1.034	.302
	X6_AF	-.104	.027	-.220	-3.879	.000

a. Dependent Variable: Z_FD

Sumber: Data diperoleh dari SPSSv25

Coefficients[a]

Tabel 4.13 Hasil Uji T Model II

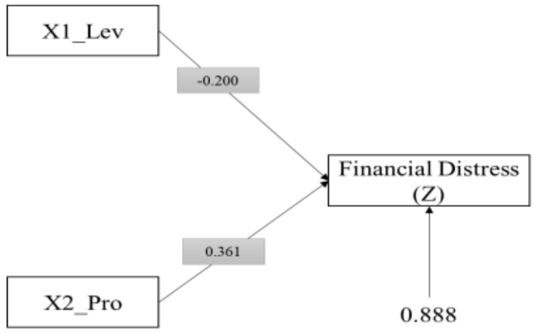
Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	3.500	2.117		1.653	.100
	X1_LEV	.008	.004	.116	1.882	.061
	X2_PRO	.033	.052	.043	.637	.525
	X3_UP	-.163	.154	-.064	-1.058	.291
	X4_AGR	.003	.016	.012	.184	.854
	X5_SG	-.003	.008	-.029	-.465	.643
	X6_AF	-.031	.024	-.073	-1.265	.207
	Z_FD	.407	.054	.463	7.536	.000

Coefficients[a]

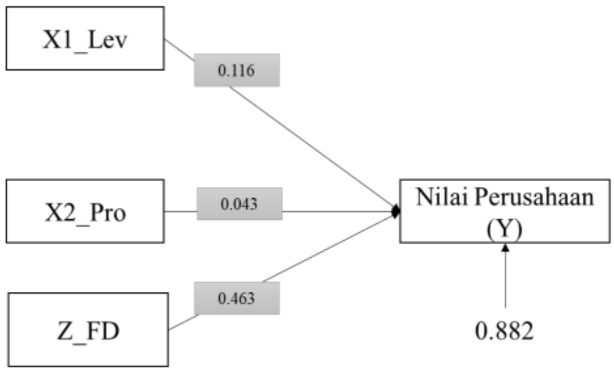
a. Dependent Variable: Y_NP

Sumber: Data diperoleh dari SPSSv25

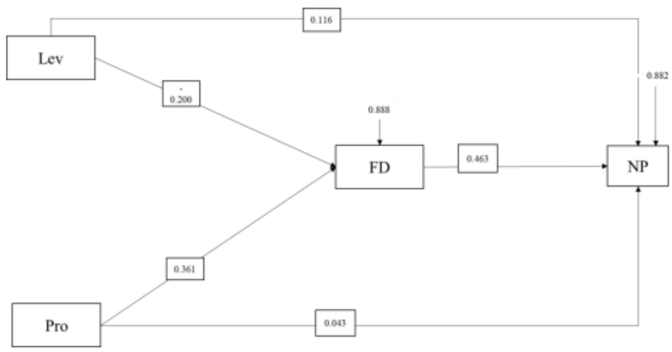
4.5.1 Path Analysis



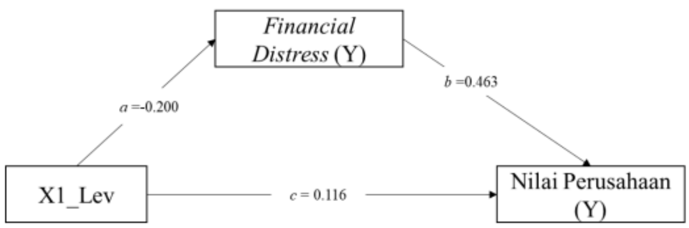
Gambar 4.0.5 Diagram Jalur Model I



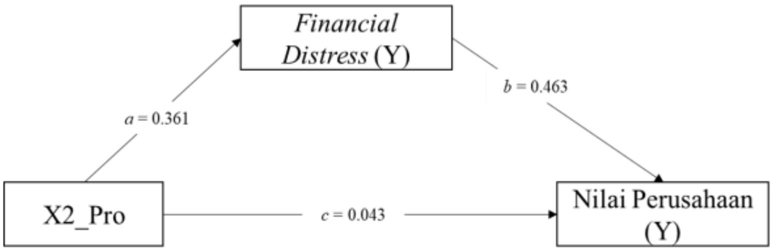
Gambar 4.0.6 Diagram Jalur Model II



Gambar 4.0.7 Diagram Jalur Model I dan II



Gambar 4.0.8 Diagram Jalur Pengaruh Tidak Langsung Variabel Leverage



Gambar 4.0.9 Diagram Jalur Pengaruh Tidak Langsung Variabel Profitabilitas

5. Conclusion

The negative impact of using debt to deal with financial difficulties is one of the research's key conclusions, according to the findings and results of the hypothesis testing in the previous chapter. Secondly, the researchers' hypothesis regarding the significant positive influence of profitability on financial distress is not supported by the data. notion The fourth hypothesis in this research, which states that leverage has a negative effect on company value, was also rejected, and the researcher's final hypothesis was also disproved by the research's findings: financial turmoil has a positive and significant influence on a company's value. When financial strain is used as a mediating variable, profitability has a positive and significant impact on company value. Therefore, the researcher's sixth hypothesis—which holds that leverage has a negative and significant influence on company value—is rejected. The researcher's seventh hypothesis, on the other hand, was accepted.

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