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THE EFFECT OF FINANCIAL PERFORMANCE AND AUDIT COMMITTEE SIZE ON FINANCIAL DISTRESS IN MANUFACTURING COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE

Novi Akhsani[1], Eka Salfa Wulandari[2]
[1,2]Faculty of Economics and Business, Pamulang University. South Tangerang, Indonesia

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Corresponding author:
dosen00887@unpam.ac.id

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Abstract: This study aims to examine the effect of financial performance and audit committee size on financial distress in manufacturing firms listed on the Indonesia Stock Exchange. Financial performance is represented by profitability and liquidity, while financial distress is measured using a modified Altman model. The research applies a quantitative approach using secondary data derived from published financial statements. The sample consists of selected manufacturing companies that meet specific criteria and are observed over a continuous period. Data analysis is conducted using panel data regression to evaluate both partial and simultaneous effects of the independent variables on financial distress. The findings indicate that profitability and liquidity significantly influence financial distress, suggesting that firms with stronger financial performance are less likely to experience financial difficulties. In contrast, audit committee size does not show a significant individual effect, although it contributes jointly with financial performance variables. These results highlight the importance of financial indicators in predicting corporate financial stability.

Keywords: Profitability, Liquidity, Audit Committee Size, Financial Distress, Manufacturing Firms

INTRODUCTION

Financial distress is a condition experienced by a company when it is unable to meet its debt obligations or financial liabilities, thereby facing the risk of bankruptcy. Financial distress may arise due to internal and external factors. Internal factors include cash flow difficulties, high levels of debt, and operational losses sustained over several years. Meanwhile, external factors include government policies that may increase the company's burden, as well as rising interest rates that lead to higher interest expenses borne by the company (Riko Angguda, Blongkod, and Mahmud, 2024).

During the period from 2020 to 2024, many manufacturing companies experienced financial distress influenced by changes in consumer behavior. Consumers increasingly preferred lower-priced products despite lower quality, creating challenges for companies that maintained premium pricing strategies based on higher quality. This condition was further exacerbated by the inability of some manufacturing firms to adapt to new business models that emphasize convenience and accessibility, resulting in declining profitability and an increased likelihood of financial distress.

Many companies experienced a decline in sales volume as consumers shifted toward more affordable products. This led to a significant decrease in revenue, which directly affected net income. For instance, data indicate that although some companies experienced an increase in sales volume, their net income still declined due to high operational costs and cost of goods sold that were not proportional to revenue.

Companies that failed to remain competitive often encountered difficulties in managing their assets efficiently. Inefficient asset utilization can lead to higher operational costs and reduced profit margins. This condition prevents companies from meeting their financial obligations when they become due, indicating a shortage of working capital. As a result, such companies face the risk of bankruptcy due to their inability to settle liabilities on time, driven by sustained losses over several years.

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Table 1. Data of Companies Experiencing Profit Decline

Code	2020	2021	2022	2023	2024
APII	30,152,459,780	20,672,232,124	14,054,281,418	41,338,721,475	11,163,484,740
ARKA	6,993,467,313	3,442,039,458	6,110,063,988	10,159,997,069	2,921,315,290
KIAS	-51,749,994,901	-5,554,727,386	6,553,870,572	-33,921,000,000	-25,094,000,000
KOIN	41,142,681,020	-27,840,100,544	-73,270,055,868	-75,121,000,000	-35,510,000,000

Table 1. presents data on several manufacturing companies that experienced fluctuations and declines in profit over the observed period. The data indicate that some firms show unstable financial performance, including persistent losses and inconsistent profit growth. This condition reflects potential financial vulnerability that may lead to financial distress if not properly managed.

To provide a clearer illustration of these trends, Figure 1. visualizes the development of profit changes across the selected companies. The figure highlights the pattern of profit fluctuations and emphasizes the declining performance experienced by several firms over time.

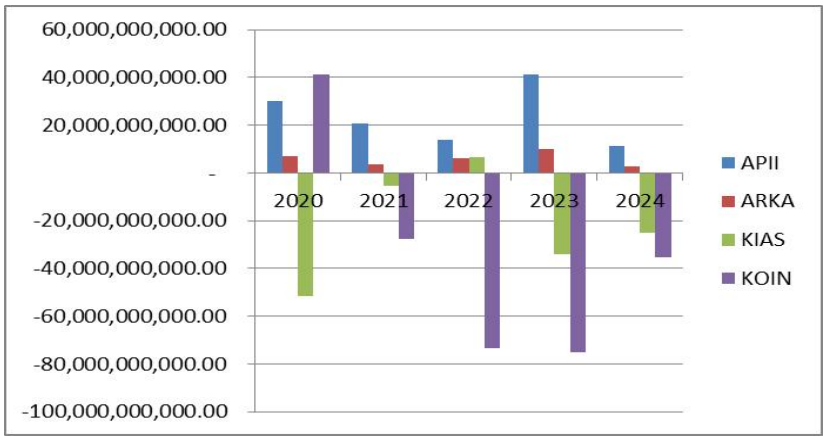

Figure 1. Profit Trend Graph

Based on the example above, it can be observed that financial performance has a significant influence on a company's financial distress. Therefore, it is important to understand the factors that affect financial performance. One of the key factors influencing financial performance is financial ratios. Commonly used financial ratios to assess financial performance include profitability, liquidity, activity, and solvency.

In addition to financial performance, another factor that influences financial distress is the size of the audit committee. An optimal audit committee size is necessary to ensure that its members can contribute effectively. If the number of members is too large, they may lose focus, whereas if it is too small, there may be a lack of skills and expertise required to perform their duties effectively.

LITERATURE REVIEW

Signaling Theory

Signaling theory aims to explain that financial statements are essentially used by companies to convey signals regarding their performance to users. A well-prepared financial report serves as a positive signal, indicating that the company operates effectively and maintains good financial management (Riko Angguda et al., 2024).

Originally developed by Ross, signaling theory explains the firm's motivation to provide both positive signals and negative signals to external parties regarding its condition (Loviera and Akhsani, 2023). These signals are typically reflected in financial reports. The availability of such information is expected to assist investors in making informed investment decisions. Furthermore, signaling theory helps reduce information asymmetry between management and investors, as management generally possesses more comprehensive information about the company's prospects compared to external stakeholders (Sariroh, 2021).

Agency Theory

Agency theory describes the relationship between the principal and the agent, where the principal delegates authority to the agent to manage the company in accordance with agreed objectives (Jensen and Meckling, 1976). In this context, shareholders act as principals who provide resources, while management acts as agents responsible for operating the company to maximize performance and avoid financial distress (Febriana and Christiawan, 2020).

Conflicts arise when the interests of the agent differ from those of the principal. Since agents have greater access to internal information, they may act opportunistically to pursue personal interests. Such behavior can lead to financial inefficiencies and potentially trigger financial distress within the company (Febriana and Christiawan, 2020).

Financial Distress

Financial distress refers to a condition in which a company experiences financial decline prior to bankruptcy or liquidation (Platt, 2002; Atmini and Wuryana, 2005). Indicators of financial distress include delayed deliveries, declining product quality, and overdue payments to creditors. Early detection of financial distress is crucial, as it enables companies to take preventive actions before facing more severe financial consequences (Febriana and Christiawan, 2020).

A company is generally considered to be in financial distress when it experiences continuous losses and fails to distribute dividends over a certain period. One of the primary approaches to predicting financial distress is through the analysis of financial performance indicators derived from published financial statements. These reports serve as essential information for both internal and external stakeholders in making economic decisions (Lubis et al., 2022). In this study, financial distress is predicted using financial ratios, particularly profitability and liquidity.

Financial Performance

Financial performance refers to the achievements obtained by management in effectively managing company resources over a specific period (Rudianto, 2013). It reflects the overall financial condition of a company and serves as an important tool for evaluating the success of its operational activities.

According to Fahmi, financial performance represents the results of activities carried out by a company and indicates how well it adheres to proper financial management practices. It provides a basis for performance evaluation and continuous improvement, enabling companies to remain competitive. Financial statements are a key source of information used to assess financial performance and measure the effectiveness of business operations (Rachmawati and Retnani, 2020).

Profitability

Profitability refers to a company's ability to generate profit and reflects the effectiveness of management in utilizing resources (Rinofah et al., 2021). Higher profitability indicates better performance in managing company assets and achieving financial goals.

Profitability is commonly measured using Return on Assets, which evaluates how efficiently a company uses its assets to generate earnings. A low level of profitability suggests inefficient asset utilization, which may hinder the company's ability to generate internal funding and increase the risk of financial distress or even bankruptcy.

Liquidity

Liquidity represents a company's ability to meet its short-term obligations by converting assets into cash. A company is considered liquid if it can fulfill its liabilities when they become due (Hery, 2016; Rinofah et al., 2021).

Liquidity is typically measured using the current ratio, which assesses the firm's capacity to cover short-term liabilities with its current assets. A higher level of liquidity indicates a stronger financial position and reduces the likelihood of financial distress, while low liquidity increases the risk of financial difficulties.

Audit Committee Size

An audit committee should consist of at least three members, including an independent commissioner serving as the chair and independent members with expertise in accounting and finance. An appropriately sized audit committee enables members to effectively apply their knowledge and experience for the benefit of shareholders (Fitriza et al., 2021).

The audit committee plays an important role in overseeing financial reporting, external audit processes, and corporate governance practices. It also contributes to improving the quality of financial reporting and reducing the risk of earnings management (Abdillah, 2014; Fitriza et al., 2021).

Audit committee size refers to the total number of committee members. A larger committee may enhance effectiveness through diverse perspectives and expertise, thereby strengthening oversight and reducing the likelihood of financial distress. However, the size must remain optimal to ensure efficiency in decision-making and coordination (Dwi Putra and Serly, 2020).

METHODOLOGY

This study adopts a quantitative research approach to examine the relationship between financial performance, audit committee size, and financial distress. A quantitative design is considered appropriate because the variables under investigation can be measured numerically and analyzed statistically to test the proposed hypotheses. The study focuses on identifying causal relationships and explaining how variations in financial performance and governance structures influence the likelihood of financial distress in companies.

The research utilizes secondary data obtained from the published financial statements of manufacturing companies listed on the Indonesia Stock Exchange. These data are accessed through official sources, including the exchange's website and company reports. The use of secondary data allows the study to rely on objective and verifiable financial information, ensuring the reliability and consistency of the dataset used for analysis.

The population of this study consists of all manufacturing companies listed on the Indonesia Stock Exchange during the observation period. From this population, a sample is selected using a purposive sampling technique, where only companies that meet specific criteria are included. These criteria ensure that the selected firms provide complete and consistent financial data required for the analysis, allowing for more accurate and meaningful results.

The observation period covers several consecutive years to capture the dynamic nature of financial performance and its potential impact on financial distress. By analyzing panel data, the study is able to combine cross-sectional and time-series dimensions, providing a more comprehensive understanding of the behavior of firms over time. This approach enhances the robustness of the analysis and allows for better generalization of findings within the context of the manufacturing sector.

The dependent variable in this study is financial distress, which is measured using a modified Altman model. This model is widely used in financial research to assess the likelihood of financial difficulties based on key financial indicators. It provides a systematic way to classify firms according to their financial condition, making it suitable for evaluating distress risk.

The independent variables consist of financial performance and audit committee size. Financial performance is represented by profitability and liquidity. Profitability is measured using Return on Assets, reflecting the firm's ability to generate earnings from its assets, while liquidity is measured using the current ratio, indicating the firm's ability to meet short-term obligations. Audit committee size is measured based on the total number of members serving on the committee, representing the governance structure within the firm.

To analyze the data, this study employs panel data regression techniques. Several model estimation approaches are considered, including common effects, fixed effects, and random effects models. Appropriate model selection tests are conducted to determine the most suitable model for the dataset. This process ensures that the estimation results are both statistically valid and consistent with the underlying data characteristics.

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Before conducting hypothesis testing, classical assumption tests are performed to ensure the reliability of the regression model. These include tests for normality, multicollinearity, and heteroskedasticity. After confirming that the model satisfies these assumptions, hypothesis testing is carried out using partial and simultaneous significance tests. The coefficient of determination is also examined to assess how well the independent variables explain variations in financial distress. Through these procedures, the study aims to produce robust and credible empirical findings.

RESULTS

Descriptive Statistics

Table 2. Descriptive Statistics Results

Statistic	Y	X1	X2	X3
Mean	2.370629	0.016495	2.049670	2.952381
Median	2.865100	0.022800	1.544700	3.000000
Maximum	9.098100	0.251000	11.76250	3.000000
Minimum	-15.91500	-0.682400	0.158200	2.000000
Std. Dev.	4.067132	0.113386	1.923314	0.213980
Skewness	-1.616616	-2.666534	3.131077	-4.248529
Kurtosis	7.587143	16.84704	14.14364	19.05000
Jarque-Bera	137.7936	963.2967	714.8538	1442.886
Probability	0.000000	0.000000	0.000000	0.000000
Sum	248.9160	1.732000	215.2154	310.000
Sum Sq. Dev.	1720.323	1.337058	384.7102	4.761905
Observations	105	105	105	105

Based on the table above, the results indicate that financial distress, profitability, and liquidity exhibit high variability, as reflected by their coefficients of variation exceeding the threshold, indicating heterogeneous data distribution. This suggests that these variables show considerable dispersion across observations.

In contrast, audit committee size demonstrates low variability, with a coefficient of variation below the threshold, indicating a homogeneous distribution. This implies that the number of audit committee members is relatively consistent across the sampled firms.

Panel Data Regression Model

Common Effect Model (CEM) Results

Table 3. Common Effect Model (CEM) Estimation Results

Dependent Variable: Financial Distress (Y)
Method: Panel Least Squares
Sample Period: 2020–2024
Number of Periods: 5
Number of Cross-sections: 21
Total Observations: 105

Variable	Coefficient	Std. Error	t-Statictic	Prob.
C	-26.88481	3.941113	-6.821629	0.0000
X1	4.592933	2.518307	1.823818	0.0711
X2	0.949725	0.144925	6.553219	0.0000
X3	9.224099	1.342222	6.872259	0.0000
R-Squared	0.531326	Mean dependent var		2.370629
Adjusted R-Squared	0.517405	S.D. dependent var		4.067132
S.E. of regression	2.825399	Akaike info criterion		4.952527
Sum squared resid	806.2711	Schwarz criterion		5.053630
Log likelihood	-256.0077	Hannan-Quinn criter.		4.993496

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F-statistic	38.16715	Durbin- Watson stat	0.842858
Prob(F-statistic)	0.000000		

Based on the table above, the Common Effect Model shows that the constant coefficient is negative, while the coefficients of profitability, liquidity, and audit committee size are positive. This indicates that all independent variables have a positive relationship with financial distress in the model.

Fixed Effect Model (FEM) Results

Table 4. Fixed Effect Model (FEM) Estimation Results

Dependent Variable: Financial Distress (Y)
Method: Panel EGLS (Cross-section Weights)
Sample Period: 2020–2024
Number of Periods: 5
Number of Cross-sections: 21
Total Observations: 105
Estimation Method: Linear estimation after one-step weighting matrix

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-8.339113	5.056821	-1.649082	0.1030
X1	4.613267	1.588143	2.904818	0.0047
X2	1.543672	0.125838	12.26712	0.0000
X3	2.530034	1.713943	1.476149	0.1438
Effects Specification				
Cross-section fixed (dummy variables)				
Weighted Statistics				
R-squred	0.947736	Mean dependent var		6.128772
Adjusted R-squared	0.932896	S.D. dependent var		6.687029
S.E. of regression	1.201270	Sum squared resid		116.8870
F-statistic	63.86249	Durbin-Watson stat		1.772643
Prob(F-statistic)	0.000000			
Unweighted Statistics				
R-squred	0.859690	Mean dependent var		2.370629
Sum squared resid	241.3783	Durbin-Watson stat		1.613080

Based on the table above, the Fixed Effect Model shows a negative constant coefficient, while profitability, liquidity, and audit committee size have positive coefficients, indicating a positive relationship with financial distress.

Random Effect Model (REM) Results

Table 5. Random Effect Model (REM) Estimation Results

Dependent Variable: Financial Distress (Y)
Method: Panel EGLS (Cross-section Random Effects)
Sample Period: 2020–2024
Number of Periods: 5
Number of Cross-sections: 21
Total Observations: 105
Estimator: Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-11.75160	2.655579	-4.425248	0.0000
X1	-2.961355	1.608642	-1.840903	0.0686
X2	1.223508	0.151539	8.073861	0.0000

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X3	3.950467	0.895703	4.410465	0.0000
Effects Specification				
			S.D.	Rho
Cross-section random			1.739580	0.5880
Idiosyncratic random			1.456214	0.4120
Weighted Statistics				
R-squred	0.444757	Mean dependent var		0.831148
Adjusted R-squared	0.428264	S.D. dependent var		2.260405
S.E. of regression	1.709165	Sum squared resid		295.0458
F-statistic	26.96740	Durbin-Watson stat		1.305482
Prob(F-statistic)	0.000000			
Unweighted Statistics				
R-squred	0.373134	Mean dependent var		2.370629
Sum squared resid	1078.411	Durbin-Watson stat		0.357171

Based on the table above, the Random Effect Model shows a negative constant coefficient and a negative coefficient for profitability, while liquidity and audit committee size have positive coefficients, indicating differing relationships with financial distress.

Panel Data Regression Model Selection

Chow Test

Table 6. Chow Test Results (Redundant Fixed Effects Test)

Redundant Fixed Effects
Tests Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	14.960823	(20.81)	0.0000
Cross-section Chi-square	162.360614	20	0.0000

Based on the results of the Chow test above, the probability value of the cross-section F is less than the significance level, indicating that the Fixed Effect Model is the most appropriate model to be used.

Hausman Test

Table 7. Hausman Test Results

Test: Correlated Random Effects – Hausman Test
Equation: Untitled
Test: Cross-section Random Effects

Test Summary	Chi-Square Statistic	Chi-Square d.f.	Probability
Cross-section random	41.135907	3	0.0000

Based on the results of the Hausman test above, the probability value of the cross-section random is less than the significance level, indicating that the Fixed Effect Model is the most appropriate model to be used.

Lagrange Multiplier Test

Table 8. Lagrange Multiplier Test Results

Test: Lagrange Multiplier Tests for Random Effect
Null Hypothesis: No effects
Alternative Hypothesis: Two-sided (Breusch–Pagan) and one-sided (others)

	Test Hypothesis

	Cross-section	Time	Both
Breusch-Pagan	37.82825	0.071693	37.89994
	(0.0000)	(0.7889)	(0.0000)
Honda	6.150467	-0.267755	4.159706
	(0.0000)	(0.6056)	(0.0000)
King-Wu	6.150467	-0.267755	2.266492
	(0.0000)	(0.6056)	(0.
Standardized Honda	6.773253	0.052055	1.028259
	(0.0000)	(0.4792)	(0.1519)
Standardized King- Wu	6.773253	0.052055	-0.307891
	(0.0000)	(0.4792)	(0.6209)
Gourieroux, et al.	-	-	37.82825
			(0.0000)

Based on the Lagrange Multiplier test results above, the probability value of the cross-section is less than the significance level, indicating that the Random Effect Model is the most appropriate model to be used.

Model Selection Summary

Table 9. Model Selection Summary

No.	Regression Model Test	Comparison	Result
1	Chow Test	CEM vs FEM	FEM
2	Hausman Test	REM vs FEM	FEM
3	Lagrange Multiplier Test	CEM vs REM	REM

Based on the results of the three model selection tests above, it can be concluded that the Fixed Effect Model is the most appropriate model to be used. Therefore, the next step is to conduct multiple regression analysis using the Fixed Effect Model.

Classical Assumption Tests

Normality Test

The normality test aims to examine whether the residuals in the regression model are normally distributed. This test is also used to assess whether the regression model applied is appropriate, as a good regression model should have residuals that follow a normal or near-normal distribution.

In this study, the normality test is conducted using the Jarque–Bera statistical test on the residuals of the regression equation. The testing criteria state that if the probability value is greater than the significance level, the data are considered to be normally distributed. Conversely, if the probability value is lower than the significance level, the data are not normally distributed.

In addition, this study employs graphical analysis to support the normality assessment. If the residual data are normally distributed, the plotted data points will closely follow the expected distribution pattern.

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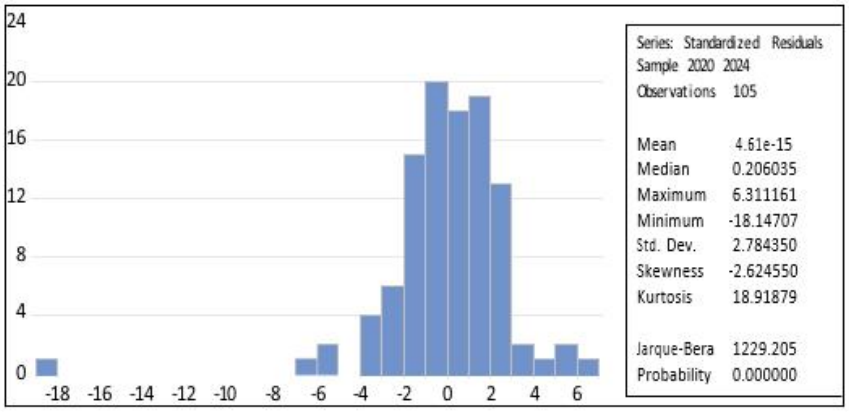

Figure 2. Normality Test Results

The Jarque–Bera test indicates that the residuals are not normally distributed, as the probability value is below the significance level.

However, this does not affect the validity of the model since the sample size is large. According to the Central Limit Theorem, parameter estimates remain approximately normal, and normality is not required under the Gauss–Markov theorem for obtaining unbiased estimators.

Multicollinearity Test

Table 10. Multicollinearity Test Results

	X1	X2	X3
X1	1.000000	0.006343	0.241185
X2	0.006343	1.000000	0.107832
X3	0.241185	0.107832	1.000000

Based on the correlation matrix, all correlations among the independent variables are well below the accepted threshold, indicating no strong relationships between them.

Therefore, it can be concluded that the regression model does not suffer from multicollinearity, and all independent variables are suitable for inclusion in the analysis.

Heteroskedasticity Test

The heteroskedasticity test is conducted to determine whether the variance of residuals is constant across observations. A regression model is considered good if it exhibits homoskedasticity, meaning the residual variance is consistent and no heteroskedasticity is present.

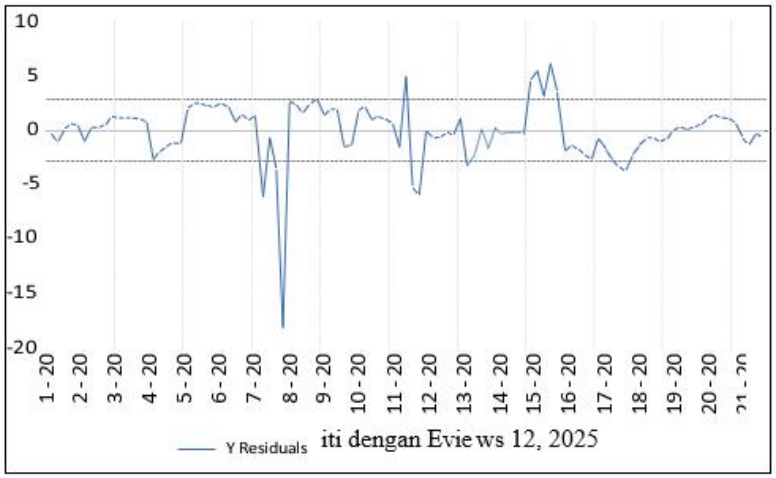

Figure 3. Heteroskedasticity Test Results

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Based on the residual plot, no clear or consistent pattern is observed, indicating no strong evidence of heteroskedasticity. The residual values also remain within the specified range, suggesting constant variance. Therefore, the regression model satisfies the homoskedasticity assumption and is free from heteroskedasticity.

Multiple Linear Regression Analysis

This study employs multiple linear regression analysis to examine the effect and significance of the relationships between the independent variables, profitability, liquidity, and audit committee size, and the dependent variable, financial distress. Based on the model selection results, the Fixed Effect Model is applied. The regression results using this model are presented as follows.

Table 11. Multiple Linear Regression Analysis Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-8.339113	5.056821	-1.649082	0.1030
X1	4.613267	1.588143	2.904818	0.0047
X2	1.543672	0.125838	12.26712	0.0000
X3	2.530034	1.713943	1.476149	0.1438

Panel Data Regression Equation Interpretation

1. The constant value indicates that, in the absence of profitability, liquidity, and audit committee size, financial distress tends to decrease.
2. The coefficient of profitability shows that an increase in profitability is associated with an increase in financial distress, assuming other variables remain constant. Similarly, a decrease in profitability leads to a decrease in financial distress.
3. The liquidity coefficient indicates that higher liquidity is associated with higher financial distress, while a decrease in liquidity leads to a decrease in financial distress.
4. The coefficient of audit committee size suggests that an increase in the number of audit committee members is associated with an increase in financial distress, and vice versa, assuming other variables remain constant.

Hypothesis Testing Results

t-Statistic Test (Partial Test)

The t-test is used to examine the individual effect of each independent variable on the dependent variable. If the probability value is below the significance level, the variable has a significant effect; otherwise, it has no significant effect. The results of the t-test analysis are presented in the following table.

Table 12. t-Statistic Test Results (Partial Test)

Variable	Coefficient	Std. Error	t-Statistic	Probability
C	-8.339113	5.056821	-1.649082	0.103
X1	4.613267	1.588143	2.904818	0.0047
X2	1.543672	0.125838	12.26712	0.0000
X3	2.530034	1.713943	1.476149	0.1438

Based on the t-test results, profitability and liquidity have probability values below the significance level, indicating that both variables significantly affect financial distress. In contrast, audit committee size has a probability value above the significance level, indicating that it does not have a significant effect on financial distress.

F-Test (Simultaneous Test)

The F-test is used to examine the simultaneous effect of all independent variables on the dependent variable.

Decision criteria:

1. If the p-value is below the significance level, the null hypothesis is rejected, indicating a significant effect.
2. If the p-value is equal to or above the significance level, the null hypothesis is accepted, indicating no significant effect.

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The results of the F-test are presented in the following table:

Table 13. F-Statistic Test Results (Simultaneous Test)

R-squred	0.947736	Mean dependent var	6.128772
Adjusted R-squared	0.932896	S.D. dependent var	6.687029
S.E. of regression	1.201270	Sum squared resid	116.8870
F-statistic	63.86249	Durbin-Watson stat	1.772643
Prob(F-statistic)	0.000000		

Based on the analysis results, the F-statistic value is high with a probability below the significance level. This indicates that profitability, liquidity, and audit committee size simultaneously have a significant effect on financial distress.

Coefficient of Determination (R^2) Test

The coefficient of determination is used to measure how well the independent variables explain the variation in the dependent variable. A higher value indicates greater explanatory power of the regression model.

Table 14. Coefficient of Determination (R^2) Test Results

R-squred	0.947736	Mean dependent var	6.128772
Adjusted R-squared	0.932896	S.D. dependent var	6.687029
S.E. of regression	1.201270	Sum squared resid	116.8870
F-statistic	63.86249	Durbin-Watson stat	1.772643
Prob(F-statistic)	0.000000		

The R-squared value indicates that the independent variables explain most of the variation in the dependent variable, while the remaining variation is influenced by other factors outside the model. The adjusted R-squared remains high after accounting for the number of variables and sample size, indicating a good model fit. Therefore, the regression model is considered to have strong explanatory power in capturing the relationship between the variables.

Research Discussion

The Effect of Profitability on Financial Distress

The results of this study indicate that profitability, measured using Return on Assets, has a significant effect on financial distress. The probability value is below the significance level, with a positive regression coefficient. These findings are consistent with previous studies, which also report that profitability significantly influences financial distress. This implies that higher profitability reduces the likelihood of a company experiencing financial distress. Profitability reflects a company's ability to effectively utilize its assets and capital to generate profits. A higher level of profitability indicates efficient management performance and provides important information for investors regarding the company's financial condition. It also serves as a key indicator in assessing the potential risk of financial distress.

The Effect of Liquidity on Financial Distress

The results show that liquidity, measured using the current ratio, has a significant effect on financial distress. The probability value is below the significance level, indicating statistical significance. These findings are in line with previous studies, which suggest that liquidity plays an important role in determining financial distress. Higher liquidity indicates a stronger ability of the company to meet its short-term obligations, thereby reducing the risk of financial distress. An increase in liquidity contributes to a higher Z-score, which implies a lower probability of financial distress. Companies with strong liquidity are generally more capable of managing short-term liabilities, maintaining financial stability, and responding effectively to operational needs and market opportunities.

The Effect of Audit Committee Size on Financial Distress

The results indicate that audit committee size does not have a significant effect on financial distress. The probability value exceeds the significance level, indicating that the variable is not statistically significant.

This finding is consistent with prior studies, which suggest that audit committee size does not directly influence financial distress. The effectiveness of oversight is more dependent on the quality, competence, and independence of committee members rather than the number of members. A larger audit committee does not necessarily improve monitoring effectiveness and may even create coordination challenges. Therefore, increasing the number of audit committee members alone is insufficient to reduce the risk of financial distress, as the primary causes of financial difficulties often lie beyond the scope of audit committee oversight.

The Effect of Profitability, Liquidity, and Audit Committee Size on Financial Distress

The results show that the probability value of the F-statistic is below the significance level, indicating that profitability, liquidity, and audit committee size simultaneously have a significant effect on financial distress. This suggests that the combined influence of financial performance and governance structure plays an important role in determining the likelihood of financial distress.

CONCLUSION

This study aims to examine the effect of financial performance and audit committee size on financial distress in manufacturing companies. The findings reveal that profitability and liquidity have a significant influence on financial distress, while audit committee size does not show a significant effect individually. These results indicate that financial performance plays a crucial role in determining a company's financial condition, particularly in preventing financial distress.

Higher profitability reflects the company's ability to generate earnings efficiently, thereby reducing the likelihood of financial difficulties. Similarly, strong liquidity indicates the firm's capability to meet short-term obligations, which contributes to maintaining financial stability. In contrast, audit committee size alone is not sufficient to influence financial distress, as the effectiveness of governance depends more on the quality and competence of its members rather than the number.

Furthermore, the simultaneous test demonstrates that profitability, liquidity, and audit committee size collectively have a significant effect on financial distress. This implies that both financial performance and governance mechanisms are important in shaping a company's financial resilience. Overall, the study provides empirical evidence that strengthening financial performance is essential in minimizing the risk of financial distress, while governance structures should focus on effectiveness rather than size alone.

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