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The Effect of Financial Distress, Profitability, Liquidity, Solvency, and Activity on Stock Prices

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Abstract

Purpose: This study examines how financial distress, profitability, liquidity, solvency, and activity relate to stock prices in the Indonesia Stock Exchange Small-Medium Capitalization (IDX SMC) Liquid Index during 2020–2022, addressing the need to understand valuation determinants of small-medium cap stocks.

Research Methodology: This quantitative study uses purposive sampling of 21 companies consistently included in the index, yielding 63 firm-year observations. Profitability, liquidity, solvency, and activity are measured by Cash Return on Assets (CROA), Current Ratio (CR), Debt to Asset Ratio (DAR), and Total Asset Turnover Ratio (TATR), and financial distress by the Altman Z″-Score. The Chow test rejects the common effect model, while the Hausman and Lagrange Multiplier tests support the Random Effect Model as the final specification.

Results: Profitability and solvency are significantly and positively associated with stock prices, whereas financial distress, liquidity, and activity show no significant association. The insignificant effect of financial distress should not be read solely as evidence of financial safety, as it may also reflect the lower signaling power of distress indicators.

Conclusions: The findings support the applicability of signaling theory in the IDX SMC Liquid Index context, showing that financial indicators differ in signaling power. This constitutes preliminary evidence of differentiated signaling roles rather than a formal extension of the theory.

Limitations: Findings are based on 21 companies over three years, which limits generalizability.

Contributions: The study identifies stock price determinants in the under-researched IDX SMC Liquid Index, informing investors' portfolio selection and managers' assessment of financial indicators and market valuation.

Keywords: *Activity, Financial Distress, Liquidity, Profitability, Solvency*

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1. Introduction

The capital market plays a crucial role as a source of financing for businesses and an investment vehicle for the public. In Indonesia, the number of Single Investor Identification (SID) accounts

reached 12.17 million by the end of 2023 (KSEI, 2023), reflecting rising public participation supported by improved financial literacy, digital financial services, and easier access to investment platforms (Rohyati, Rokhmah, Syazeedah, Fitriyaningrum, Ramadhan, & Syahwildan, 2024). This growth has been accompanied by increasing market capitalization and Initial Public Offering (IPO) activity. Nevertheless, the Indonesian capital market remains vulnerable to external shocks, as the sharp decline of the Jakarta Composite Index (IHSG) during the COVID-19 crisis illustrates (Panjaitan & Novel, 2021).

Within this market, the IDX Small-Medium Capitalization (SMC) Liquid Index comprises highly liquid stocks with small and medium market capitalization. According to the IDX Stock Index Handbook, constituents are selected from the IDX SMC Composite based on liquidity criteria (transaction value, free-float market capitalization, and stock price) and other criteria, including financial performance, business continuity, and analyst coverage (IDX, 2021). The constituent list is reviewed every six months. The index is attractive for its growth potential, but its constituents also exhibit higher price volatility than blue-chip stocks. Baltussen, Swinkels, and Vliet (2021) document that small and medium-cap portfolios offer greater return potential than large-cap portfolios, a size premium observed across global markets. Lusindah and Sumirat (2021) back-tested a technical trading strategy on IDX SMC Liquid constituents from January 2018 to December 2020 and reported a return of about 164% over three years. That result reflects a specific trading rule rather than the return potential of the index as a whole. Such return opportunities also carry risk. Duong, Khanh, and Tran (2023) show that size-related return premia in emerging markets are concentrated in firms with higher default risk, and Asafo-Adjei, Adam, Idun, and Ametepi (2022) document that systematic risk dynamics amplify risk exposures for smaller firms. Given these characteristics, the index serves both as a reference for high-growth companies and as an indicator of investor risk appetite toward small and medium-cap segments.

The return potential of small and medium-cap stocks is accompanied by significant risks, of which financial distress is among the most critical. Financial distress denotes a condition of declining financial health that may lead to bankruptcy or liquidation (Hutabarat, 2021). Recent Indonesian cases illustrate its consequences for investors. The shares of PT Sri Rejeki Isman Tbk (SRIL) were suspended for more than 41 months before facing potential delisting, while PT Omni Inovasi Indonesia Tbk (TELE) recorded a negative equity position and was temporarily suspended from trading after delayed bond payments (MarketNews, 2022; PT, 2022; Noviani, 2024). Evidence from smaller construction firms indicates that leverage and cash flow are significant predictors of financial distress, underscoring the importance of early detection for investors and policymakers (Meiliana, Muslimin, & Dalimunthe, 2024).

Fundamental analysis is a common tool for assessing these risks. By examining financial statements, investors can identify strengths and weaknesses that are not yet reflected in market prices. Profitability ratios indicate a firm's ability to generate earnings, while liquidity and solvency ratios capture short-term financial flexibility and long-term financial risk (Riwayati, Markonah, & Sholeha, 2023). Akhtar (2021) further reports that fundamental ratios have significant predictive power for stock returns in emerging markets.

Prior empirical research on stock price determinants in Indonesia has largely focused on single sectors or single firms, including food and beverage, banking, transport and logistics, coal mining, and one listed company (Pratiwi, Miftahuddin, & Amelia, 2020; Sutopo, 2022; Simanjuntak, 2024; Kanjaya, & Muhammad, 2025; Fauziani, & Kosadi, 2024). Studies on the IDX SMC Liquid Index remain limited. Safaruddin, Amalia, Nasir, and Hismendi (2024) examined Debt-to-Equity Ratio (DER), Total Asset Turnover (TATO), Return on Equity (ROE), Earnings per Share (EPS), Book Value per Share (BVS), and firm size over 2018–2021. They found DER, TATO, EPS, and BVS to have significant positive effects, firm size a significant negative effect, and ROE an insignificant effect. Their framework does not include financial distress or liquidity, and its observation period ends in 2021. Based on the

literature reviewed in this study, no work on this index has jointly examined financial distress, profitability, liquidity, solvency, and activity. The gap therefore lies in the joint treatment of these dimensions within the index, rather than in the absence of research on the index altogether.

This study addresses this gap in three ways. First, it updates the evidence for the IDX SMC Liquid Index to 2020–2022, extending the window beyond the 2018–2021 period of the most closely related study. Second, it examines financial distress, measured by the Altman Z″-Score, together with profitability (CROA), liquidity (CR), solvency (DAR), and activity (TATR) in a single panel framework. This design allows the relative signaling roles of these indicators to be compared. Third, the study compares its findings with prior evidence on the same index. Relative to Safaruddin et al. (2024), it adds financial distress and liquidity, and it finds that profitability measured by CROA is significantly and positively associated with stock prices, whereas ROE was insignificant in that study.

Theoretically, the findings examine whether the signaling roles of financial indicators differ within this index, providing preliminary evidence on the applicability of signaling theory in this market segment. Practically, the results indicate which financial information is associated with stock prices among companies in the index, which may inform portfolio selection and corporate financial management. The sample of 21 firms over three years, however, limits generalizability.

Accordingly, this study examines the influence of financial distress, profitability, liquidity, solvency, and activity on the stock prices of companies in the IDX SMC Liquid Index during 2020–2022. It addresses five questions: whether each of these indicators has a significant effect on stock prices when examined simultaneously.

2. Literature Review and Hypotheses Development

2.1 Signalling Theory

Signaling theory, introduced by Spence (1973) and applied to corporate financing by Ross (1977) provides the main theoretical lens for explaining how financial information serves as a signal that reduces information asymmetry between managers and investors. The theory suggests that managers possess more comprehensive information about the firm's internal conditions and future prospects than external stakeholders. Therefore, firms communicate relevant information through financial statements and corporate disclosures so that investors can evaluate firm quality and future performance.

In capital markets, particularly among high-risk and high-volatility small–medium capitalization stocks, information asymmetry tends to be greater due to limited analyst coverage, lower transparency, and thinner trading volumes. Consequently, observable financial indicators become important signals for investors in assessing firm condition and future prospects. Financial performance indicators such as profitability and capital structure provide information that investors may use in evaluating company value and investment decisions (Salsa & Nugraha, 2022).

Profitability indicates management efficiency and the capacity to generate sustainable earnings and returns. Liquidity represents short-term financial flexibility and operational resilience, providing investors with confidence in the firm's ability to withstand cash flow disruptions. Solvency, measured by the Debt-to-Asset Ratio (DAR) in this study, describes the extent to which a firm's assets are financed by debt. Its signal is ambiguous. A higher DAR may indicate greater financial risk, including a higher probability of financial failure, whereas debt may also signal managers' confidence in future cash flows that can service obligations (Ross, 1977). A higher DAR therefore does not by itself indicate stronger financial stability. Financial distress, in contrast, represents a negative signal of increasing financial risk, potential bankruptcy, and possible declines in firm value (Budiman, 2023; Oktaviani & Sembiring, 2021).

In the context of small–medium capitalization firms, where uncertainty and perceived risk may be higher, these financial indicators may play a stronger signaling role, as investors rely more heavily on observable financial metrics to form expectations. Whether they do so, and whether their signaling

power differs, is an empirical question. Accordingly, profitability, solvency, liquidity, and financial distress are treated in this study as potential market signals whose association with stock prices is tested.

2.2 Stock Price of IDX SMC Liquid Index

Stocks remain a highly popular capital market instrument in Indonesia, offering potential returns through dividends and capital appreciation. To monitor market performance, the Indonesia Stock Exchange provides various indices, including the IDX SMC Liquid Index, which measures the price performance of highly liquid stocks with small and medium market capitalization (IDX, 2021). Its constituents are selected from the IDX SMC Composite based on liquidity criteria and other factors, and the list is reviewed every six months (IDX, 2021).

Empirical research on this index remains limited. Safaruddin et al. (2024) examined DER, TATO, ROE, EPS, Book Value per Share (BVS), and firm size for 2018–2021. They found DER, TATO, EPS, and BVS to have significant positive effects, firm size a significant negative effect, and ROE an insignificant effect. Studies on small and mid-cap stocks in Indonesia also suggest that their price dynamics are more sensitive to liquidity and capitalization risk than those of large-cap stocks (Riyadh, Wahyudi, & Fadli, 2024). In this study, stock price (Y) is measured as the base-10 logarithm of the closing price in rupiah on 31 December of each fiscal year. Because the dependent variable is in logarithmic form, a one-unit change in an explanatory variable is associated with a change of β in log10 price, which corresponds to a multiplicative change of 10^β in the price level.

2.3 Financial Distress

Financial hardship denotes a state of declining financial stability that precedes insolvency or liquidation, encompassing stages such as economic failure, business failure, technical insolvency, and legal bankruptcy (Altman, Iwanicz-Drozdowska, Laitinen, & Suvas, 2017). Brigham and Daves (2018) identify this state as a company's failure to fulfill its obligations or the forecast of negative cash flows. Recent studies indicate that in Indonesian firms, company size and operating cash flow significantly affect the likelihood of financial distress (Hasanah & Zenebia, 2025). Furthermore, Sumarni (2022) found that during the Covid-19 pandemic, numerous companies listed on the Indonesia Stock Exchange entered an early warning phase, in which financial distress served as a preliminary indicator of impending insolvency. This suggests that financial hardship serves as both a historical signal and an instrument for early warning and risk mitigation for management and investors.

In this study, financial distress is measured by the Altman Z''-Score, the version developed for non-manufacturing firms and emerging markets (Altman, Hartzell, & Peck, 1998): $Z'' = 3.25 + 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$, where X_1 is working capital to total assets, X_2 is retained earnings to total assets, X_3 is earnings before interest and taxes to total assets, and X_4 is book value of equity to total liabilities. Firms with Z'' above 2.60 are classified as safe, those between 1.10 and 2.60 as grey, and those below 1.10 as distressed.

2.4 Profitability Ratios

Recent empirical studies indicate that these ratios substantially influence financial performance and company valuation. Dewi and Albeta (2025) demonstrate that Return on Assets (ROA) and Return on Equity (ROE) positively influence stock returns in Indonesian infrastructure firms, indicating that profitability is a crucial determinant of investor returns. Marnilin (2023) further provides evidence that profitability indicators, particularly ROA and ROE, significantly influence stock prices among Indonesian food and beverage companies. These findings illustrate that profitability ratios serve not only as measures of current operational performance but also as important signals for investors in assessing firm quality and future prospects, particularly in emerging markets.

In this study, profitability is measured by Cash Return on Assets (CROA), defined as operating cash flow divided by total assets. Because CROA uses cash flow rather than accounting net income, it is less affected by accounting accruals than Return on Assets (ROA). The ROA-based studies

cited above therefore serve as evidence on profitability in general rather than as direct evidence on CROA.

2.5 Liquidity Ratios

Evidence on the relationship between liquidity and stock prices is mixed. Sutopo (2022) found that the liquidity ratio partially had no effect on stock prices of food and beverage sub-sector companies listed on the IDX for 2017–2021. Loya and Rahmawati (2022) reported an insignificant partial effect of liquidity for food and beverage companies over 2015–2019. Pratiwi, Miftahuddin, and Amelia (2020) found that the Current Ratio (CR) had no significant partial effect on the share price of PT Indofood Sukses Makmur Tbk for 2009–2018, although CR, DER, and EPS jointly had a significant effect. Sihombing and Zakchona (2024) found that the current ratio did not affect stock prices of companies in the JII index. In contrast, Nurasiah, Permata, and Auliana (2023) reported that liquidity has a significant effect on stock prices of food and beverage companies. These mixed results suggest that the effect of liquidity may depend on sector, sample period, and measurement.

Liquidity is also linked to operating performance. Wati, Violinda, and Amelia (2024) report that CR positively influences ROA in telecommunications companies listed on the IDX. Adib, Hartono, and Verlandes (2024) report that the current ratio and quick ratio affect ROA in a single listed company (PT Suparma Tbk). Rahmi, Simanjorang, and Pasaribu (2024) examine the effect of liquidity and solvency ratios on financial performance.

2.6 Solvency Ratios

Solvency ratios indicate how well a firm can meet its long-term obligations. In this study, solvency is measured by the Debt-to-Asset Ratio (DAR). Empirical evidence from recent Indonesian studies supports the relevance of leverage in explaining stock returns and prices. Cahyani and Imronudin (2025) report a significant positive effect of leverage on stock returns in consumer non-cyclical companies, and Winata and Ekadjaja (2025) find that leverage significantly influences stock price volatility in consumption goods companies. Annisa and Amalia (2025) report that a high debt-to-equity ratio negatively affects firm value in construction companies, and Hamidah and Nurhayati (2025) report that a higher DER is associated with stock returns. This divergence across sectors underscores the importance of industry context.

The interpretation of DAR depends on how investors process debt. Under signaling theory, debt may signal managers' confidence in future cash flows, which may raise investor expectations and support stock prices (Ross, 1977). From a risk perspective, however, a higher DAR increases default risk, reduces financial flexibility, and may lower investor expectations of future returns. Given these competing channels, the sign of the association between DAR and stock prices is an empirical question.

2.7 Activity Ratios

Activity ratios measure how efficiently a firm uses its assets to generate sales. In this study, activity is measured by the Total Asset Turnover Ratio (TATR), defined as net sales divided by total assets. Evidence is mixed. Fatmasari, Said, and Suparmoko (2025) report a positive association between total asset turnover and stock prices, whereas Sihombing and Zakchona (2024) found that TATO had a negative and significant effect on stock prices in the JII index. Fauziani and Kosadi (2024) report that TATO, together with solvency and return on assets, substantially affects stock prices of coal mining firms during 2016–2023.

2.8 Hypothesis Development

Based on the above, the following hypotheses are proposed:

- H_1: Financial distress (Z″-Score) has a negative effect on stock prices
- H_2: Profitability (CROA) has a positive effect on stock prices
- H_3: Liquidity (CR) has a significant effect on stock prices. The direction is not specified because the evidence is mixed

H₄: Solvency (DAR) has a significant effect on stock prices. The direction is not specified, given the competing signaling and risk channels

H₅: Activity (TATR) has a significant effect on stock prices. The direction is not specified because the evidence is mixed

3. Research Methodology

3.1 Research Design

This study adopts a quantitative descriptive–verificative design using secondary data. Panel data regression is employed to examine the effects of financial distress, profitability, liquidity, solvency, and activity on stock prices.

3.2 Population, Sample, and Observation Period

The population consists of companies constituting the IDX Small-Medium Capitalization (SMC) Liquid Index. According to the IDX Stock Index Handbook (IDX, 2021), constituents are selected from the IDX SMC Composite on the basis of liquidity criteria (transaction value in the regular market, free-float market capitalization, and stock price) and other criteria (financial performance, business continuity, and analyst coverage). The index is reviewed semiannually in January and July, with changes effective in February and August. A purposive sample of 21 companies consistently included in the index over 2020–2022 was selected. The observation period covers fiscal years 2020, 2021, and 2022, yielding 63 firm-year observations.

3.3 Data Sources

Financial data were obtained from audited annual financial statements published on the Indonesia Stock Exchange (IDX) website. Closing stock prices on 31 December of each fiscal year were obtained from the IDX market summary (Ringkasan Saham). Year-end prices are used so that market valuation refers to the same fiscal year as the financial statements. Because annual reports are published after the fiscal year-end, year-end prices may precede the release of some information; this timing choice is noted among the limitations.

3.4 Variables and Operational Definitions

Table 1. Variables and operational definitions

No	Variable	Operational definition	Symbol	Hypothesis
1	Stock price	Base-10 logarithm of the closing price (IDR) on 31 December	Y	Dependent variable
2	Financial distress	Altman Z″-Score (components X1–X4 defined in Section 3.4)	Z-Score	H_1: negative effect
3	Profitability	Operating cash flow divided by total assets	CROA	H_2: positive effect
4	Liquidity	Current assets divided by current liabilities	CR	H_3: significant effect
5	Solvency	Total liabilities divided by total assets	DAR	H_4: significant effect
6	Activity	Net sales divided by total assets	TATR	H_5: significant effect

Table 1 summarizes the variables and their operational definitions. The components of the Z''-Score are X_1 = working capital/total assets, X_2 = retained earnings/total assets, X_3 = earnings before interest and taxes/total assets, and X_4 = book value of equity/total liabilities. Firms with Z'' above 2.60 are classified as safe, those between 1.10 and 2.60 as grey, and those below 1.10 as distressed (Altman et al., 1998). All balance-sheet ratios use year-end values.

3.5 Panel Regression Model

The model is specified as:

$$Y_{it} = \beta_0 + \beta_1 Z\text{-Score}_{it} + \beta_2 CROA_{it} + \beta_3 CR_{it} + \beta_4 DAR_{it} + \beta_5 TATR_{it} + \mu_i + \varepsilon_{it} \quad (1)$$

where *i* denotes firms (*i* = 1, …, 21), t denotes years (2020, 2021, 2022), *μ_i* captures unobserved firm-specific effects, and *e_it* is the idiosyncratic error term. Equation (1) is estimated using the common effect, fixed effect, and random effect specifications.

3.6 Model Selection

Model selection follows three tests. The Chow (1960) test compares the fixed effect model with the common effect model; a significant result favors the fixed effect model. The Lagrange multiplier Breusch and Pagan (1980) test compares the random effect model with the common effect model; a significant result favors the random effect model. The Hausman (2015) test compares the fixed and random effect models. Its null hypothesis is that firm-specific effects are uncorrelated with the regressors, under which the random effect estimator is consistent and efficient; a non-significant result favors the random effect model. The random effect model is selected as the final specification when the Hausman test does not reject its null hypothesis and the LM test favors the random effect model over the common effect model. Conceptually, the random effect model is appropriate only if firm-specific effects are uncorrelated with the explanatory variables. This assumption is therefore tested rather than presumed. The test results are reported in Section 4.1.

3.7 Hypothesis Testing

The partial effects in H_1–H_5 are assessed with t-tests at the 5% significance level. The joint significance of the regressors is assessed with the *F*-test. The explanatory power of the model is reported by R^2 and adjusted R^2.

4. Results and Discussions

The discussion extends beyond the statistical significance of the estimates by interpreting the findings through financial theory, signaling theory, and prior empirical evidence. The positive and significant impact of profitability suggests that earnings success acts as a positive indicator for investors. Signaling theory posits that higher profitability reduces information asymmetry by signaling managerial efficacy and sustainable cash flow generation (Spence, 1973). Investors may therefore rely more on observable accounting metrics, such as profitability, when forming valuation expectations. This finding is consistent with prior evidence that earnings-based metrics are associated with stock prices (Safaruddin et al., 2024). Whether the association is stronger in smaller and riskier firms was not tested.

Second, solvency, measured by the Debt-to-Asset Ratio (DAR), has a positive and significant association with stock prices (coefficient = 0.2194, p = 0.0138). This positive coefficient indicates a positive association between leverage and stock prices in the sample. It does not necessarily reflect stronger financial stability. A higher DAR means that a larger share of assets is financed by debt, which increases default risk. Under signaling theory, the positive association may reflect investors' interpretation of debt as a signal of managers' confidence in future cash flows that can service obligations (Ross, 1977). This interpretation is consistent with the data but is not tested directly in this study.

Third, liquidity shows a negative but statistically insignificant association with stock prices (coefficient = −0.0421, p = 0.1971), so H_3 is not supported. The negative sign should not be interpreted as evidence that investors disfavor liquidity. Under signaling theory, the current ratio may be treated as a routine working-capital measure rather than a valuation-relevant signal (Spence, 1973). The result is consistent with prior studies that find no significant partial effect of liquidity on stock prices (Pratiwi et al., 2020; Sutopo, 2022).

Finally, financial distress, measured by the Z″-Score, has a negative but statistically insignificant association with stock prices (coefficient = −0.0021, p = 0.9074). The sign is consistent with H_1, but the relationship is not statistically significant, so H_1 is not supported. Signaling theory predicts that

distress indicators function as negative signals (Spence, 1973). The absence of a significant effect therefore suggests that, in this sample, the *Z″*-Score does not reliably relate to stock prices. Possible explanations are discussed in Section 4.2.

4.1 Results

4.1.1 Descriptive Analysis of Research Variables

Table 2. Descriptive statistics of IDX SMC liquid index stocks

	Y (log10)	Z″-Score	CROA	CR	DAR	TATR
Mean	3.09	8.61	0.134	2.48	0.77	0.47
Median	3.00	7.50	0.09	1.87	0.43	0.50
Maximum	4.59	18.00	0.64	8.01	3.85	0.91
Minimum	2.18	3.00	-0.04	0.37	0.11	0.11
Std. Deviation	0.48	3.68	0.13	1.79	0.78	0.23

Table 2 reports descriptive statistics for the 63 firm-year observations. The dependent variable is the base-10 logarithm of the closing stock price, with a mean of 3.09 and a median of 3.00. The median and mean correspond to prices of about Rp1,000 and Rp1,230, respectively. Among the explanatory variables, financial distress (*Z″*-Score) has the largest absolute dispersion (SD = 3.68), while profitability (CROA) has the smallest (SD = 0.13). Because the variables are measured on different scales, these standard deviations are not directly comparable. Every observation has a *Z″*-Score above 2.60 (minimum = 3.00), so no firm falls in the grey or distress zone.

4.1.2 Panel Data Regression Estimation

Table 3. Chow test result

Effects Test	Statistic	d.f.	Prob.
Cross-section F	45.313341	(20,37)	0.0000
Cross-section Chi-square	204.021170	20	0.0000

Based on Table 3, the Chow test compares the common effect model with the fixed effect model. The cross-section *F*-statistic is 45.31 (df = 20, 37) with $p = 0.0000$, so the common effect model is rejected in favor of the fixed effect model.

Table 4. Hausman test result

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	6.370212	5	0.2718

Based on Table 4, the Hausman test compares the fixed and random effect models. The chi-square statistic is 6.37 (df = 5) with $p = 0.2718$. Because p exceeds 0.05, the null hypothesis that firm-specific effects are uncorrelated with the regressors is not rejected, and the random effect estimator is consistent and efficient.

4.1.3 Lagrange Multiplier Test

Table 5. Lagrange multiplier test result

	Test Hypothesis	Test Hypothesis	Test Hypothesis
Breusch-Pagan	Cross-section	Time	Both
	49.36999	1.556716	50.92671
	(0.0000)	(0.2121)	(0.0000)

Based on Table 5, the Lagrange multiplier test compares the random effect model with the common effect model. The cross-section statistic is 49.37 ($p = 0.0000$), so the random effect model is preferred over the common effect model. The time-effect statistic is 1.56 ($p = 0.2121$), so time effects are not significant. The final specification therefore includes firm-specific effects only, estimated with the random effect model.

4.1.4 Classical Assumption Test Analysis

4.1.4.1 Normality Test

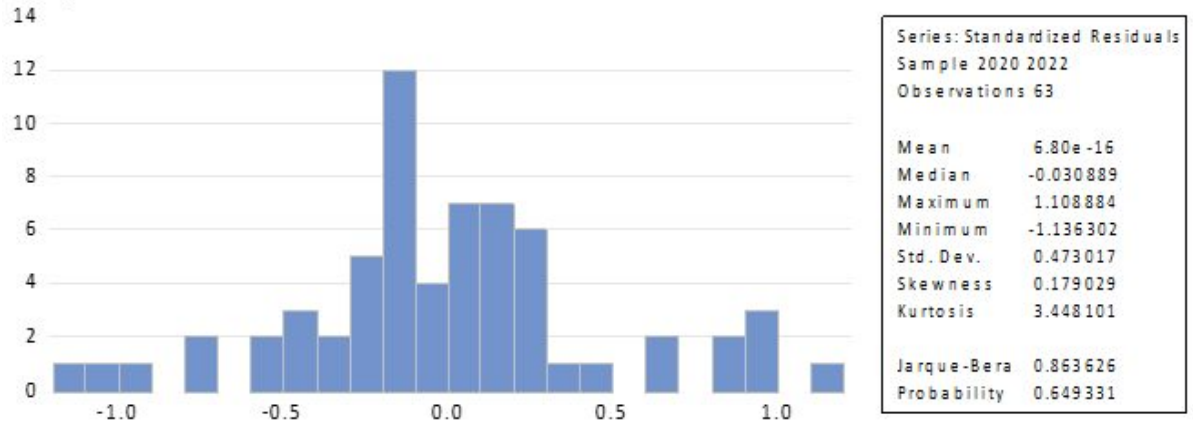


Figure 1. Jarque-Bera test result

As shown in Figure 1, the Jarque–Bera test gives $p = 0.649$, which exceeds 0.05. The null hypothesis of normally distributed residuals is therefore not rejected.

4.1.4.2 Autocorrelation Test

Table 6. Durbin watson test result

Statistics	Value	Conclusion
Durbin-Watson stat	1.818787	No Autocorrelation

Based on Table 6, the Durbin–Watson statistic is 1.82. Using the critical bounds $d_U = 1.7675$ and $4 - d_U = 2.2325$, the statistic falls within the no-autocorrelation region ($1.7675 < 1.8188 < 2.2325$).

4.1.4.3 Multicollinearity Test

Table 7. Variance Inflation Factor (VIF) Test Result

No	Variable	VIF	Significance Value	Conclusion
1	Financial distress (Z″-Score)	6.062	10	No multicollinearity
2	Profitability (CROA)	1.232	10	No multicollinearity
3	Liquidity (CR)	3.968	10	No multicollinearity
4	Solvency (DAR)	1.096	10	No multicollinearity
5	Activity (TATR)	5.341	10	No multicollinearity

As presented in Table 7, all independent variables have VIF values well below the threshold of 10, ranging from 1.096 (solvency) to 6.062 (financial distress). Multicollinearity is therefore not a concern for this model.

4.1.5 Hypothesis Testing

4.1.5.1 Panel Data Regression

$$Y_{it} = 2.9007 - 0.0021Z\text{-Score}_{it} + 0.7205CROA_{it} - 0.0421CR_{it} + 0.2194DAR_{it} + 0.0961TATR_{it} + \mu_i + e_{it} \quad (2)$$

The Random Effect Model (REM) is the best model based on the findings of the panel data regression analysis. The investigation gave us the following regression equation (2).

4.1.5.2 Partial Test (t-Test)

Table 8. Partial test results (random effect model)

Variables	Coefficient	Std. Error	t	p-value
Constant	2.900704	0.341171	8.502194	0.0000

Variables	Coefficient	Std. Error	t	p-value
Financial distress (Z″-Score)	-0.002125	0.018195	-0.116783	0.9074
Profitability (CROA)	0.720506	0.191943	3.753746	0.0004
Liquidity (CR)	-0.042083	0.032244	-1.305139	0.1971
Solvency (DAR)	0.219400	0.086358	2.540584	0.0138
Activity (TATR)	0.096059	0.436636	0.219999	0.8267
Effects Specification				
			S.D.	Rho
Cross-section random			0.474213	0.9490
Idiosyncratic random			0.109945	0.0510
Weighted Statistics				
R-squared	0.403562	Mean dependent var		0.410030
Adjusted R-squared	0.351243	S.D. dependent var		0.138132
S.E. of regression	0.111259	Sum squared resid		0.705575
F-statistic	7.713464	Durbin-Watson star		1.818787
Prob(F-statistic)	0.000014			

The estimated regression equation derived from the Random Effect Model (REM) is presented in Equation (3), illustrating the relationship between financial distress, profitability, liquidity, solvency, activity, and stock prices.

$$Y = 2{,}9 - 0{,}002125X_1 + 0{,}720506X_2 - 0{,}042083X_3 + 0{,}2194X_4 + 0{,}096059X_{5it} + \mu_i + e_{it} \quad (3)$$

Based on the partial test results in Table 8, profitability (CROA) has a positive and significant effect on stock prices (coefficient = 0.7205, t = 3.75, p = 0.0004), supporting H_2. Solvency (DAR) has a positive and significant effect (coefficient = 0.2194, t = 2.54, p = 0.0138). H_4 was formulated without a predicted direction, so the test supports the significance of the effect, and the positive sign describes its direction. Financial distress (Z″-Score) has a negative but insignificant coefficient (−0.0021, t = −0.12, p = 0.9074), so H_1 is not supported. Liquidity (CR) (coefficient = −0.0421, t = −1.31, p = 0.1971) and activity (TATR) (coefficient = 0.0961, t = 0.22, p = 0.8267) are not significant, so H_3 and H_5 are not supported. The F-statistic of 7.71 (p = 0.000014) indicates that the regressors are jointly significant

4.1.5.3 Coefficient of Determination (R^2) Test
Table 9. Results of the coefficient of determination test

Statistics	Value
R-squared	0.403562
Adjusted R-squared	0.351243

Based on Table 9, the R^2 is 0.4036 and the adjusted R^2 is 0.3512. The adjusted R^2 indicates that the five variables explain about 35% of the variation in the log stock price among sample firms. The remaining variation is attributed to factors outside the model.

4.2 Discussion

The results indicate that the financial indicators differ in their association with stock prices. Profitability (CROA) and solvency (DAR) have significant positive coefficients, whereas financial distress (Z″-Score), liquidity (CR), and activity (TATR) show no significant association. Within a signaling framework, this pattern is consistent with differentiated signaling power among financial indicators in this sample. The discussion below relates each result to the reported

statistics and prior evidence. Mechanisms that were not tested directly are presented as possible explanations.

Several possible explanations for the insignificant effect of financial distress are not tested in this study. First, investor risk tolerance may matter. Small and medium-cap stocks may attract investors who accept elevated risk in exchange for higher expected returns, and for such investors, signs of financial weakness may not necessarily trigger negative price reactions. This explanation is plausible, but the study does not measure investor risk tolerance. Second, information dissemination may matter. Where analyst coverage is limited, distress information may be incorporated into prices with a delay. The study does not measure analyst coverage or the speed of information incorporation. Third, speculative trading may shift investor attention toward short-term momentum and growth prospects. The study does not measure trading activity or momentum, so this remains a potential explanation rather than a demonstrated result.

4.2.1 The Impact of Financial Distress on the IDX SMC Liquid Index's Stock Prices

Financial distress, measured by the Z″-Score, has a negative but statistically insignificant coefficient (−0.0021, p = 0.9074), so H_1 is not supported. The Z″ classification uses thresholds of 2.60 (safe), 1.10–2.60 (grey), and below 1.10 (distress) (Altman et al., 1998). In this sample, all firm-years have Z″ values above 2.60 (minimum 3.00, median 7.50, maximum 18.00; Table 2), so no observation falls in the grey or distress zone. This classification alone does not explain the insignificant coefficient. The Z″-Score still varies within the safe zone (SD = 3.68), so the absence of a relationship is not due to the absence of variation. A high Z″ indicates a lower modeled probability of distress, not a guarantee of financial soundness.

From a signaling perspective, distress indicators affect prices when investors perceive them as credible and value-relevant (Ross, 1977; Spence, 1973). Because all sample observations fall in the safe zone, the distress signal varies only within a range in which investors may not respond strongly. This explanation is consistent with the data but was not tested directly, for example by comparing firms with lower and higher Z″ values within the safe zone. Prasetianto, Rinofah, and Kusumawardhani (2022), report that the effect of the Altman Z-score on stock prices differed around the COVID-19 pandemic, which suggests that the relationship may depend on market conditions. Taken together, the insignificant coefficient is consistent with lower signaling power of financial distress indicators in this sample, but the specific mechanisms remain untested.

4.2.2 The Impact of Profitability on the IDX SMC Liquid Index's Stock Prices

Profitability, measured by CROA, has a positive and significant coefficient (0.7205, t = 3.75, p = 0.0004), supporting H_2. Under signaling theory, higher cash-based profitability is a credible signal of managerial efficiency and cash-generating capacity, which may reduce information asymmetry and support investor expectations (Spence, 1973). This result is partly consistent with Safaruddin et al. (2024), who report significant positive effects for EPS and BVS in the same index, and it differs from their finding that ROE is insignificant. The difference may reflect how profitability is measured, since CROA uses operating cash flow whereas ROE uses accounting net income. This explanation was not tested directly. The positive profitability effects reported by Cahyani and Imronudin (2025) and Dewi and Albeta (2025) are consistent with this result. Whether the effect is stronger for smaller firms than for larger firms was not tested.

4.2.3 How the Liquidity Ratio Affects the IDX SMC Liquid Index's Stock Prices

Liquidity, measured by the current ratio, has a negative but statistically insignificant coefficient (−0.0421, t = −1.31, p = 0.1971), so H_3 is not supported. The negative sign should not be read as evidence that investors disfavor liquidity, because the coefficient is not distinguishable from zero. Under signaling theory, the current ratio is an observable indicator of short-term solvency. However, investors may treat it as a routine working-capital measure rather than a valuation-relevant signal, especially when it reflects temporary working-capital conditions rather than long-term growth prospects (Spence, 1973). Higher liquidity may also reflect idle resources if assets are not deployed productively. This is one possible explanation and was not tested. Sectoral differences in

working-capital needs may also matter. According to the IDX Stock Index Handbook, the index is sector-diverse, with basic materials (30.3%), infrastructure (16.4%), and energy (12.6%) accounting for the largest shares of weight as of January 2021 (IDX, 2021).

The insignificant result is consistent with Sutopo (2022), Pratiwi et al. (2020), Loya and Rahmawati (2022), and Sihombing and Zakchona (2024), who report no significant partial effect of liquidity. Pratiwi et al. (2020) also report that CR, DER, and EPS jointly have a significant effect, so the insignificant partial effect does not rule out a combined role. Nurasiah et al. (2023) report a significant effect of liquidity for food and beverage companies. This contrast suggests that the relationship may depend on sector, period, and measurement, and it cannot be resolved by the present sample.

4.2.4 The Impact of Solvency Ratio on IDX SMC Liquid Index Stock Prices

Solvency, measured by DAR, has a positive and significant coefficient (0.2194, $t = 2.54$, $p = 0.0138$). H_4 is supported in terms of significance, and the positive sign indicates a positive association between leverage and stock prices in this sample. The result does not establish that higher leverage reflects stronger financial stability. A higher DAR means that a larger share of assets is financed by debt, which increases default risk. The positive association is consistent with a signaling interpretation in which debt reflects managers' confidence in future cash flows (Ross, 1977). This interpretation was not tested directly.

One possible explanation is that firms use debt to finance expansion, and that low borrowing costs made this option more attractive during part of the sample period. Bank Indonesia kept the BI 7-Day Reverse Repo Rate at 3.50% from February 2021 until July 2022 and raised it for the first time on 23 August 2022 (Maria, 2022; Pink, 2022). The low-rate period therefore overlaps with the pandemic and most of the study window. This context is consistent with the explanation, but it does not show that firms used debt for expansion or that expansion increased stock prices. Testing this mechanism would require firm-level data on investment and debt use, which this study does not provide. Firm life-cycle stage, which is also a potential explanation, was not measured.

The positive association is consistent with Cahyani and Imronudin (2025) and Rusnani, Romdioni, and Ilham (2025), who report positive relationships between leverage or debt ratios and stock returns or prices. Kanjaya and Muhammad (2025), by contrast, report a negative and significant effect of solvency on prices in the transport and logistics sector. The difference may reflect sector composition and firm life-cycle stage, which were not measured in this study. The evidence therefore supports a consistent positive association with some prior studies, but the underlying mechanism remains a tentative interpretation that requires further research.

4.2.5 The Activity Ratio's Impact on the IDX SMC Liquid Index's Stock Prices

Activity, measured by TATR (net sales divided by total assets), has a positive but statistically insignificant coefficient (0.0961, $t = 0.22$, $p = 0.8267$), so H_5 is not supported. Because the coefficient is not significant, the study cannot conclude that asset turnover affects stock prices in this sample. Two possible explanations are sector heterogeneity and intangible-asset intensity. TATR depends on total assets, and sectors differ in asset intensity. The index's largest sectors by weight (basic materials, infrastructure, and energy as of January 2021) have different asset structures, so a single TATR coefficient may average across sectors with different relationships. Firms with substantial intangible assets may also report lower measured asset turnover. Neither mechanism was tested, because sector-level and intangible-asset data were not included in the model.

The insignificant result is consistent with Simanjuntak (2024), who reports a positive but insignificant effect of asset turnover for banking companies. It contrasts with Sihombing and Zakchona (2024), who find a negative and significant effect of TATO in the JII index, and with Fatmasari et al. (2025), who report a positive association. The mixed evidence suggests that the sign and significance of activity may depend on sector and sample.

Overall, the pattern of significant profitability and solvency coefficients, alongside insignificant distress, liquidity, and activity coefficients, is consistent with differentiated signaling power among financial indicators in this sample. The study does not directly measure investor perceptions, information frictions, or risk preferences, so the mechanisms discussed above remain interpretations. Future research could test them using measures of analyst coverage, trading activity, and investor composition.

5. Conclusions

5.1 Conclusion

This study examined whether financial distress, profitability, liquidity, solvency, and activity are associated with the stock prices of companies in the IDX SMC Liquid Index during 2020–2022. Using a random effect panel model with 21 firms and 63 firm-year observations, the study finds that profitability, measured by Cash Return on Assets (CROA), and solvency, measured by the Debt-to-Asset Ratio (DAR), have significant positive associations with stock prices (p = 0.0004 and p = 0.0138, respectively). Financial distress, measured by the Altman Z″-Score, has a negative but statistically insignificant association (p = 0.9074). Liquidity, measured by the current ratio, has a negative but insignificant association (p = 0.1971), and activity, measured by total asset turnover, has a positive but insignificant association (p = 0.8267). The model is jointly significant (p = 0.000014), and the explanatory variables account for about 35% of the variation in the log stock price (adjusted R^2 = 0.3512). In terms of the hypotheses, H_2 and H_4 are supported in terms of significance, whereas H_1, H_3, and H_5 are not supported.

Theoretically, the findings support the applicability of signaling theory in the IDX SMC Liquid Index context. The indicators differ in their association with stock prices: profitability and solvency are significantly associated with prices, whereas financial distress, liquidity, and activity are not. This provides preliminary evidence of differentiated signaling roles among financial indicators, rather than a formal extension of signaling theory. The study does not test signaling mechanisms directly, such as information asymmetry or investor perceptions.

Practically, the results indicate which financial indicators are associated with stock prices among companies in this index. For investors and portfolio managers, the findings suggest that profitability and solvency are related to market valuation in this sample. For corporate managers, the findings suggest that profitability and debt structure are related to market valuation. The results are associational. They do not establish causality, and they do not show that changes in these indicators would alter stock prices.

5.2 Research Limitations

The findings should be interpreted with several limitations in mind. First, the sample consists of 21 companies, yielding 63 firm-year observations. This limits the statistical power of the tests and the precision of the estimates. Second, the three-year observation period (2020–2022) includes the COVID-19 pandemic and the subsequent changes in the policy rate. The results may therefore reflect market conditions specific to this period and may not extend to other periods. Third, no observation falls in the grey or distress zone of the Z″-Score; the minimum is 3.00, above the safe-zone threshold of 2.60. The study therefore cannot assess how more severe financial distress relates to stock prices. Fourth, the findings depend on measurement choices, including the Z″-Score variant, the use of year-end closing prices (which may precede the release of annual reports), and the definition of CROA with year-end total assets. Different choices could change the estimates. Fifth, the model includes five financial variables and no control variables for firm size, sector, macroeconomic conditions, market sentiment, or corporate governance, so the estimated associations may be affected by omitted factors. Finally, the random effect estimator assumes that firm-specific effects are uncorrelated with the explanatory variables. The Hausman test supports this assumption, but the assumption cannot be verified with certainty.

5.3 Suggestions and Directions for Future Research

Future studies may extend the observation period beyond 2022 and expand the sample to include firms from the broader IDX SMC Composite. This would provide greater variation in financial distress, including firms in the grey and distress zones, and would allow a comparison with the IDX SMC Liquid Index. Including control variables for firm size, sector, and macroeconomic conditions would help isolate the associations examined here. Researchers may also compare alternative Altman Z-Score variants and test whether the results are robust to alternative definitions of stock price, such as average annual prices. Future studies could also test the mechanisms discussed in Section 4.2, such as investor risk tolerance, analyst coverage, and trading activity, using direct measures.

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Author Contributions

YH contributed to the conceptualization, formal analysis, methodology, investigation, project administration, manuscript writing, and manuscript review and editing. DH contributed to the methodology, investigation, project administration, validation, visualization, manuscript writing, and manuscript review and editing. HAB contributed to the formal analysis, methodology, investigation, project administration, validation, visualization, manuscript writing, and manuscript review and editing.

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