

LEVERAGE, LIQUIDITY AND PROFIT GROWTH: EVIDENCE FROM INDONESIA

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Abstract. The profit growth attracts the attention of shareholders in the capital market, and lenders are willing to lend money. For suppliers, this growth ensures that the companies can buy the materials. Based on the theoretical issue, this study aims to examine the impact of leverage and liquidity on the profit growth. All the food and beverage enterprises listed in the Indonesian capital market from 2015 to 2023 are employed as the samples, with a total of fourteen. Furthermore, this investigation utilizes the secondary data modeled by regression to prove these two relationships. After processing the data, this investigation concludes that the more leveraged the firms, the higher their profit growth. Similarly, this positive tendency occurs in the relationship between liquidity and profit growth: the more liquid the companies, the higher their growth. Based on these pieces of evidence, this study suggests that managers utilize debt to enhance profits by considering the tax shield as a benefit for debt application. Additionally, the managers should utilize the excess liquidity to purchase materials at a discounted price from the supplier, thereby increasing this growth.

Keywords: *food and beverage enterprises, leverage, liquidity, profit growth*

Introduction

The food and beverage industry is a key sector in Indonesia. According to data from the Central Statistics Agency in Indonesia, a decreasing exponential trend in domestic gross product (GDP) growth was observed from 2015 to 2023 (*Figure 1*). The growth rates in 2015, 2016, 2017, 2018, and 2019 were 7.54%, 8.33%, 9.23%, 7.91%, and 7.79%, respectively. Due to the impact of the COVID-19 pandemic on the Indonesian economy at the beginning of 2020, the growth rate decreased to 1.58% by the end of the year. Then, this growth increased to 4.9% in 2022 and then reduced to 4.47% in 2023. Although this decreasing tendency, this sector remains attractive because it serves basic social needs and creates jobs to reduce unemployment (Ananda et al., 2024). Additionally, the growth in profits reflects the prospects in the capital market (Natalia et al., 2021), and it attracts the attention of public shareholders to buy or sell stocks and creditors to borrow money (Njotoprajitno et al., 2022). The studies investigating the determinants of profit growth are numerous. At least, they identify the leverage and liquidity as its related factors. Unfortunately, their result related to the association between leverage and this growth is not consistent. In their investigation, Siswanto et al. (2022) and Renaldo et al. (2024) document a positive sign. However, Nasution et al. (2024) declare a negative mark. Meanwhile, Simorangkir et al. (2021), Pulungan et al. (2023), and Arigita and Aprilyanti (2024) document an inconsequential tendency.

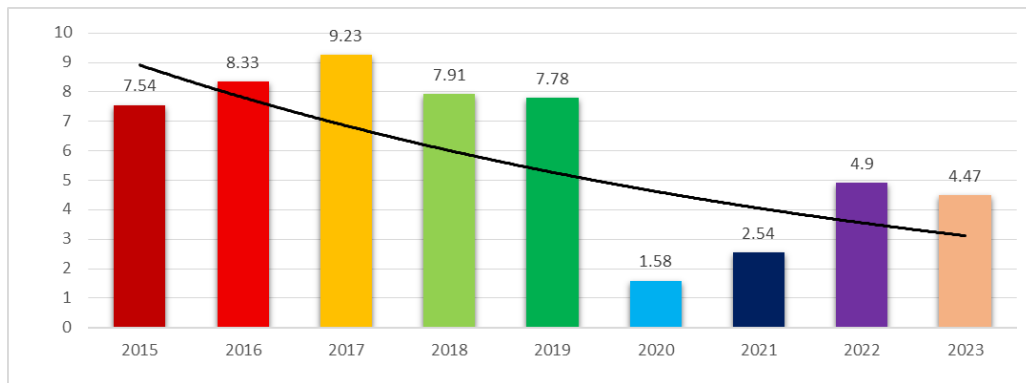


Figure 1. The Indonesian GDP Growth in the Food and Beverage Industry from 2015 to 2023.

Similarly, the inconsistent results exist when scholars investigate the relationship between liquidity and profit growth. They depict that liquidity can affect profit growth both positively (Renaldo et al., 2024; Chika et al., 2022; Petra et al., 2020) and negatively (Putri and Sitohang, 2019). However, Arigita and Aprilyanti (2024), Nasution et al. (2024), Pulungan et al. (2023), and Simorangkir et al. (2021) document a tendency towards valuelessness. Based on the situations explained above, this research intends to prove and analyze the impact of leverage and liquidity on the earnings growth of the food and beverage companies in Indonesia by employing nine years as time observations. This circumstance differs from scholars who use shorter periods, like six years from 2016 to 2021 (Renaldo et al., 2024; Chika et al., 2022), five years between 2014 and 2018 (Petra et al., 2020) and between 2017 and 2021 (Nasution et al., 2024; Pulungan et al., 2023), four years from 2016 to 2019 (Siswanto et al., 2022) and from 2019 to 2022 (Arigita and Aprilyanti, 2024), and three years between 2017 and 2019 (Simorangkir et al., 2021).

Leverage is an important financial consideration because the use of debt may provide benefits as well as financial consequences for companies. Based on the static trade-off theory, debt can provide a tax shield when it is managed effectively, which may eventually support earnings growth (Brealey et al., 2020). Empirical evidence, however, remains mixed. Renaldo et al. (2024) and Siswanto et al. (2022) document a positive relationship between leverage and profit growth, whereas Nasution et al. (2024) reports a negative relationship. These different findings indicate that the effect of leverage on profit growth may depend on how effectively companies employ and manage their debt. The reference to Brealey et al. (2020) is also used in the manuscript's theoretical discussion of the tax-shield benefit of debt. Liquidity is also relevant because it reflects the ability of firms to manage their current assets and current liabilities effectively (Gitman and Zutter, 2015). Adequate liquidity can provide companies with greater flexibility in financing operational activities and acquiring materials from suppliers. Njotoprajitno et al. (2022) explain that firms can utilize cash to obtain supplier discounts, while Chika et al. (2022), Petra et al. (2020), and Renaldo et al. (2024) provide evidence of a positive relationship between liquidity and profit growth. Nevertheless, the existence of negative and insignificant findings in previous studies suggests that higher liquidity does not automatically result in higher profit growth. These concepts and empirical findings are likewise used in the manuscript's literature review.

Therefore, examining leverage and liquidity simultaneously is important for understanding the financial determinants of profit growth in Indonesian food and beverage companies. The contradictory findings from previous studies create an empirical gap that requires further investigation over a longer observation period. By employing observations from 2015 to 2023, this research covers conditions before, during, and after the COVID-19 disruption reflected in the industry's GDP growth pattern. Consequently, the longer observation period is expected to provide broader evidence concerning whether leverage and liquidity consistently explain profit growth among food and beverage companies in the Indonesian capital market.

Literature review

Leverage and earnings growth

According to the static trade-off theory, debt is a funding source with two consequences. The first is the tax shield in the form of benefits. A tax shield occurs when a firm can effectively manage its debt, resulting in earnings growth (Brealey et al., 2020). In their research, Siswanto et al. (2022) and Renaldo et al. (2024) depict a relationship between leverage and profit growth. The second is the cost of the financial distress. When a company reaches this stage, it is unable to meet its promises to creditors due to financial difficulties (Brealey et al., 2020). Indeed, when this situation arises, leverage will negatively affect profit growth, as affirmed by Nasution et al. (2024). Based on the tax benefits of the static trade-off theory, this study formulates: The relationship between leverage and profit growth can therefore be understood from the balance between the benefits and costs associated with debt financing. On the one hand, the tax shield provides an opportunity for firms to reduce the effective cost of financing and consequently improve their earnings. On the other hand, excessive reliance on debt can increase financial obligations and expose firms to financial distress. This theoretical consideration explains why the effective management of debt becomes important in determining whether leverage contributes positively or negatively to profit growth (Brealey et al., 2020). Empirical studies also provide different evidence concerning the relationship between leverage and profit growth. Renaldo et al. (2024) and Siswanto et al. (2022) provide evidence supporting a positive relationship, indicating that the effective use of debt can contribute to an increase in company earnings. In contrast, Nasution et al. (2024) document a negative relationship between leverage and earnings growth. These different findings demonstrate that the influence of leverage on profit growth remains an empirical issue requiring further investigation (Renaldo et al., 2024; Nasution et al., 2024; Siswanto et al., 2022).

H1: Leverage positively affects profit growth

Liquidity and earnings growth

Firm liquidity demonstrates its capability to manage current assets and liabilities well (Gitman and Zutter, 2015). The firms can use cash to obtain discounts from suppliers, thereby acquiring a wide range of materials at a lower price. If they recognize this condition, they can sell the goods at a normal price but at a lower cost, leading to increased earnings (Njotoprajitno et al., 2022). Employing pharmaceutical companies in Nigeria, Chika et al. (2022) confirm a positive correlation between liquidity and profit growth. From Indonesia, Petra et al. (2020) and Renaldo et al. (2024) document a

positive relationship between liquidity and earnings growth in manufacturing companies and industrial enterprises, respectively. Based on this opportunity of using cash properly, this study formulates: Liquidity is essential for supporting the operational activities of a company because sufficient current assets enable firms to fulfill their short-term obligations. Furthermore, the availability of cash provides companies with opportunities to conduct transactions efficiently, including purchasing materials from suppliers. When firms can obtain materials at lower costs through discounts, they may improve the difference between sales revenue and operating costs, which ultimately creates an opportunity for higher earnings (Njotoprajitno et al., 2022). Therefore, liquidity is not only related to the ability to meet current liabilities but can also contribute to profit-generating activities. The empirical evidence supports the potential role of liquidity in increasing profit growth. Renaldo et al. (2024), Chika et al. (2022), and Petra et al. (2020) document a positive relationship between liquidity and profit growth in different business settings. Although the studies examine different types of firms, their findings indicate that companies with adequate liquidity may have greater opportunities to manage their operating resources effectively. Consequently, the ability to maintain and utilize liquid assets appropriately can become an important factor in supporting earnings growth (Renaldo et al., 2024; Chika et al., 2022; Petra et al., 2020).

H2: Liquidity positively influences profit growth

Materials and Methods

Profit growth (PG) is measured by the change in current net earnings, as denoted by Putri and Sitohang (2019). Drawing on Arigita and Aprilyanti (2024), Nasution et al. (2024), Renaldo et al. (2024), Pulungan et al. (2023), Siswanto et al. (2022), Natalia et al. (2021), and Simorangkir et al. (2021), this study employs the debt-to-equity ratio (DER) to measure leverage. Following Nasution et al. (2024), Renaldo et al. (2024), Pulungan et al. (2023), Chika et al. (2022), Simorangkir et al. (2021), Petra et al. (2020), and Putri and Sitohang (2019), this study employs the current ratio (CR) to quantify liquidity. The selection of these measurements is consistent with the empirical approaches adopted in previous studies. Specifically, the debt-to-equity ratio provides a measurement of leverage that has been employed in studies examining earnings or profit growth (Arigita and Aprilyanti, 2024; Nasution et al., 2024; Renaldo et al., 2024; Pulungan et al., 2023; Siswanto et al., 2022; Simorangkir et al., 2021). Similarly, the current ratio has been employed to represent liquidity in previous investigations of profit growth (Nasution et al., 2024; Renaldo et al., 2024; Pulungan et al., 2023; Chika et al., 2022; Simorangkir et al., 2021; Petra et al., 2020; Putri and Sitohang, 2019). This investigation uses all population members of food and beverage companies listed in the Indonesian capital market between 2015 and 2023, where the appropriate number is only fourteen enterprises, and their names are (1) FKS Food Sejahtera (AISA), (2) Tri Banyan Tirta (ALTO), (3) Wilmar Cahaya Indonesia (CEKA), (4) Delta Jakarta (DLTA), (5) Indofood CBP Sukses Makmur (ICBP), (6) Indofood Sukses Makmur (INDF), (7) Multi Bintang Indonesia (MLBI), (8) Mayora Indah (MYOR), (9) Prasadha Aneka Niaga (PSDN), (10) Nippon Indosari Corpindo (ROTI), (11) Sekar Bumi (SKBM), (12) Sekar Laut (SKLT), (13) Siantar Top (STTP), and (14) Ultrajaya Milk Industry & Trading (ULTJ).

The use of all fourteen enterprises enables this investigation to cover the population of food and beverage companies that meet the study requirements during the observation period. Furthermore, the nine-year period from 2015 to 2023 provides observations across companies and time. Consequently, the research design combines cross-sectional observations represented by the selected enterprises with time-series observations represented by the study period, which is consistent with the pooling data regression approach applied in this investigation (Sugiyanto et al., 2022). This investigation employs archival methods, utilizing secondary data to measure the variables, as Hartono (2014) explains. The secondary data are sourced from annual reports downloaded from the official company website and manuscripts published in journals. Acting as the method to analyze the data, this investigation uses the pooling data regression model. In this investigation, the regression model exists in the first equation as follows.

$$PG_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 CR_{it} + \varepsilon_{it} \quad \text{Eq. (1)}$$

According to Sugiyanto et al. (2022), this model combines the cross-section and time series to estimate the coefficient based on ordinary least squares. Ideally, this model must be free from multicollinearity, autocorrelation, heteroskedasticity, and non-normality residuals. The regression model therefore estimates profit growth as the dependent variable by incorporating DER and CR as the explanatory variables representing leverage and liquidity, respectively. Before interpreting the estimated coefficients, the appropriateness of the regression model is assessed through the classical assumption tests stated above. The manuscript subsequently reports multicollinearity, autocorrelation, heteroskedasticity, and residual normality testing as part of this assessment, supporting the application of the ordinary least squares estimation procedure (Sugiyanto et al., 2022).

Results and Discussion

Table 1 presents the descriptive statistics for earnings growth, debt policy, liquidity, and firm size, quantified by the relative change in after-tax earnings, debt-equity ratio (DER), current ratio (CR), and the natural logarithm of total assets (LN(TA)), based on 126 observations. (1) The minimum, maximum, mean, and standard deviation for earnings growth are -9.19, 5.66, 0.9345, and 1.73212. (2) DER's minimum, maximum, mean, and standard deviation are -2.13, 17.04, 1.0908, and 1.99081. (3) For CR, the minimum, maximum, mean, and standard deviation are 0.15, 9.95, 2.4546, and 1.96533. (4) For LN(TA), the minimum, maximum, mean, and standard deviation are 25.75, 32.86, 28.9428, and 1.57198. The descriptive statistics demonstrate variations in earnings growth, leverage, liquidity, and firm size across the 126 observations. In particular, earnings growth ranges from -9.19 to 5.66, indicating that the observations include companies experiencing both decreases and increases in earnings. Meanwhile, the DER ranges from -2.13 to 17.04, with a mean of 1.0908, demonstrating considerable variation in the leverage position among the observed companies. The CR also varies from 0.15 to 9.95, with an average of 2.4546, showing differences in the liquidity position of the companies during the observation period..

Table 1. *Descriptive statistics.*

Variable	N	Minimum	Maximum	Mean	Standard deviation
EG (decimal)	126	-9.19	5.66	0.9345	1.73212
DER (decimal)	126	-2.13	17.04	1.0908	1.99081
CR (decimal)	126	0.15	9.95	2.4546	1.96533
LN(TA) (decimal)	126	25.75	32.86	28.9428	1.57198

The testing of the classical assumptions

Table 2, Table 3 and Table 4 are the examination results of the classical assumptions, including multicollinearity, autocorrelation, heteroskedasticity, and normality, required when the regression model estimates the coefficient based on the ordinary least squares technique. (1) Table 2 presents the results of multicollinearity detection, as reflected by the variance inflation factor (VIF) values of DER, CR, and LN(TA), which are 1.119, 1.090, and 1.029, respectively. All of these values are lower than 10; therefore, multicollinearity does not occur. Table 3 presents the autocorrelation testing outcome, which is mirrored by the asymptotic significance (2-tailed) of the t-statistic, exceeding the α of 5% at 0.899. Hence, autocorrelation is unavailable. (3) Table 4 displays the White heteroskedasticity results with insignificant probabilities of 0.9541, 0.1200, and 0.0781 for the squared DER, CR, and LN(TA), respectively, which exceed an α of 5%. Thus, the heteroskedasticity does not occur. (4) Figure 2 depicts the Jarque-Bera normality testing result, with a probability of 0.0000. Due to this situation, the normality of residuals is not observed. According to the central limit theorem, cited by Ajija et al. (2011), this situation is tolerable if the total number of observations exceeds 30. Therefore, violating the normality assumption in this study is acceptable because the total number of observations is as high as 126. Overall, the classical assumption testing provides support for the use of the regression model despite the non-normality of residuals. The VIF results indicate that DER, CR, and LN(TA) do not create a multicollinearity problem, while the run-testing result indicates the absence of autocorrelation. Furthermore, the White heteroskedasticity test demonstrates that heteroskedasticity does not occur. Although the Jarque-Bera test indicates that residual normality is not achieved, the number of observations reaches 126, exceeding the minimum of 30 referred to under the central limit theorem by Ajija et al. (2011)..

Table 2. Multicollinearity detection result.

Independent variable	Tolerance	VIF
DER	0.894	1.119
CR	0.918	1.090
LN(TA)	0.972	1.029

Table 3. Run-testing result.

Description	Unstandardized residual
Test Value based on the largest mode	5.08899
Z-statistic	0.127
Asymp. Sig. (2-tailed)	0.899

Table 4. White Heteroskedasticity test result: $RESID^2 = f(DER^2, CR^2, LN_TA^2)$.

Variable	Coefficient	Std. Error	t-Statistic	Probability
C	19.11466	8.842417	2.161701	0.0326
DER ²	-0.001835	0.031819	-0.057669	0.9541
CR ²	-0.091565	0.058480	-1.565746	0.1200

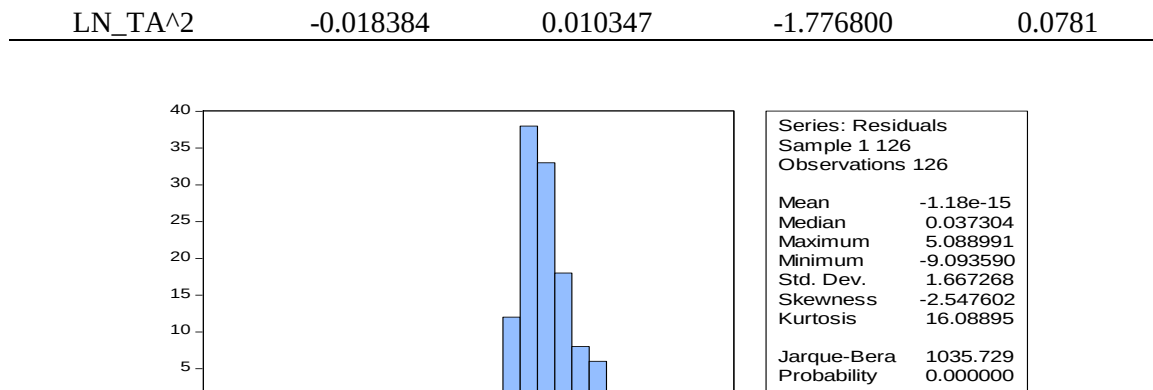


Figure 2. Jarque-Bera Normality Testing Result.

The estimation of the research model

Table 5 presents the results of the regression model estimation, providing the probability of a t-statistic of 0.037, 0.026, and 0.085 for DER, CR, and LN(TA), respectively, with a positive sign. Thus, the first and second hypotheses, which state that debt policy and liquidity have a positive impact on earnings growth, are acceptable. The regression estimation provides additional evidence regarding the relative contribution of leverage and liquidity to profit growth. DER has an unstandardized coefficient of 0.169 and a standardized coefficient of 0.194, with a probability of 0.037. Meanwhile, CR has an unstandardized coefficient of 0.180 and a standardized coefficient of 0.205, with a probability of 0.026. Since both probabilities are below the 5% significance level, the results provide empirical support for the positive effects specified in the first and second hypotheses.

Table 5. The estimation result of the regression model: The impact of debt policy and liquidity on profit growth.

Independent variable	Unstandardized coefficient		Standardized coefficient	t-statistic	Probability
	B	Std. Error	Beta		
(Constant)	-4.592	2.847	N.A.	-1.613	0.109
DER	0.169	0.080	0.194	2.107	0.037
CR	0.180	0.080	0.205	2.249	0.026
LN(TA)	0.169	0.097	0.154	1.738	0.085

This investigation supports the first hypothesis, declaring a positive tendency of leverage towards profit growth. This fact indicates that managers can use debt effectively by considering the debt benefits of the tax shield. Therefore, this positive evidence aligns with Renaldo et al. (2024) and Siswanto et al. (2022) when studying nine transportation companies from 2016 to 2019 and 34 industrial firms between 2016 and 2021 in the Indonesian Capital Market. The positive relationship between leverage and profit growth strengthens the argument presented in the literature review concerning the benefits of debt. In particular, the manuscript explains that debt can provide a tax shield when companies effectively manage their debt, which can subsequently contribute to earnings growth. The current empirical result supports this reasoning because DER demonstrates a positive coefficient and a probability below 5%. Therefore, the finding is consistent with the positive relationship between leverage and profit growth documented by Renaldo et al. (2024) and Siswanto et al. (2022).

Besides, this investigation accepts the second hypothesis, stating a positive propensity of liquidity towards profit growth. This evidence indicates that managers smartly manage the liquidity by using this excess to purchase materials from suppliers with discounts. Thus, this positive fact supports Chika et al. (2022), who found a positive correlation between liquidity and profit growth in six Nigerian pharmaceutical companies from 2016 to 2021, reinforced by Petra et al. (2020) and Renaldo et al. (2024) document a positive impact in manufacturing firms between 2014 and 2018 as well as 34 industrial enterprises from 2016 to 2021 in Indonesia, respectively. The positive liquidity finding is also consistent with previous empirical evidence. Specifically, Renaldo et al. (2024), Chika et al. (2022), and Petra et al. (2020) document a positive relationship between liquidity and profit growth in their respective research contexts. The present result extends this positive tendency to food and beverage enterprises in the Indonesian Capital Market between 2015 and 2023. With a CR coefficient of 0.180 and a probability of 0.026, liquidity demonstrates a statistically significant positive relationship with profit growth in this investigation. Taken together, the findings demonstrate that both leverage and liquidity play important roles in explaining profit growth within the observed food and beverage companies. The significant positive coefficients of DER and CR indicate that these two financial characteristics move positively with profit growth within the research model. These results support both hypotheses and are consistent with the evidence reported by Renaldo et al. (2024), Chika et al. (2022), Siswanto et al. (2022), and Petra et al. (2020). At the same time, the findings provide an empirical basis for the managerial implications concerning the effective utilization of debt and excess liquidity discussed in this investigation..

Conclusion

This investigation aims to prove and analyze the influence of leverage and liquidity on profit growth by employing 14 enterprises in the Indonesian Capital Market for nine years, starting from 2015 to 2023. Based on the two hypotheses examined, this investigation declares that a positive sign exists in both the causal relationships between leverage and profit growth and between liquidity and profit growth. Practically, this research recommends that managers utilize more debt and the excess liquidity to grow profits based on debt benefits and supplier discounts. Academically, this investigation has some limitations, such as two determinants and a single industry. Thus, the succeeding academics can add the other factors, namely the managerial and institutional ownership, inventory turnover, asset utilization ratio, and company size, into their research model. Additionally, they can utilize the non-financial industry, comprising multiple sectors of enterprises, to achieve a more comprehensive generalization. The positive influence of leverage on profit growth obtained in this investigation confirms that debt can contribute to improving company performance when it is effectively managed. This result is consistent with the positive relationship documented by Renaldo et al. (2024) and Siswanto et al. (2022). From a managerial perspective, this evidence emphasizes the importance of appropriately utilizing debt to obtain its potential benefits while maintaining the company's financial capability. Therefore, leverage can be considered an important financial factor in supporting profit growth among the enterprises investigated in this study.

Similarly, the positive influence of liquidity on profit growth demonstrates the importance of effectively managing current assets and current liabilities. The result is consistent with the positive evidence documented by Renaldo et al. (2024), Chika et al. (2022), and Petra et al. (2020). Sufficient liquidity provides companies with greater flexibility in managing their operational requirements and utilizing available cash to obtain materials from suppliers at discounted prices. Consequently, appropriate liquidity management can support the ability of companies to increase their profits while maintaining their short-term financial capacity. For future research, the limitations identified in this investigation provide opportunities to develop a more comprehensive model of profit growth. Previous studies have examined various financial and corporate factors related to profit growth (Nasution et al., 2024; Renaldo et al., 2024; Pulungan et al., 2023; Njotoprajitno et al., 2022; Simorangkir et al., 2021; Petra et al., 2020). Therefore, succeeding academics can extend the current model by incorporating additional determinants and applying it to companies from several non-financial sectors. Expanding the number of determinants, industries, and observations may provide broader empirical evidence concerning the factors associated with profit growth..

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Conflict of interest

The authors confirm that there is no conflict of interest involve with any parties in this research study.

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