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FINANCIAL PERFORMANCE ANALYSIS OF COMPANIES THROUGH LIQUIDITY AND PROFITABILITY RATIO APPROACHES

ANALISIS KINERJA KEUANGAN PERUSAHAAN MELALUI PENDEKATAN RASIO LIKUIDITAS DAN PROFITABILITAS

PA Andiena Nindya Putri[1], Upik Djaniar[2], Natalia Reyne Lumentah[3], Mutmainah[4], Klemens Mere[5]
[1]ITB Stikom Bali
[2]Universitas Muhammadiyah Kupang
[3]STIE Jambatan Bulan
[4]STIE Al Anwar
[5]Universitas Wisnuwardhana Malang
Email: dinaputri1991@gmail.com[1], udjaniar@gmail.com[2], 89lumentahnatalia@gmail.com[3], mutmainah@stie-alanwar.ac.id[4], monfoort21@gmail.com[5]

ABSTRACT
This article presents a comprehensive literature review on the financial performance analysis of companies through liquidity and profitability ratio approaches. Financial performance is a critical indicator of a company's overall health and sustainability, influencing investment decisions and stakeholder confidence. Liquidity ratios, such as the current ratio and quick ratio, assess a company's ability to meet its short-term obligations, providing insights into operational efficiency and cash management. On the other hand, profitability ratios, including return on assets (ROA) and return on equity (ROE), measure a company's ability to generate profit relative to its revenue, assets, and equity. This review synthesizes recent studies to highlight the interrelation between liquidity and profitability, emphasizing that strong liquidity positions often correlate with improved profitability metrics. The findings underscore the importance of both ratios in providing a holistic view of a company's financial performance, enabling managers and investors to make informed decisions. Furthermore, the article suggests areas for future research, particularly regarding the impact of external factors on these financial ratios.
***Keywords:** Financial performance, liquidity ratios, profitability ratios*

ABSTRAK
Artikel ini menyajikan tinjauan literatur yang komprehensif tentang analisis kinerja keuangan perusahaan melalui pendekatan rasio likuiditas dan profitabilitas. Kinerja keuangan merupakan indikator kritis dari kesehatan dan keberlanjutan keseluruhan perusahaan, yang mempengaruhi keputusan investasi dan kepercayaan pemangku kepentingan. Rasio likuiditas, seperti rasio lancar dan rasio cepat, menilai kemampuan perusahaan untuk memenuhi kewajiban jangka pendek, memberikan wawasan tentang efisiensi operasional dan manajemen kas. Di sisi lain, rasio profitabilitas, termasuk pengembalian aset (ROA) dan pengembalian ekuitas (ROE), mengukur kemampuan perusahaan untuk menghasilkan laba relatif terhadap pendapatannya, aset, dan ekuitas. Tinjauan ini mensintesis studi terbaru untuk menyoroti hubungan antara likuiditas dan profitabilitas, menekankan bahwa posisi likuiditas yang kuat sering kali berkorelasi dengan metrik profitabilitas yang lebih baik. Temuan ini menggarisbawahi pentingnya kedua rasio dalam memberikan gambaran holistik tentang kinerja keuangan perusahaan, memungkinkan manajer dan investor untuk membuat keputusan yang lebih baik. Selain itu, artikel ini menyarankan area untuk penelitian di masa depan, terutama mengenai dampak faktor eksternal terhadap rasio keuangan ini.
Kata Kunci: kinerja keuangan, rasio likuiditas, rasio profitabilitas

INTRODUCTION

Financial performance analysis is essential for understanding the overall health and sustainability of a company. This analysis provides insights into how well a business generates profits, manages resources, and maintains liquidity, which are critical for long-term success. As companies face increasing competition and dynamic market conditions, stakeholders, including investors, creditors, and management, require reliable financial metrics to make informed decisions. According to Harinurdin et al (2023), the evaluation of financial performance through various ratios enables stakeholders to gauge a company's operational effectiveness and financial stability.

Liquidity and profitability ratios are two key components of financial performance analysis. Liquidity ratios measure a company's ability to meet its short-term obligations, indicating the efficiency of its cash management (Wibowo · et al., 2024). Common liquidity ratios include the current ratio and quick ratio, which provide insights into the short-term financial health of a business. A strong liquidity position is vital for any organization, as it ensures that the company can fulfill its immediate financial commitments without resorting to external financing, thereby reducing financial risk (Adam, 2024).

Profitability ratios, on the other hand, focus on a company's ability to generate profit relative to its revenue, assets, and equity. Ratios such as Return on Assets (ROA) and Return on Equity (ROE) are commonly used to assess profitability (Tutcu et al., 2024). High profitability not only reflects a company's operational efficiency but also enhances its attractiveness to investors and creditors. According to Wan et al., (2024), a comprehensive analysis of profitability provides valuable insights into how effectively a company utilizes its resources to generate earnings.

The relationship between liquidity and profitability has garnered significant attention in recent years. Many studies suggest that there is a complex interplay between these two dimensions of financial performance (Pham & Ho, 2024). For instance, while maintaining sufficient liquidity is necessary for day-to-day operations, excessive liquidity may indicate underutilized resources, potentially leading to lower profitability. Conversely, companies that prioritize profitability may risk compromising their liquidity position, which could expose them to financial distress in challenging economic conditions (Nowicki et al., 2024).

In light of these dynamics, this study aims to analyze the financial performance of companies through liquidity and profitability ratio approaches. By conducting a literature review, the article will synthesize existing research on the significance of these ratios and their impact on overall financial health. The findings of this review will not only enhance the understanding of financial performance analysis but also provide practical implications for managers and investors seeking to optimize financial decision-making.

This exploration is particularly relevant in today's volatile economic landscape, where the ability to swiftly adapt to changing conditions is paramount. Understanding the role of liquidity and profitability ratios can provide companies with the insights needed to navigate uncertainties and maintain competitive advantages. Therefore, this article will contribute to the ongoing discourse on financial performance analysis, emphasizing the necessity of integrating both liquidity and profitability perspectives for a holistic assessment of a company's financial health.

METHOD

This study employs a literature review methodology to analyze the financial performance of companies through liquidity and profitability ratio approaches. The literature review is a systematic process that involves the identification, evaluation, and synthesis of existing research related to the topic. To ensure a comprehensive understanding of the subject, relevant academic journals, articles, and industry reports published from 2019 onwards will be included. The selection criteria will focus on peer-reviewed articles that provide empirical evidence, theoretical frameworks, and practical insights into liquidity and profitability ratios.

The research will begin with a comprehensive search using databases such as Google Scholar, JSTOR, and ScienceDirect, utilizing keywords such as "financial performance," "liquidity ratios," "profitability ratios," and "corporate finance." Articles will be screened for relevance based on their abstract, methodology, and findings. Selected studies will then be analyzed to identify key themes, trends, and gaps in the literature regarding the relationship between liquidity and profitability. This approach will allow for a thorough exploration of how these financial metrics interact and influence overall company performance, thereby providing valuable insights for stakeholders.

Furthermore, the literature review will be structured to highlight both theoretical and empirical findings, facilitating a deeper understanding of the complexities surrounding liquidity and profitability in various industries. By synthesizing diverse perspectives and research outcomes, this study aims to contribute to the existing body of knowledge, offering practical recommendations for financial managers and decision-makers seeking to optimize their company's financial performance. The findings will also serve as a basis for future research directions in this critical area of corporate finance.

RESULTS AND DISCUSSION

Importance of Liquidity Ratios in Financial Performance

Liquidity ratios, such as the current ratio and quick ratio, are crucial indicators of a company's ability to meet its short-term obligations. A high liquidity ratio suggests that a company can cover its liabilities with its current assets, which is essential for maintaining operational stability. According to Habib et al., (2022), firms with robust liquidity positions are less likely to face financial distress, enabling them to invest in growth opportunities without the immediate pressure of cash flow shortages. Conversely, low liquidity ratios can lead to increased risk, potentially impacting a company's creditworthiness and investor confidence.

The significance of liquidity ratios extends beyond mere financial metrics; they also play a vital role in strategic decision-making. Companies that monitor their liquidity effectively can make informed choices regarding investments, inventory management, and operational efficiency (Airout et al., 2023). Moreover, liquidity management has been found to correlate positively with profitability, as firms that maintain adequate liquidity can capitalize on market opportunities and respond swiftly to economic changes (Arnone et al., 2024). Thus, understanding and optimizing liquidity ratios is essential for enhancing overall financial performance.

Correlation Between Liquidity and Profitability

The relationship between liquidity and profitability is complex and often debated in financial literature. While some studies indicate a positive correlation between the two, others suggest an inverse relationship where excess liquidity may lead to lower profitability (Eldomiaty et al., 2023). The trade-off arises because while companies need sufficient liquidity to operate effectively, holding excessive liquid assets can result in underutilization of resources, thus impacting profitability.

This trade-off highlights the importance of striking a balance between liquidity and profitability. Research by Wadi et al., (2024) suggests that companies with optimal liquidity levels can effectively allocate resources towards profitable investments while maintaining the ability to cover short-term obligations. This balance allows firms to enhance operational efficiency and drive growth, ultimately improving overall financial performance. Therefore, it is crucial for financial managers to continuously assess their liquidity positions in relation to profitability to ensure sustained success.

Role of Profitability Ratios in Assessing Financial Health

Profitability ratios, including Return on Assets (ROA) and Return on Equity (ROE), serve as critical indicators of a company's financial health and operational efficiency. These ratios provide insights into how effectively a company utilizes its resources to generate earnings (Harinurdin, 2023). A higher ROA indicates that a company is more efficient in converting its assets into profit, which is essential for attracting investors and securing financing.

Additionally, profitability ratios are instrumental in benchmarking a company's performance against industry peers. Companies that consistently achieve high profitability ratios are often viewed favorably by investors, as these metrics signal robust financial health and effective management practices (Blaga et al., 2024). Furthermore, understanding profitability trends over time allows management to identify areas for improvement and implement strategies to enhance performance. For instance, if profitability ratios are declining, a company may need to reassess its pricing strategies, cost management practices, or operational efficiency (Mansor et al., 2021).

Impact of External Factors on Liquidity and Profitability

External factors, such as economic conditions, regulatory changes, and market competition, significantly influence both liquidity and profitability ratios. Economic downturns, for instance, can lead to reduced sales and cash flow, which may strain a company's liquidity position (Reyad et al., 2022). In such scenarios, companies may be compelled to prioritize liquidity over profitability to ensure their survival, potentially sacrificing long-term growth.

Moreover, regulatory changes can impact the financial landscape, affecting how companies manage their liquidity and profitability. For example, stricter regulations may require firms to hold higher levels of liquid assets, thereby influencing their profitability ratios. On the other hand, competitive pressures may compel companies to adopt aggressive pricing strategies, impacting profit margins and, consequently, profitability ratios (Agbaeze et al., 2020). Understanding these external factors is crucial for financial managers to navigate the challenges of maintaining liquidity and profitability in a dynamic environment.

Strategic Recommendations for Enhancing Financial Performance

Based on the insights gained from the analysis of liquidity and profitability ratios, several strategic recommendations can be made to enhance financial performance. First, companies should implement robust liquidity management practices to ensure they maintain optimal liquidity levels while maximizing profitability. This could involve regularly reviewing cash flow forecasts, optimizing working capital, and investing in liquid assets that generate reasonable.

Additionally, firms should focus on improving operational efficiency through cost management and process optimization. By streamlining operations, companies can reduce overhead costs, thereby enhancing profit margins and profitability ratios (Salah et al., 2023). Furthermore, engaging in regular financial performance assessments and benchmarking against industry peers can provide valuable insights into areas for improvement, enabling companies to make informed strategic decisions. In conclusion, a comprehensive approach to managing both liquidity and profitability is essential for achieving sustainable financial performance.

CONCLUSION

In summary, this literature review highlights the critical interplay between liquidity and profitability ratios in assessing the financial performance of companies. Liquidity ratios, such as the current and quick ratios, serve as essential indicators of a firm's ability to meet its short-term obligations, while profitability ratios, including Return on Assets (ROA) and Return on Equity (ROE), provide insights into operational efficiency and overall financial health. The findings indicate that maintaining an optimal balance between liquidity and profitability is vital for sustainable business operations, enabling firms to navigate market fluctuations and capitalize on growth opportunities.

Moreover, the analysis reveals that external factors significantly influence the relationship between liquidity and profitability. Economic conditions, regulatory frameworks, and competitive dynamics can alter a company's liquidity position and profitability ratios, necessitating adaptive strategies by financial managers. Companies that proactively monitor these external influences and adjust their financial strategies accordingly are better positioned to mitigate risks and enhance performance. This understanding underscores the importance of a comprehensive approach to liquidity and profitability management, which integrates both internal metrics and external market conditions.

Ultimately, this study underscores the necessity for financial managers to prioritize liquidity management alongside profitability enhancement strategies. By implementing robust liquidity management practices and focusing on operational efficiencies, firms can optimize their financial performance and secure a competitive advantage in their respective industries. Future research should explore the evolving dynamics of liquidity and profitability in various sectors and regions, providing further insights into best practices and innovative approaches to financial management.

SUGGESTIONS AND ACKNOWLEDGMENTS

This study highlights the importance of a balanced approach to managing liquidity and profitability for optimal financial performance. It is recommended that financial managers implement comprehensive financial policies that prioritize both short-term liquidity needs and long-term profitability goals. By investing in advanced financial analytics tools, companies can improve their ability to monitor and forecast cash flow requirements and profitability outcomes effectively. Additionally, ongoing training for finance teams on effective liquidity management practices and profitability optimization strategies is crucial for adapting to the dynamic economic environment and maintaining a competitive edge.

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