

## THE FACTORS AFFECTING PROFITABILITY OF MANUFACTURING COMPANY LISTED ON THE INDONESIAN STOCK EXCHANGE

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### ABSTRACT

This study aimed to investigate the effects of liquidity, intangible assets, working capital, leverage, company size, and efficiency on the profitability of manufacturing companies listed on the Indonesian Stock Exchange (IDX). A purposive sampling method was used to obtain 74 manufacturing companies listed from 2017 to 2021 based on the specified criteria. The sample selection criteria encompassed manufacturing companies listed on the IDX, representing diverse sectors, including the basic and chemical industry, consumer goods industry, and miscellaneous industry. The selection was restricted to companies not undergoing delisting and initial public offering procedures during the research period to ensure a balanced panel data structure, and the financial statements of these companies were required to meet all criteria for each respective variable. Furthermore, the statistical analysis instrument used was panel data regression with a random effect as the best econometric model selected. The results showed that liquidity, working capital, leverage, company size, and efficiency positively affected profitability. The predictor of intangible assets did not significantly affect profitability. Meanwhile, this study was expected to contribute in the form of managerial implications to consider liquidity, working capital, leverage, company size, and efficiency to enhance profitability.

**Keywords:** Profitability, Liquidity, Intangible Assets, Working Capital, Leverage, Company Size, Efficiency

### ABSTRAK

Penelitian ini bertujuan untuk menginvestigasi pengaruh likuiditas, aset tak berwujud, modal kerja, leverage, ukuran perusahaan, dan efisiensi terhadap profitabilitas perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (IDX). Dalam konteks ini, digunakan metode pengambilan sampel purposif untuk mendapatkan 74 perusahaan manufaktur yang terdaftar dari tahun 2017 hingga 2021 berdasarkan kriteria yang ditentukan. Kriteria pemilihan sampel mencakup perusahaan manufaktur yang terdaftar di IDX, mewakili beragam sektor, termasuk industri dasar dan kimia, industri barang konsumsi, dan aneka industri. Pemilihan terbatas pada perusahaan yang tidak sedang dalam proses delisting dan initial public offering selama periode penelitian untuk memastikan struktur data panel yang seimbang, dan laporan keuangan perusahaan-perusahaan ini harus memenuhi semua kriteria untuk setiap variabel yang bersangkutan. Selain itu, instrumen analisis statistik yang digunakan adalah regresi data panel dengan efek acak sebagai model ekonometrik terbaik yang terpilih. Hasil penelitian menunjukkan bahwa likuiditas, modal kerja, leverage, ukuran perusahaan, dan efisiensi berpengaruh positif terhadap profitabilitas. Prediktor aset tak berwujud tidak berpengaruh signifikan terhadap profitabilitas. Sementara itu, penelitian ini diharapkan dapat memberikan kontribusi dalam bentuk implikasi manajerial untuk mempertimbangkan likuiditas, modal kerja, leverage, ukuran perusahaan, dan efisiensi dalam meningkatkan profitabilitas perusahaan sektor industri manufaktur.

**Kata Kunci:** Profitabilitas, Likuiditas, Aset Tak Berwujud, Modal Kerja, Leverage, Ukuran Perusahaan, Efisiensi

### ARTICLE INFO

#### Article History:

Received: July 06, 2023

Revised: October 05, 2023

Published Online: October 31, 2023

#### How to cite:

Atmaja, R., & Usman, B. (2023). The Factors Affecting Profitability of Manufacturing Company Listed on the Indonesian Stock Exchange. *International Journal of Digital Entrepreneurship and Business (IDEB)*, 4(2), 72–83. <https://doi.org/10.52238/ideb.v4i2.112>



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**Conflict of interest statement:** The author(s) reported no conflict of interest.

## INTRODUCTION

The primary objective of a company is to enhance shareholder welfare through the optimization of profitability. In this context, the optimization can serve as a means to achieve the main aim, and an established metric for the assessment is Return on Assets (ROA). The average ROA of 513 companies listed on the Indonesia Stock Exchange (IDX) over the last eight years is 7.04%, 5.11%, 5.93%, 6.27%, 5.78%, 3.02%, -1.05%, and 4.07% in 2014, 2015, 2016, 2017, 2018, 2019, 2020, and 2021, respectively. The movement indicates that profitability fluctuates, and the company needs to consider the determining factors (Damodaran, 2015; A. B. Hartono et al., 2020). A related study is recognized for the potential to enhance the value of a company. Meanwhile, the increase in value is an indicator of achieving the main objective (Ofori-Sasu et al., 2017, 2019), and the concept is believed to affect the economic growth of business activities (Giri & Joshi, 2017; Salvatori et al., 2020). In this context, the operations make a significant macroeconomic contribution by paying taxes. A key indicator for assessing the capacity to contribute to taxes lies in examining liquidity concerning debt fulfillment, meeting short-term financial obligations, and conducting business activities (Zutter & Smart, 2019).

Liquidity is an important factor in maintaining optimal profitability and the company should ensure the capability to meet current liabilities. In this context, there is a significant risk of impeding supply chain management and causing disruptions to business when raw material inventory payments rely on short-term debts (Fassas, Bellos, & Kladakis, 2021; Hartono, Lestari, Wijaya, Hartono, & Tinungki, 2020; Muslih, 2019). Furthermore, liquidity indicates a company's capacity to leverage its current assets for profit generation through business activities. To ensure the ability to meet short-term business needs, the company must maintain optimal working capital. With this in place, supply chain management can be secured, facilitating smooth business operations (Fassas et al., 2021; Miswanto et al., 2017; Vázquez et al., 2016). Liquidity should also be maintained to preserve profitability, as depicted in the balance sheet that adopts the recognized accounting system.

The application of the Financial Accounting Standards Statements (PSAK) adapted by Indonesian company records financial statements (Syah et al., 2023) as tangible and intangible assets. Intangible assets are typically overlooked due to their abstract nature significantly affecting future high returns. Various types of companies should maximize the potential of intangible assets, which significantly affect their performance. These assets provide a good return, enabling the company to maintain profitability (Alarussi & Gao, 2021; Li & Wang, 2014). Furthermore, the ownership structure needs to be examined to achieve optimal profitability.

Asset ownership can come from both equity and liabilities. In this context, assets sourced from long-term debt affect company cash flow, namely interest liabilities on the debt. High and improperly managed debt can also influence the success or failure of a company. In extreme debt conditions, difficulties can be faced in meeting the principal debt and interest. Therefore, an optimal debt should be ensured to enhance profitability (Bintara, 2020; Rahman et al., 2020). This is because company size can be determined by asset ownership from both equity and liabilities.

Company size is measured by the total assets owned and not assessed by the amount of liabilities or equity. A small company size in the initiation phase of the product life cycle tends to have low profitability. This condition implies that the mature phase of the product life cycle tends to have a small opportunity to increase profitability continuously. Therefore, product innovation is necessary to prevent

the declining phase (Abeyrathna & Priyadarshana, 2019; Azhar & Ahmed, 2019; Harisa et al., 2019) and maintain efficiency.

Efficiency should also be maintained in asset management, with a key evaluation indicator being the turnover ratio, representing sales. At an optimal turnover level, the company is considered efficient in managing its assets to generate sales. The company can assess its management performance through asset turnover and maintain optimal profitability when properly managed efficiently. Additionally, this measurement aids in evaluating the company by creditors and debtors, which is closely connected to profitability (Akmalia & Panbudi, 2020; Irman & Purwati, 2020).

Based on the outlined background, it is important to examine the effect of liquidity, working capital, intangible assets, leverage, company size, and efficiency on profitability, as stated by Alarussi and Gao (2021). This study focuses on manufacturing companies contributing to the national economy at macro and micro levels (Bakung et al., 2019; P. G. Hartono et al., 2020). According to Wijaya and Suganda (2020), companies tend not to have dominant intangible assets due to their characteristics. However, this study analyzes the effect of non-dominant intangible assets on profitability.

## **LITERATURE REVIEW**

Financial performance is the effective and efficient achievement of company management over a specific period. Furthermore, it is the periodic effectiveness determination of company operationalization and human resources based on set aims, established standards, and expected criteria. In this context, a company's financial performance is measured by its profitability (Jakataofik et al., 2023; Osadchy et al., 2018).

Profitability serves as an indicator of success in achieving the main objective of maximizing shareholder welfare. Meanwhile, the determining factors need to be considered to optimize shareholder welfare. Liquidity is a factor postulated to affect profitability, and working capital also influences a company's optimization to achieve profits. Some previous results showed that intangible assets were a determining factor for profitability. In this context, company efficiency is essential and can observe asset turnover to generate sales revenue (Alarussi & Gao, 2021; P. G. Hartono et al., 2020; Nichita, 2019; Puspita & Hartono, 2018; Wardani & Andarini, 2016).

Liquidity is defined as the ease level of a company in converting its current assets into cash and a measure of the safety margin and ability to settle current liabilities. Therefore, the company can repay short-term debts from trading activities when liquidity is assured to maintain supply chain management activities. Ebimobowei et al. (2021) and P. G. Hartono et al. (2020) stated that liquidity positively affected profitability. Based on logical thinking and previous studies, the first hypothesis is as follows: H<sub>1</sub>: Liquidity has a positive effect on profitability.

Working capital is measured as the difference between current assets and liabilities. This difference indicates the ability to meet operational needs in conducting business. Furthermore, the company becomes more capable of meeting operational needs with increasing working capital. This condition leads to an increase in profitability because the business becomes more executable. Alarussi & Gao (2021); Winda & Wiksuana (2021); and Ambarwati, Yuniarta, & Sinarwati (2015) reported that working capital had a positive effect on profitability. Based on logical thinking and previous studies, the second hypothesis is as follows:

H<sub>2</sub>: Working capital has a positive effect on profitability.

Intangible assets lack physical form but can be identified due to their value. The value possesses economic properties that yield returns in the future when increased. This is recognized as profits, and the concept leads to an enhancement in profitability. Alarussi & Gao (2021); Appelbaum et al. (2017); Li & Wang (2014); and Faza & Hidayah (2014) stated that intangible assets had a positive effect on profitability. Based on logical thinking and previous studies, the third hypothesis is as follows:

H<sub>3</sub>: Intangible assets have a positive effect on profitability.

Leverage signifies the extent to which a company relies on debt in proportion to its assets. The higher the debt, the more burdened is the interest payments, reducing cash flow. This lowers the profits acquired by the company, resulting in a decline in profitability. Alexander and Minnema (2018) stated that leverage had a negative effect on profitability. Furthermore, Alarussi and Gao (2021) and Sari and Abundanti (2018) reported a negative effect of leverage on profitability. Based on logical thinking and previous studies, the fourth hypothesis is as follows:

H<sub>4</sub>: Leverage has a negative effect on profitability.

Company size depicts the magnitude reflected in total assets. This variable is directly proportional to the capacity of assets to generate profits. Therefore, the larger the size, the more capable the company in enhancing its profitability. According to Alarussi and Gao (2021), Wulandari (2021), Ambarwati et al. (2015), and Yuliasuti and Merawati (2022), there was a positive effect of company size on profitability. Based on logical thinking and previous studies, the fifth hypothesis is as follows:

H<sub>5</sub>: Company size has a positive effect on profitability.

Company efficiency is measured by the asset turnover, representing net sales recognized as revenue. This revenue is deducted from the cost of goods sold, expenses, interest, and tax, resulting in net profits. Therefore, asset turnover positively affects profitability and company efficiency. Akmalia and Panbudi (2020), Irman and Purwati (2020), and Indriastuti and Ruslim (2020) reported that company efficiency had a positive effect on profitability. Based on logical thinking and previous studies, the sixth hypothesis is as follows:

H<sub>6</sub>: Company efficiency has a positive impact on profitability.

## **METHODS**

This study investigated and analyzed potential factors impacting a company's profitability. These factors encompassed Liquidity, Working Capital, Intangible Assets, Leverage, Company Size, and Efficiency. We applied a quantitative approach to test hypotheses, assessing the causal relationship between these variables and their significance (P. G. Hartono, Tinungki, et al., 2023). Our research employed panel data and centered on manufacturing companies listed on the IDX (Indonesia Stock Exchange) from 2017 to 2021. We collected secondary data related to these variables from the official website of Indonesian Stock Exchange.

We employed purposive sampling to ensure a representative sample (Sekaran & Bougie, 2016). Our selection criteria encompassed manufacturing companies listed on the IDX, representing a variety of sectors, including basic industries, chemicals, consumer goods, and diverse enterprises. Companies selected for the study had to maintain their listing status throughout the study period, ensuring a

balanced panel data structure. Moreover, the financial statements used in the analysis met all relevant criteria for each variable.

**Table 1:** Variables, Measures, and Formulas

Constructs	Measures	Formulas	Sources
Profitability	Return on Assets	$ROA = \frac{Net\ Profit\ after\ Tax}{Total\ Assets}$	Akben-Selcuk (2016); Alarussi & Gao (2021); Octaceria & Rahardja (2020)
Liquidity	Current Ratio	$CR = \frac{Current\ Assets}{Current\ Liability}$	Dsouza & Habibniya (2021); and Husna & Satria (2019).
Working capital	Working Capital Ratio	$RMK = \frac{Current\ Assets - Current\ Liability}{Total\ Assets}$	Alarussi & Gao (2021).
Intangible Assets	Intangible Asset Ratio	$ATWA = \frac{Intangible\ Assets}{Total\ Assets}$	Alarussi & Gao (2021).
Leverage	Debt to Assets Ratio	$DAR = \frac{Total\ Liabilities}{Total\ Assets}$	Alarussi & Gao (2021).
Company Size	Total Assets	$TA = \text{Natural logarithm of total assets}$	Alarussi & Gao (2021); Aritonang & Rahardja, (2022); P. G. Hartono et al. (2023)
Company Efficiency	Asset Turnover Ratio	$TATO = \frac{Total\ Sales\ Revenue}{Total\ Assets}$	Alarussi & Gao (2021).

The statistical analysis instrument used was panel data, specifically multiple linear regression adapted for the structure. Parameter estimation was carried out using EViews version 10. The test was conducted in two stages, namely 1) model selection test to select the best econometric model through Chow, Lagrange Multiplier, and Hausman tests, and 2) adjusted R-square, global, and individual tests to examine the hypotheses (Gujarati & Porter, 2020). The regression model equation for this study is as follows:

$$ROA_{it} = \beta_0 + \beta_1 CR_{it} + \beta_2 RMK_{it} + \beta_3 ATWA_{it} + \beta_4 DAR_{it} + \beta_5 (\ln TA)_{it} + \beta_6 TATO_{it} + e_{it}$$

Where  $ROA_{it}$ : return on assets,  $CR_{it}$ : current ratio,  $RMK_{it}$ : working capital ratio,  $ATWA_{it}$ : ratio of intangible assets to total assets,  $DAR_{it}$ : debt to asset ratio,  $TA_{it}$ : natural logarithm of total assets,  $TATO_{it}$ : total asset turnover,  $e_{it}$ : error.

## RESULT AND DISCUSSION

Table 2 provides an overview of the data's descriptive statistics. Notably, the range of profitability, as measured by Return on Assets (ROA), varies from -0.40143 to 0.920997, with PT Keramika Indonesia Assosiasi Tbk showing the lowest ROA in 2019 and the highest in 2020. In terms of liquidity, as measured by the Current Ratio (CR), the lowest and highest values are 0.021359 and 15.82232, respectively, with PT Eterindo Wahanatama Tbk and PT Campina Ice Cream Company holding these extremes in 2017 and 2013. The working capital, assessed using a ratio, exhibits a mean of 0.098448 and a standard deviation of 0.630845. The lowest and highest working capital values, based on the RMK measure, are -4.30701 and 0.869243, with PT. Asia Pacific Fibers Tbk and PT Hartadinata Abadi Tbk in 2020 and 2013 being the respective owners of these values. Regarding intangible assets, the data

shows a mean of 0.024635 and a standard deviation of 0.630845. The lowest and highest intangible asset values, based on the ATWA measure, are 0 and 0.5393, with PT. Asia Pacific Fibers Tbk and PT. Indofood CBP Sukses Makmur Tbk in 2020 and 2013 holding these values, respectively.

**Table 2: Descriptive Statistics**

Constructs	N	Minimum	Maximum	Mean	Standard Deviation
ROA	370	-0.401	0.921	0.037	0.109
CR	370	0.021	15.822	2.314	2.316
RMK	370	-4.307	0.869	0.098	0.631
ATWA	370	0	0.539	0.025	0.064
DAR	370	0.081	5.168	0.573	0.656
TA	370	11.400	19.722	15.030	1.635
TATO	370	0.000	6.949	1.036	0.770

Leverage demonstrates a range of values, with the lowest and highest values being 0.081293 and 5.167738, respectively. PT Emdeki Utama Tbk records the lowest leverage in 2019, while PT. Asia Pacific Fibers Tbk exhibits the highest leverage in 2016. Company size, which is based on the natural logarithm transformation of total assets, ranges from 12.01485 to 16.32368. PT. Megapolitan Development Tbk has the smallest company size in 2019, while PT. Lippo Karawaci Tbk has the largest in 2018. Company efficiency, as measured by total asset turnover (TATO), also ranges from 12.01485 to 16.32368. In this case, PT. Megapolitan Development Tbk demonstrates the lowest efficiency in 2019, whereas PT. Lippo Karawaci Tbk boasts the highest efficiency in 2018.

It's worth noting that the negative minimum values for ROA indicate that certain companies experienced negative net profits during specific years. Similarly, the negative minimum RMK values suggest that, in these instances, current liabilities exceeded the value of assets. The minimum values of 0 for ATWA and TATO indicate that, for certain companies and years, intangible assets and sales revenue were reported as zero. Table 3 showcases the panel data regression model selection process, involving the application of the Chow, Hausman, and Lagrange Multiplier tests.

**Table 3: Model Selection Test**

Test	Test Statistics	Statistical Value	p-Value	Decision
Chow Test	Cross Section $\chi^2$	158.582	0.000	FEM is selected.
Hausman Test	Cross Section Random	8.357	0.213	REM is selected.
Lagrange Multiplier Test	Breusch-Pagan (both)	16.944	0.000	REM is selected.

The selection of the panel data regression model was based on three tests: the Chow test, Hausman test, and Lagrange Multiplier test. The Chow test indicated that the Fixed Effects Model (FEM) was the most suitable, while the Hausman test suggested that the Random Effects Model (REM) was preferable. The Lagrange Multiplier test also favored the REM. Given these results, the REM was considered the best econometric model, consistent with the Hausman and Lagrange Multiplier tests.

A goodness of fit test was conducted in Table 4, but no classical assumption tests were performed on the random effect model. The adjusted R-squared value of 0.114 suggested that approximately 11.4% of the variation in the dependent variable could be explained by the independent variables, with the remaining 88.6% attributed to factors outside the model. A global test using an F-test revealed that at

least one independent variable significantly influenced the dependent variable, with a statistic value of 7.306 and a p-value of 0.000. Subsequently, a one-tailed partial test confirmed the significant impact of working capital, leverage, company size, and efficiency on profitability.

**Table 4:** Panel Data Regression Estimation Results

Independent Variable Proxy	Dependent Variable: Profitability (measured by: Return on Assets)		
	Coefficient	Significance (one-tailed)	Conclusion ( $\alpha = 10\%$ )
Constant	-0.310882	0.0000	Significant
CR	0.005118	0.0553	Significant
RMK	0.135695	0.0000	Significant
ATWA	0.006721	0.4755	Insignificant
DAR	0.106172	0.0004	Significant
TA	0.016084	0.0003	Significant
TATO	0.018764	0.0198	Significant

The effect of liquidity on profitability has been proven, hence,  $H_1$  is accepted. This result contradicts Ebimobowei et al. (2021) and P. G. Hartono et al. (2020) that liquidity has a positive effect on profitability. Therefore, current assets in the ability to meet liabilities affect profitability in asset use. The condition shows that current liabilities have an effect on business activities in generating profits. In this context, liquidity regarding current assets focuses on meeting short-term liabilities. Extremely high liquidity serves as an indicator that company is unable to use assets in generating profits. Similarly, excessively low liquidity may affect business by failing to meet current liabilities. The condition is viewed as optimal and positively affects profitability (Ambarwati et al., 2015; Damodaran, 2015; Mahalue, 2020; Rizki, 2019).

Since working capital has a positive effect on profitability,  $H_2$  is accepted. This result is consistent with Alarussi & Gao (2021); Winda & Wiksuana (2021); and Ambarwati et al. (2015) that working capital has a positive effect on profitability. Therefore, company working capital, invested in its business activities, has a positive effect on the variable. Optimal working capital that can finance business activities enables the generation of profits. Meanwhile, decreasing the variable lowers business activities, affecting the profitability in generating profits (Alarussi & Gao, 2021; Ambarwati et al., 2015; Winda & Wiksuana, 2021).

Intangible assets do not affect profitability since  $H_3$  is rejected and this result is in line with Dewi & Rahayu (2020) and Yuliasuti & Merawati (2022). Meanwhile, Alarussi & Gao (2021); Appelbaum, Calla, Desautels, & Hasan (2017); Li & Wang (2014), and Faza & Hidayah (2014) stated that intangible assets had a positive effects on profitability. The absence of effect indicates that the variable cannot optimize company performance. This result is supported by the justification that the implementation of each element is suboptimal. Therefore, the market does not give a high assessment to company with high or low intangible assets based on the physical resources possessed. The absence of the effect is due to the suboptimal relationship between company and stakeholders, and the suboptimal use of capital facilities (Dewi & Rahayu, 2020; Yuliasuti & Merawati, 2022). Manufacturing company typically do not possess substantial intangible assets due to the predominant allocation of resources towards tangible assets. Therefore, the provision does not affect profitability due to the non-dominance of the asset type (Wijaya & Suganda, 2020).

Since leverage has a positive effect on profitability, H<sub>4</sub> is rejected in line with Adria & Susanto (2020) and Dalci (2018). However, this result contradicts Alexander & Minnema (2018), Alarussi & Gao (2021), and Sari & Abundanti (2018) indicating a negative effect of leverage on the variable. The phenomenon can be explained by the trade-off theory where an increase in debt decreases tax payment liabilities. This occurs because higher debt up to a certain optimal point will lead to increased interest payments, resulting in a decrease in earnings before tax and the amount paid. Therefore, the cash flow benefits from higher tax payments to enhance profitability (Dalci, 2018; Damodaran, 2015).

Since company size has a positive effect on profitability, H<sub>5</sub> is accepted in line with Alarussi & Gao (2021); Wulandari (2021); Ambarwati et al. (2015); and Yuliastuti & Merawati (2022). A larger company size measured by total assets enhances the ability to generate profits based on the use. Larger company faces fewer obstacles in conducting the business to increase profitability. Therefore, a larger company size implies a greater ability to generate profits (Alarussi & Gao, 2021; Damodaran, 2015; Wulandari, 2021).

Since company efficiency has a positive effect on profitability, H<sub>6</sub> is accepted in line with Akmalia & Panbudi (2020); Irman & Purwati (2020); and Indriastuti & Ruslim (2020). This result shows that there is a direct relationship between asset turnover and business activities as indicated by increased sales revenue. In this context, increased business activities, marked by sales revenue, result in higher profits. This condition enhances the profits obtained by the company from asset use (Akmalia & Panbudi, 2020; Irman & Purwati, 2020).

Nevertheless, this study is not without its limitations. It focused exclusively on manufacturing companies in Indonesia, which may limit the generalizability of its findings. Furthermore, the absence of Gross Domestic Product (GDP) as a control variable, particularly in light of the global crisis in 2020, underscores the need for future research to expand the sample to encompass companies from various sectors, including those with substantial intangible assets. The inclusion of additional control variables would contribute to a more comprehensive and unbiased estimation of parameters, further advancing our understanding of these complex dynamics in the world of finance.

## **CONCLUSION**

The findings of this study shed light on the intricate relationship between various financial variables and a company's profitability. Liquidity, working capital, company size, leverage, and efficiency were discerned to exert a positive influence on profitability, underscoring their pivotal roles in shaping a company's financial health. In contrast, the independent variable of intangible assets did not demonstrate a significant impact on profitability. These insights hold substantial practical significance for both corporate decision-makers and investors alike.

For businesses, this study offers valuable recommendations to bolster profitability. It highlights the importance of carefully managing liquidity, optimizing working capital, and leveraging up to an optimal debt level. Moreover, companies should explore opportunities to enhance their size and, critically, streamline their operational efficiency. By implementing these strategies, businesses can foster an environment conducive to profit generation. Investors, on the other hand, are encouraged to consider liquidity, working capital, leverage, company size, and efficiency as pivotal factors when evaluating potential investments. These variables provide key insights into a company's performance and the potential for long-term financial success. In an ever-evolving financial landscape, this research



reinforces the significance of delving into the critical determinants of profitability to make informed investment decisions.

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