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Navigating Economic Shocks: The Role of Smoothing Behavior and Leverage in Manufacturing Profitability and Financial Risk

Mely Martina[1], Ikhwan Wadi[2]

Abstract:

This study aims to analyze the impact of income smoothing, consumption smoothing, and leverage on financial distress and profitability in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2020-2023 period. The study employs a purposive sampling method to select samples based on specific criteria, resulting in 50 sample companies with a total of 200 observations. The research utilizes regression analysis with a mediation approach to identify both direct and indirect relationships among variables, using SmartPLS 4 software. The findings indicate that income smoothing has a negative but insignificant effect on financial distress and profitability. In contrast, consumption smoothing has a positive and significant impact on both variables. Meanwhile, leverage negatively affects financial distress but positively influences profitability. These findings highlight the importance of prudent financial management in ensuring stability and profitability in the manufacturing industry.

Keywords: *Income Smoothing; Consumption Smoothing; Leverage; Financial Distress; Profitabilitas*

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1. Introduction

The capital market is one of the most critical components of a country's economic system, serving as a platform where securities such as stocks and bonds are traded. Through the capital market, companies can raise funds from investors to support their operational activities and expansion, while investors have the opportunity to invest and earn returns. The capital market consists of two primary segments: the primary market, where new securities are issued, and the secondary market, where existing securities are traded. An efficient and transparent capital market is essential for sustaining economic growth (Rahman et al., 2021). In Indonesia, the capital market has experienced significant growth in recent years. According to the Financial Services Authority (OJK), the number of companies listed on the Indonesia Stock Exchange (IDX) has surpassed 700 in 2024. This growth is driven by factors such as increased public investment awareness, financial product innovation, and strong regulatory support from the government and OJK (Diyanto, 2020).

[1] *Universitas Gunung Rinjani, Indonesia, melymartina59@gmail.com*
[2] *Universitas Gunung Rinjani, Indonesia,*

Despite its growth, the Indonesian capital market faces several significant challenges. The COVID-19 pandemic has had a major impact on global capital markets, including Indonesia. At the beginning of the pandemic, the market experienced high volatility, with many stocks experiencing sharp price declines. This created uncertainty among investors and disrupted market stability. However, as the economy recovered and vaccines were rolled out, the Indonesian capital market began to show signs of recovery, with investors returning and the Composite Stock Price Index (IHSG) showing a positive trend (Gungoraydinoglu & Öztekin, 2021). In dealing with these challenges, earnings management practices such as income smoothing and consumption smoothing have become crucial areas of study. Income smoothing refers to the practice of companies adjusting their financial statements to reduce earnings fluctuations from period to period, creating a more stable financial performance outlook. Meanwhile, consumption smoothing involves managing expenses to maintain steady consumption despite income fluctuations (Bansal, 2024).

Many studies have shown that earnings management practices, such as income smoothing, positively impact company performance and can reduce financial distress risk. For example, Bui (2024) found that companies employing income smoothing practices tend to have better financial performance. However, existing research often fails to consider the interaction between income smoothing and consumption smoothing and their impact on leverage. This study aims to fill this gap by analyzing the relationship between these three variables simultaneously. On the other hand, some studies suggest that earnings management practices can have negative effects, such as increasing bankruptcy risk and damaging investor confidence (Ogundajo et al., 2021). Research by Kalash (2023) found that companies engaged in income smoothing are at a higher risk of financial distress if not managed properly. This study will explore how these practices contribute to financial distress risk and how leverage moderates this relationship.

Several studies have found no significant relationship between earnings management practices and financial distress, indicating that other factors such as corporate governance and macroeconomic conditions may have a greater influence. Ogasawara (2024) showed that in times of economic uncertainty, companies are more likely to engage in income smoothing, but the results vary depending on the context. This study will take external factors into account and examine how they influence the relationship between earnings management, leverage, and financial distress. Unlike previous research that typically focuses on only one aspect, this study integrates three key variables—income smoothing, consumption smoothing, and leverage—into a single analytical framework. This allows for a more holistic understanding of how these three factors interact and influence financial distress and corporate profitability (Ezeduru et al., 2018).

By integrating various perspectives and variables, this study is expected to make a significant contribution to understanding how financial management practices affect financial distress risk and profitability. Additionally, this research aims to provide recommendations for companies on managing financial risk more effectively and offer new insights for academics and practitioners on the dynamics of the Indonesian

capital market and the importance of earnings management in a broader context. Previous research has shown that earnings quality positively affects firm value, meaning that higher earnings quality leads to higher firm value (Chen et al., 2019). Conversely, variables such as income smoothing and financial distress do not significantly affect firm value (Dewi & Suryandari, 2023). The study by Prakosa and Supriyanto (2022) found that firm size does not influence income smoothing practices, while profitability (ROA) and taxation (ETR) have a positive effect. This indicates that more profitable companies are more likely to engage in income smoothing to create earnings stability and attract investor interest. Furthermore, research by Tarighi et al. (2022) found that leverage positively affects financial distress, meaning that higher corporate debt ratios increase the likelihood of financial distress. Meanwhile, leverage has been shown to have a negative and significant impact on profitability, indicating that higher leverage levels reduce corporate profitability (Wati & Murtanto, 2022).

This study will analyze the simultaneous impact of income smoothing, consumption smoothing, and leverage on financial distress and profitability, offering a comprehensive approach that has not been thoroughly explored in previous studies. The findings are expected to provide practical implications for companies seeking to optimize financial management strategies and enhance financial stability.

2. Theoretical Background

Income smoothing refers to managerial efforts to reduce earnings fluctuations, creating a perception of financial stability. According to Earnings Management Theory**,** firms engage in income smoothing to manage investor expectations and maintain financial predictability (Prabowo et al., 2022). When earnings are stable, companies are less likely to face severe financial shocks, reducing the probability of financial distress. Sari et al. (2020) found that income smoothing significantly decreases financial distress risk, especially in sectors with volatile earnings, such as mining. Companies practicing income smoothing can maintain positive relationships with creditors and investors, securing better financing terms and reducing the risk of liquidity crises. Therefore, firms with stable earnings are more resilient to financial distress compared to those with high income volatility.
H1: Income Smoothing Affects Financial Distress in Manufacturing Companies

Consumption smoothing is a strategy that enables firms to stabilize expenditures despite revenue fluctuations. Agency Theory suggests that financial management plays a crucial role in reducing dependency on external funding sources, minimizing the likelihood of financial distress (Dobridge, 2018). Pratiwi (2021) found that companies implementing consumption smoothing strategies experience lower financial distress risks, as stable expenditure patterns help firms navigate economic downturns. Maintaining a balanced approach to costs and revenue allows firms to avoid excessive borrowing, which in turn reduces interest burden and financial strain. Thus, firms that effectively manage consumption patterns are better positioned to withstand financial distress.

H2: Consumption Smoothing Affects Financial Distress in Manufacturing Companies

Leverage refers to the extent to which a company relies on debt to finance its operations. Capital Structure Theory(Modigliani & Miller, 1958) suggests that while debt can provide tax benefits and increase returns, excessive leverage raises financial distress risk. Hidayati et al. (2022) found that high leverage is strongly associated with financial distress, as companies with excessive debt obligations struggle to meet their financial commitments during economic downturns. Similarly, Agustina et al. (2022) emphasized that high debt ratios significantly contribute to financial instability, making leverage a key predictor of financial distress. Firms with high leverage are more vulnerable to financial difficulties due to rising interest costs and the obligation to service debt even when revenues decline.

H3: Leverage Affects Financial Distress in Manufacturing Companies

Financial distress occurs when companies face difficulties in meeting their financial obligations, leading to a decline in profitability. Agency Theory suggests that when firms experience financial distress, they must allocate resources to debt repayment rather than value-creating activities, reducing profitability (Agustina et al., 2022). Lerrick (2021) found that financial distress negatively impacts profitability, as companies experiencing liquidity crises struggle to invest in growth opportunities. Firms facing financial distress often cut back on R&D, marketing, and expansion efforts, leading to reduced competitive advantage and long-term profitability. Thus, financial distress significantly hinders a firm's ability to generate sustainable profits.

H4: Financial Distress Affects Profitability in Manufacturing Companies

Income smoothing enhances financial stability, which attracts investors and improves a firm's ability to secure funding at lower costs. Earnings Management Theory suggests that firms engaging in income smoothing create the perception of financial health, increasing investor confidence and stock valuation (Prabowo et al., 2022). Santoso et al. (2021) found that companies practicing income smoothing experience higher profitability due to reduced earnings volatility. By maintaining steady financial performance, firms can avoid negative investor reactions and enhance market valuation, ultimately leading to improved profitability. Stable earnings also allow firms to focus on long-term growth rather than short-term financial concerns.

H5: Income Smoothing Affects Profitability in Manufacturing Companies

Consumption smoothing ensures that firms allocate resources efficiently, reducing financial inefficiencies and enhancing profitability. Agency Theory posits that stable consumption patterns minimize unnecessary expenditures and financial stress, contributing to better profit margins (Widiasmara et al., 2022). Handini et al. (2023) found that companies implementing consumption smoothing strategies experience higher profitability due to better cost management. By maintaining a stable cost structure, firms can optimize resource utilization, reducing financial strain and increasing operational efficiency. Firms that manage consumption effectively are better positioned to sustain profitability over the long term.

H6: Consumption Smoothing Affects Profitability in Manufacturing Companies

Leverage can be beneficial when managed effectively, as it allows firms to expand operations and generate higher returns. Capital Structure Theory suggests that an optimal level of debt can enhance profitability by providing tax benefits and increasing capital availability (Modigliani & Miller, 1958). Setiawan et al. (2021) and Kurniawan et al. (2020) found that companies with well-managed leverage levels tend to have higher profitability, as debt financing enables investment in growth opportunities. However, excessive leverage can lead to financial distress, reducing profitability due to high interest costs. Therefore, firms must balance debt utilization to maximize returns without increasing financial risks.
H7: Leverage Affects Profitability in Manufacturing Companies

Income smoothing can indirectly affect profitability by reducing financial distress risks. Earnings Management Theory suggests that stable earnings help firms maintain financial stability, reducing the likelihood of financial distress and allowing them to focus on profitability (Prabowo et al., 2022). Rodhiyah et al. (2022) found that firms engaging in income smoothing experience lower financial distress and higher profitability. By mitigating financial uncertainty, income smoothing enables firms to allocate resources toward productive investments, improving profitability in the long run. Firms that reduce financial distress through income smoothing can achieve sustained profitability and competitive advantage.
H8: Financial Distress Mediates the Relationship Between Income Smoothing and Profitability in Manufacturing Companies

Consumption smoothing helps firms manage financial uncertainty, reducing the risk of financial distress and improving profitability. Agency Theory suggests that firms with stable consumption patterns can better allocate resources, minimizing financial inefficiencies (Pratiwi, 2021). Handini et al. (2023) found that companies that effectively manage consumption patterns experience reduced financial distress, leading to increased profitability. By maintaining financial stability, firms can avoid costly financial crises and focus on revenue-generating activities. Thus, consumption smoothing enhances profitability by mitigating financial distress risks.
H9: Financial Distress Mediates the Relationship Between Consumption Smoothing and Profitability in Manufacturing Companies

Leverage can contribute to profitability if managed properly, but excessive debt increases financial distress, negatively impacting profitability. Capital Structure Theory suggests that while debt can enhance returns, high leverage increases financial distress risks, reducing profitability (Sari, 2021). Setiawan et al. (2021) found that firms with high leverage often experience financial distress, limiting their ability to generate sustainable profits. High interest costs and repayment obligations reduce cash flow availability for investment, decreasing overall profitability. Firms that fail to manage leverage effectively often face reduced financial performance due to rising financial distress risks.
H10: Financial Distress Mediates the Relationship Between Leverage and Profitability in Manufacturing Companies

3. Methodology

This study employs a quantitative approach with a causal research design to analyze the causal relationship between independent and dependent variables. The data used are secondary data obtained from the financial reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2023 period. The populationincludes all manufacturing companies listed on the IDX during this period, while the sample was selected using a purposive sampling technique based on specific criteria: (1) manufacturing companies listed on the IDX from 2020 to 2023, (2) companies that published complete financial reports throughout the study period, and (3) companies with complete data related to the studied variables, resulting in a final sample of 50 companies. The study examines independent variables, including income smoothing (measured using the Eckel Index), consumption smoothing(measured by the ratio of total operating expenses to total revenue), and leverage (measured using the Debt-to-Equity Ratio (DER)). The dependent variable is profitability, measured using Return on Assets (ROA), while financial distress serves as a mediating variable, measured using the Altman Z-Score. Data analysis is conducted using Structural Equation Modeling (SEM) with a Partial Least Squares (PLS) approach via SmartPLS software. The analysis includes measurement model evaluation (outer model) to assess reliability and validity, and structural model evaluation (inner model) to examine relationships between variables. Hypothesis testing is performed by analyzing the t-statistic and p-value to determine the significance of variable relationships.

4. Empirical Findings/Result

Descriptive Statistics

A general overview of the research variables, including Income Smoothing, Consumption Smoothing, Leverage, Financial Distress, and Profitability, is presented in Table 1 below.

Table 1. Descriptive Statistics Results

Variables	Mean	Median	Scale Min	Scale Max	Standard Deviation
Income Smoothing	-0.18	0.06	-39.930	0.41	2.875
Consumption Smoothing	12.597	9.100	0.63	187.470	19.143
Leverage	1.837	1.270	-7.170	8.000	1.955
Financial Distress	1.601	1.300	-19.200	8.600	3.447
Profitability	3.918	0.12	-8.440	34.890	6.972

The analysis procedure used in this study follows the Partial Least Squares (PLS) approach. The analysis was conducted using SmartPLS 4 software. The first step in PLS-SEM analysis involves conceptualizing the structural model.

Based on the descriptive statistics in Table 4.1, it can be explained that Income Smoothing has a mean value of -0.18, with a minimum value of -39.930 and a maximum value of 0.41. The standard deviation of 2.875 indicates significant variations among companies in applying income smoothing practices.

Consumption Smoothing has a mean of 12.597, with a minimum value of 0.63 and a maximum value of 187.470, while the standard deviation of 19.143 indicates significant differences in corporate consumption patterns.

Leverage has a mean of 1.837, with a minimum value of -7.170 and a maximum value of 8.000. The standard deviation of 1.955 suggests variations in the debt levels used by companies.

Financial Distress has a mean of 1.601, with a minimum value of -19.200 and a maximum value of 8.600. The standard deviation of 3.447 indicates differences in financial conditions among companies, where some face a higher risk of financial distress.

Finally, Profitability has a mean of 3.918, with a minimum value of -8.440 and a maximum value of 34.890. The standard deviation of 6.972 suggests high variability in profitability levels among companies, with some experiencing losses while others achieve high profitability.

Model Test Results

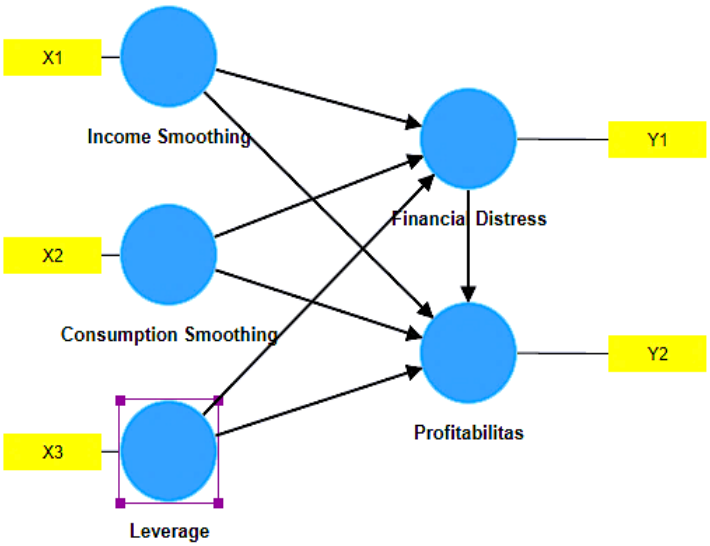

Figure 1. Output of the Modified PLS Testing Model

The output of the Modified PLS Testing Model illustrates the relationship between the independent variables, the mediating variable, and the dependent variable in this study. Income Smoothing (X1), Consumption Smoothing (X2), and Leverage (X3) act as independent variables that influence Financial Distress, which serves as the mediating variable. In turn, Financial Distress affects Profitability (Y2) as the dependent variable.

The arrows connecting the variables represent the causal relationships tested in this model. The variables in bluerepresent latent constructs in the Partial Least Squares

(PLS) analysis, while the yellow boxes indicate the indicatorsfor each variable. This model aims to evaluate the direct and indirect effects of Income Smoothing, Consumption Smoothing, and Leverage on Profitability through Financial Distress. The results of this model will provide insights into how these factors influence the financial performance of manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the study period.

R-Square Test

Table 3. R-Square Values

Variable	R-Square
Financial Distress	0.046
Profitability	0.536

The R-square value for the relationship between income smoothing, consumption smoothing, and leverage on financial distress is 0.046 or 4.6%. This indicates a very weak model influence, meaning that financial distress can only be explained by these variables by 4.6%, while the remaining 95.4% is explained by other factors outside this model.

Meanwhile, the R-square value for the relationship between income smoothing, consumption smoothing, and leverage on profitability is 0.536 or 53.6%. This suggests a moderate to strong model influence, meaning that 53.6% of profitability can be explained by these independent variables, while the remaining 46.4% is explained by other variables outside the model.

Q-Square (Predictive Relevance) Test

Table 4. Q-Square (Q^2) Values

Variable	Q-Square
Financial Distress	-0.065
Profitability	0.423

Based on the Q^2 values, the predictive relevance for financial distress is -0.065, indicating that the model has no predictive power for financial distress. This suggests that the model is insufficient to explain variations in financial distress.

On the other hand, the Q^2 value for profitability is 0.423, which is considered moderate. This implies that the model has a decent predictive relevance, explaining 42.3% of profitability variations, while the remaining 57.7% is accounted for by factors not included in the model.

F-Square Test (Effect Size Test)

Table 5. f-Square Values

Variable	Financial Distress
Consumption Smoothing	0.047
Financial Distress	-
Income Smoothing	0.000
Leverage	0.001
Profitability	-

The Goodness of Fit values show that the effect of Consumption Smoothing on Financial Distress is 0.047, which is relatively small. Similarly, other independent variables such as Income Smoothing and Leverage have very low f-square values, suggesting weak model fit.

Although the model's strength is relatively low, the evaluation results indicate that it can still be used for predictive analysis and examining the relationships between variables.

Hypothesis Test

Table 6. Path Coefficient Analysis Results

Variable	Original Sample	T Statistics	P Values	Description	Decision
CS → FD	0.213	2.817	0.005	Significant	Hypothesis accepted
CS → Profitability	-0.093	2.829	0.005	Significant	Hypothesis accepted
FD → Profitability	-0.057	0.899	0.369	Not Significant	Hypothesis rejected
IS → FD	-0.004	0.042	0.966	Not Significant	Hypothesis rejected
IS → Profitability	0.017	0.197	0.844	Not Significant	Hypothesis rejected
Leverage → FD	-0.026	0.217	0.828	Not Significant	Hypothesis rejected
Leverage → Profitability	0.717	15.025	0.000	Significant	Hypothesis accepted
CS → FD → Profitability	-0.012	0.722	0.440	Not Significant	Hypothesis rejected
IS → FD → Profitability	0.000	0.017	0.987	Not Significant	Hypothesis rejected
Leverage → FD → Profitability	0.001	0.117	0.907	Not Significant	Hypothesis rejected

The analysis results indicate that Consumption Smoothing (CS) has a significant effect on Financial Distress (FD), with a path coefficient of 0.213, a t-statistic of 2.817, and a p-value of 0.005, leading to the acceptance of the hypothesis. However, CS has a negative effect on Profitability, with a coefficient of -0.093, a t-statistic of 2.829, and a p-value of 0.005, which is also significant, resulting in the acceptance of this hypothesis. On the other hand, Financial Distress (FD) does not significantly affect Profitability, as indicated by a t-statistic of only 0.899 and a p-value of 0.369, leading to the rejection of the hypothesis. Institutional Shareholding (IS) also has no significant effect on either FD or Profitability, with t-statistics of 0.042 and 0.197 and p-values of 0.966 and 0.844, respectively, resulting in the rejection of both hypotheses. Similarly, Leverage does not significantly affect FD, with a t-statistic of 0.217 and a p-value of 0.828. However, Leverage has a positive and significant effect on Profitability, with a coefficient of 0.717, a t-statistic of 15.025, and a p-value of 0.000, leading to the acceptance of this hypothesis. Regarding the mediation effects, CS on Profitability through FD is not significant (t-statistic 0.722, p-value

0.440), nor is IS on Profitability through FD (t-statistic 0.017, p-value 0.987) or Leverage on Profitability through FD (t-statistic 0.117, p-value 0.907), resulting in the rejection of all three mediation hypotheses.

5. Discussion

The Effect of Income Smoothing on Financial Distress

The first hypothesis states that income smoothing does not lead to an increase in financial distress. The results indicate that income smoothing does not significantly influence financial distress in manufacturing firms. This finding suggests that companies engaging in income smoothing may not necessarily experience higher financial distress. According to Bansal (2024), income smoothing is a strategic earnings management tool used to reduce fluctuations and create the appearance of financial stability. However, the findings of this study do not support this theory, as income smoothing does not significantly impact financial distress. Previous studies have shown conflicting results. Khzer and Jaf (2023) found that income smoothing improves financial stability by reducing volatility in earnings reports, while Dewi and Suryandari (2023) argued that income smoothing does not always translate into better financial health. The current study aligns more with the latter, indicating that income smoothing does not have a significant role in mitigating financial distress in the manufacturing sector.

The Effect of Consumption Smoothing on Financial Distress

The second hypothesis states that higher consumption smoothing practices lead to increased financial distress. The results confirm this hypothesis, indicating that consumption smoothing has a positive and significant effect on financial distress. This suggests that firms that engage in excessive consumption smoothing may face greater financial distress. These findings align with Baugh et al. (2021), who explain that asymmetric consumption smoothing can lead to financial imbalances if not managed efficiently. While consumption smoothing is intended to ensure financial stability, in certain cases, it may lead to financial distress due to poor cash flow management. This result contrasts with Ogasawara (2024), who found that consumption smoothing in historical economies helped maintain financial resilience. The discrepancy in findings may be attributed to differences in industry characteristics or economic conditions.

The Effect of Leverage on Financial Distress

The third hypothesis proposes that higher leverage increases the risk of financial distress. However, the findings indicate that leverage does not significantly influence financial distress in the studied manufacturing firms. While Diyanto (2020) found that leverage has a direct impact on financial distress, the current study suggests that leverage may not always be a critical determinant. This aligns with Gungoraydinoglu and Öztekin (2021), who argue that firms with strong financial strategies can manage leverage effectively without leading to financial distress.

The Effect of Financial Distress on Profitability
The fourth hypothesis suggests that financial distress negatively affects profitability. However, the findings indicate that financial distress does not significantly influence profitability in manufacturing firms. This result does not fully align with Pinem et al. (2023), who found that financial distress reduces firm profitability. However, Tarighi et al. (2022) suggest that some firms are able to maintain profitability despite financial distress through effective financial reporting practices.

The Effect of Consumption Smoothing on Profitability
The fifth hypothesis states that higher consumption smoothing practices lead to lower profitability. The findings confirm this hypothesis, indicating that consumption smoothing negatively affects profitability. These results align with Rahman et al. (2021), who highlight that poor financial behavior, including excessive consumption smoothing, can lead to lower profitability. This finding contradicts Baugh et al. (2021), who found that consumption smoothing can improve financial stability under certain conditions. The difference may be due to varying financial management practices across industries.

The Effect of Leverage on Profitability
The sixth hypothesis proposes that leverage positively influences profitability. The findings strongly support this hypothesis, indicating that leverage has a significant positive impact on profitability. These results are consistent with Al-Hawatmah and Shaban (2023), who found that financial leverage plays a crucial role in enhancing profitability by providing firms with additional capital for growth and investment. Similarly, Arhinful and Radmehr (2023) suggest that leverage, when used strategically, leads to better financial performance.

The Effect of Income Smoothing on Profitability Through Financial Distress
The seventh hypothesis states that income smoothing influences profitability through financial distress. However, the findings indicate no significant indirect effect, suggesting that income smoothing does not mediate the relationship between financial distress and profitability. These results contrast with Ogundajo et al. (2021), who found that income smoothing improves profitability by reducing earnings volatility. However, Bui (2024) suggests that income smoothing's impact on profitability varies depending on managerial practices and industry characteristics

6. Conclusions

This study aims to analyze the impact of income smoothing, consumption smoothing, and leverage on financial distress and profitability in manufacturing companies listed on the Indonesia Stock Exchange (IDX). Based on the research findings, several key conclusions can be drawn. The analysis results indicate that income smoothing has a negative but insignificant effect on financial distress. This suggests that income smoothing practices tend to reduce the likelihood of financial difficulties; however, the effect is not strong enough to be a key determinant of financial distress in manufacturing companies. Meanwhile, consumption smoothing is found to have a

positive and significant effect on financial distress. This means that the higher the level of consumption smoothing implemented by a company, the greater the likelihood of experiencing financial distress. These findings suggest that firms adopting consumption smoothing strategies may face higher financial risks. On the other hand, leverage has a negative but insignificant effect on financial distress. This implies that an increase in leverage or the use of debt in a company's capital structure does not directly contribute to an increase in financial distress risk in the studied manufacturing firms.

Regarding profitability, this study finds that income smoothing also has a negative but insignificant effect. In other words, companies engaging in income smoothing tend to have lower profitability levels, although the impact is not statistically significant. In contrast, consumption smoothing has a positive and significant effect on profitability. This finding indicates that companies implementing consumption smoothing strategies can significantly enhance their profitability, making it a potential factor supporting financial performance. Unlike its impact on financial distress, leverage is found to have a positive and significant effect on profitability. This means that the higher a company's leverage, the greater its profitability. These findings suggest that optimal debt utilization can help firms increase their earnings.

Furthermore, this study examines the effect of income smoothing, consumption smoothing, and leverage on profitability through financial distress as a mediating variable. The results indicate that income smoothing, consumption smoothing, and leverage do not significantly influence profitability through financial distress. This suggests that financial distress is not a strong intermediary variable in the relationship between these factors and the profitability of manufacturing firms. Additionally, the study finds that financial distress has a negative but insignificant effect on profitability. In other words, while financially distressed companies tend to have lower profitability, the effect is not strong enough to be considered a primary determinant of profitability in manufacturing firms listed on the IDX.

Several limitations should be considered in this study. First, the research focuses only on manufacturing companies listed on the IDX during the 2020–2023 period. Therefore, the findings cannot be generalized to other sectors or companies outside this period. Second, the study only examines three main variables: income smoothing, consumption smoothing, and leverage in relation to financial distress and profitability. Other potentially influential factors, such as market conditions or regulatory changes, are not analyzed. Third, the study uses specific financial ratios to measure income smoothing, consumption smoothing, and leverage, which may have limitations in fully capturing the overall financial condition of the companies. Lastly, this research does not consider external factors such as policy changes or economic crises, as well as potential biases in financial reporting that may influence income smoothing and leverage practices within companies.

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