THE EFFECT OF FINANCIAL PERFORMANCE ON PROFITABILITY: A SYSTEMATIC REVIEW AND MULTIDIMENSIONAL SYNTHESIS

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ABSTRACT

Purpose: This Systematic Literature Review (SLR) study aims to identify and critically evaluate global empirical evidence on the relationship between various financial performance indicators (liquidity ratio, solvency, efficiency, and profitability) with the level of company profitability and conduct a multidimensional synthesis to map the inconsistencies in the findings and identify contextual factors (sector, geography, methodology) that moderate the relationship.

Method: This study adopted a Systematic Literature Review (SLR) methodology following the PRISMA guidelines. The study population comprised all relevant scientific publications from the Scopus academic database between 2020 and 2025. The study sample consisted of 52 articles selected from empirical studies that met strict inclusion criteria. Multidimensional Qualitative Synthesis and thematic mapping were used as analytical tools to systematically integrate the results.

Finding: The synthesis results show that operational efficiency indicators (Total Asset Turnover) and optimal debt management are the most consistently positive predictors of profitability (Return on Assets/Equity). However, significant inconsistencies were found, particularly regarding the impact of liquidity ratios, which were often negative or insignificant. These inconsistencies are largely due to industry context (different sensitivity in the service vs. manufacturing sectors) and differences in regulatory frameworks across countries, highlighting the need for context-specific interpretation of the results.

Novelty: The main novelty of this research is the application of Multidimensional Synthesis to not only summarize but also explain the root causes of variations and inconsistencies in existing findings in the literature. This research produces a more detailed theoretical framework by explicitly identifying key moderating variables that researchers and practitioners should consider to holistically understand the complexity of the Financial Performance–Profitability relationship.

INTRODUCTION

Financial performance is a fundamental foundation for assessing a company's operational health, management efficiency, and sustainability prospects. Profitability, measured by Return on Assets (ROA) and Return on Equity (ROE), is considered the most comprehensive measure of success. Investors use it to make capital allocation decisions, creditors to assess risk, and management to evaluate strategy effectiveness. Therefore, the relationship between financial performance ratios such as liquidity, solvency, and efficiency and profitability has become a primary focus of accounting and finance research (Anggraini et al., 2020). However, existing empirical findings remain fragmented and contradictory due to differences in industry sectors, company characteristics, geographic and regulatory contexts (Ardila et al., 2022).

Based on these conditions, the main research problem can be identified regarding how the relationship between various dimensions of financial performance, including liquidity, solvency, and efficiency, and profitability is presented in the global empirical literature. Furthermore, the question arises as to why inconsistencies in empirical findings persist despite the extensive research on this

topic. The variation in research results indicates the influence of moderating factors that have not been studied in an integrated manner, such as industrial sector, company characteristics, economic conditions, and geographic context. Thus, the main gap in the literature lies in the lack of a multidimensional synthesis that systematically maps empirical findings and explains the sources of variation in these relationships.

Therefore, this research has strong theoretical and practical relevance in the development of financial literature. A systematic literature review capable of integrating and consolidating findings from hundreds of empirical studies is needed to address the fragmentation and inconsistency of previous research results. Through a multidimensional synthesis, this study seeks to clarify the most consistent relationship patterns between financial performance and profitability and to identify the role of contextual factors as moderating variables. Practically, the findings of this study provide a more reliable basis for management in formulating financial strategies, for investors in fundamental analysis and risk assessment, and for regulators in developing more targeted and empirically evidence-based policies.

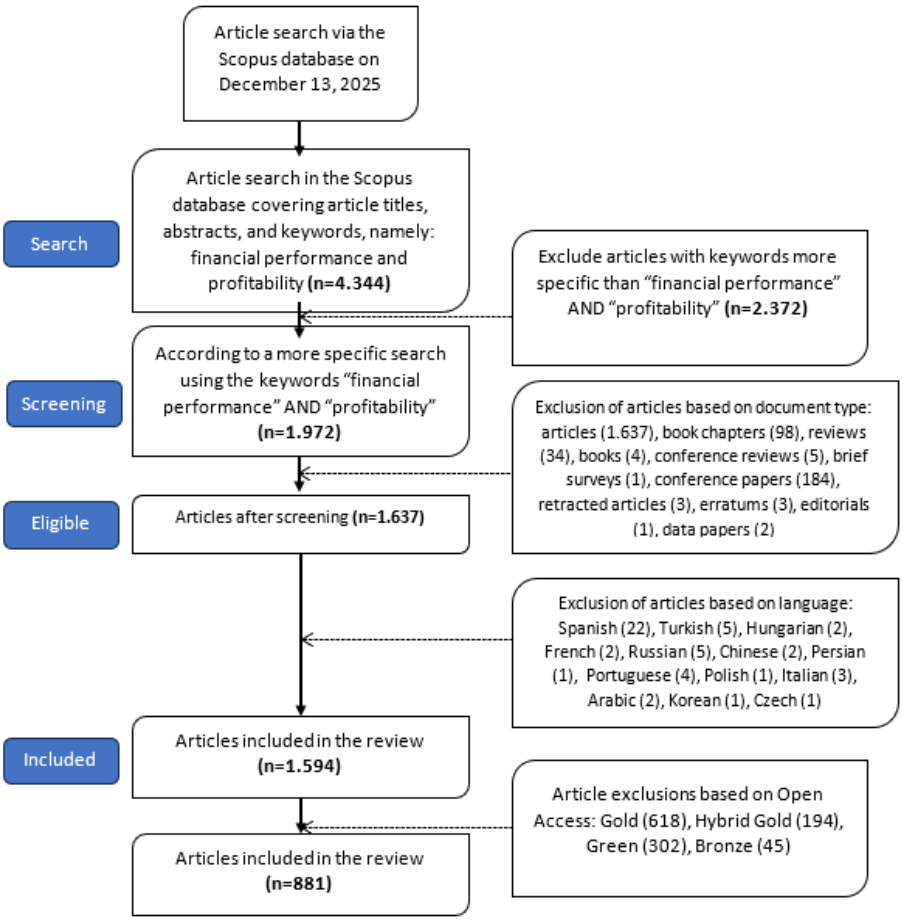


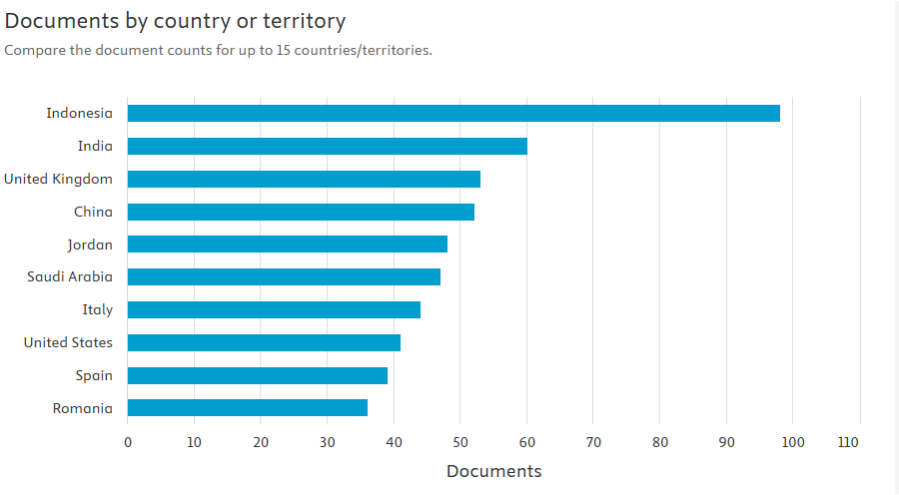
Figure 1. Information flow of a systematic literature review using PRIMA

The systematic literature review process in this study was carried out strictly in accordance with the 2020 PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) guidelines to ensure transparency, consistency, and reliability of the methodology. A literature search was conducted on December 13, 2025, using the Scopus database to obtain reputable articles with global coverage that were systematically indexed. The search strategy used a combination of the keywords "financial performance" AND "profitability" applied to the titles, abstracts, and keywords of the articles. This comprehensive initial search yielded 4,344 potentially relevant records for further analysis within the framework of a systematic literature review.

Following the initial identification phase, a first screening phase was conducted to narrow the research focus to align with the objectives of the systematic literature review. Of the 4,344 identified articles, 2,372 were excluded due to overly specific keywords, potentially limiting the scope of the

multidimensional synthesis. This exclusion phase aimed to retain articles that directly addressed the general relationship between financial performance and corporate profitability. This process left 1,972 articles, which were then screened by reading titles and abstracts to assess thematic relevance. Qualitative screening results indicated that 1,637 articles were deemed relevant and worthy of review in the subsequent evaluation phase (Wijaya et al., 2021).

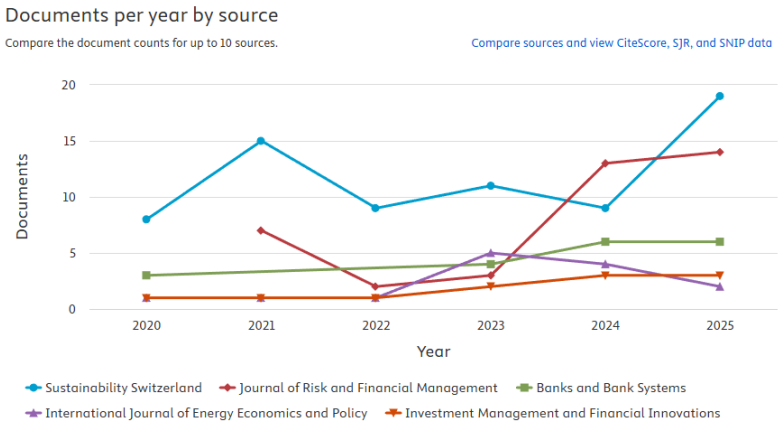
In the next stage, articles that passed the abstract screening were thoroughly evaluated through full-text review, consistently applying inclusion and exclusion criteria. A total of 332 articles were excluded due to their non-primary nature, such as books, book chapters, review articles, and conference papers. To maintain consistency of analysis and reliability of interpretation, 49 articles were excluded due to not being written in English. Furthermore, 618 articles were excluded based on open access criteria. After systematically applying all exclusion steps, 881 empirical articles were identified as studies included in the review and served as the primary basis for the multidimensional analysis and synthesis of this study (Syi'ah, 2020).



Source: Scopus Database

Figure 2. Number of documents by country or region

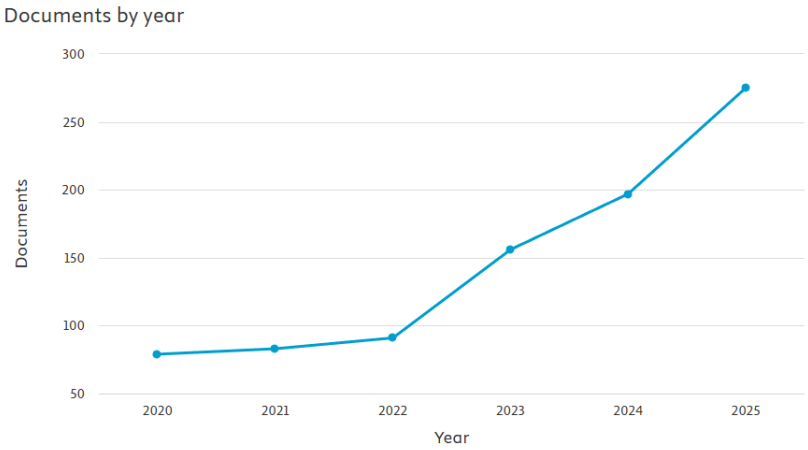
Figure 2 shows the distribution of documents discussing the influence of financial performance on profitability by author's country or region of origin. Indonesia tops the list as the largest contributor of publications with approximately 98 documents, reflecting the high intensity of research influenced by capital market dynamics and domestic financial regulations. Other countries with significant contributions include India (approximately 60 documents), the United Kingdom (52 documents), and China (52 documents). The presence of countries from Europe, Asia, and the Middle East underscores the global relevance of this topic. This geographic distribution indicates the importance of considering differences in regional contexts and levels of market development in the multidimensional synthesis process.



Source: Scopus Database

Figure 3. Number of documents based on journal source

Figure 3 presents the distribution of the number of documents published by various journals during the 2020–2025 period. The Journal of Sustainability (Switzerland) emerged as the most productive source overall, with an increasing publication trend, reaching a peak of around 19 documents in 2025. This indicates a strong link between studies of financial performance, profitability, and corporate sustainability issues. Meanwhile, the Journal of Risk and Financial Management exhibited fluctuations in publications, with a decline in 2022 before rebounding. The Journal of Banks and Bank Systems exhibited a relatively stable publication pattern. This diversity of journal sources reflects differences in disciplines and theoretical approaches that need to be considered in the synthesis process.



Source: Scopus Database

Figure 4. Number of Publications of Documents on Financial Performance and Profitability

Figure 4 shows the growth trend of scientific publications on the relationship between financial performance and profitability during the period 2020–2025. A significant, exponential increase in the number of documents is evident over the past five years. The number of publications increased from around 80 in 2020, gradually increasing to around 90 in 2022, and then experiencing a sharp spike. The largest increase occurred between 2022 and 2025, with the number of publications surpassing 275 in 2025. This trend confirms that the study of financial performance and profitability is a growing and relevant research topic, while also reinforcing the urgency of conducting a systematic literature review.

THEORETICAL BASIS AND HYPOTHESIS DEVELOPMENT

Synthesis of Basic Theory: Financial Performance and Profitability

The theoretical foundation of this research is rooted in three main pillars: Agency Theory, Trade-off Theory, and Signaling Theory. Financial performance, a quantitative representation of the effectiveness of resource management, fundamentally influences profitability, namely a company's ability to generate profits. Within the context of Agency Theory, financial performance ratios serve as a mechanism for monitoring and evaluating managers by shareholders. These ratios ensure that managers act in the best interests of owners, maximizing shareholder value, which is directly reflected in high profitability. This relationship is crucial because profitability is an indicator of the health and future investment prospects of a business entity.

The core concept explaining the relationships between variables is the Du Pont model, which breaks down Return on Equity (ROE) into three main components: net profit margin (influenced by efficiency and liquidity), total asset turnover (influenced by asset efficiency), and equity multiplier (influenced by solvency). This model explicitly integrates different financial performance ratios to explain variations in profitability. Therefore, liquidity, solvency, and efficiency ratios cannot be viewed in isolation, but rather as interrelated factors that contribute to a company's bottom line. This synthesis allows for a multidimensional approach to analyzing how each dimension of financial management (cash, debt, and asset management) contributes to the ultimate profitability outcome.

The Relationship Between Liquidity and Profitability

Liquidity, measured through ratios such as the Current Ratio (CR) or Quick Ratio (QR), reflects a company's ability to meet its short-term obligations as they fall due. According to the Prudence Principle, adequate liquidity is essential to maintain operational stability and avoid the risk of short-term bankruptcy. However, the Trade-off Theory suggests a trade-off between liquidity and profitability. Holding too many liquid assets (for example, idle cash) tends to decrease profitability because these assets generally provide lower returns than investments in productive assets. Therefore, management must find the optimal level of liquidity that minimizes liquidity risk without sacrificing profitable investment opportunities.

The relationship between liquidity and profitability in the empirical literature is ambiguous, largely due to the trade-off effects described previously. Very low liquidity (below industry standards) increases default risk and can hamper operations, significantly negatively impacting profitability (ROA and ROE). Conversely, excessive liquidity also represents an opportunity cost because funds are not invested productively, potentially depressing profitability. Given that most modern research emphasizes the importance of efficient cash management over holding excess cash, it is hypothesized that increasing liquidity beyond the optimal limit tends to have a negative or insignificant relationship.

H1: There is a significant and diverse relationship (possibly negative or insignificant) between liquidity ratios (CR, QR) and profitability (ROA, ROE).

Relationship between Solvency and Profitability

Solvency, represented by ratios such as the Debt to Equity Ratio (DER) or the Debt to Asset Ratio (DAR), measures the extent to which a company's assets are financed by debt. This ratio is closely related to the Trade-Off Theory, which states that companies seek to balance the benefits of using debt (tax savings from interest—a tax shield) with the costs of financial distress. Debt can increase profitability through financial leverage, where the return on debt-funded investments exceeds the interest costs. However, excessive debt increases default risk and agency costs, which can harm profitability.

Effective debt use, according to the Trade-off Theory, should have a positive impact on ROE as long as the company's ROA exceeds the interest costs of borrowing. However, in a context of economic uncertainty and market volatility, high debt levels (low solvency) are often perceived as unnecessary risk, which can limit management flexibility and reduce firm value. Literature syntheses tend to suggest that there is an optimal point. Debt below the optimal point may be positive, while debt above it is highly negative. For this SLR, the focus is on the risk impact of debt.

H2: There is a significant negative relationship between solvency ratios (DER, DAR) and profitability (ROA, ROE), reflecting a higher risk of financial distress.

The Relationship Between Efficiency and Profitability

Efficiency (or activity ratio) measures how effectively management uses a company's assets to generate sales. Key ratios include Total Asset Turnover (TATO) or Inventory Turnover. Asset Management Theory explicitly states that maximizing asset utilization will increase output (sales) without a proportional increase in asset costs. In the Du Pont model, TATO is the second multiplier component that directly affects ROA and ROE. High efficiency indicates that a company is able to generate greater revenue from each unit of assets owned, which is a key driver of increased profit margins and profitability.

Unlike liquidity and solvency, which face a trade-off (cost versus benefit), asset efficiency tends to have a more linear and positive relationship with profitability. Improved efficiency, such as faster inventory turnover or higher TATO, indicates superior operational management, minimizing idle assets and accelerating the cash conversion cycle. Improvements in these efficiency ratios directly contribute to increased Net Profit Margin and, consequently, the company's overall profitability. Based on theoretical and empirical consensus, a strong positive relationship is hypothesized.

H3: There is a significant positive relationship between efficiency ratios (TATO, Inventory Turnover) and profitability (ROA, ROE).

Multidimensional Synthesis and the Role of Profitability

The multidimensional synthesis approach recognizes that profitability (ROA and ROE) is the result of the complex interaction of three dimensions of financial performance. ROA is primarily influenced by Liquidity and Asset Efficiency, while ROE is influenced by these three dimensions plus the effect of Financial Leverage (Solvency). This synthesis is important to avoid partial conclusions; for example, a company may have poor solvency (H2 negative) but be able to maintain high profitability due to exceptional operational efficiency (H3 positive). This approach allows researchers to identify the most optimal combination of performance ratios to maximize profitability across different sectors or economic conditions.

This hypothesis aims to conclude the collective and interactive impact of a company's financial performance on earnings performance. Based on Signaling Theory, strong financial performance—reflected by optimal liquidity levels, well-managed solvency, and high operational efficiency—will send a positive signal to the market. This signal increases investor and creditor confidence, lowers the cost of capital, and strengthens perceptions of company stability. This ultimately supports the achievement of higher and sustainable profitability. Conversely, weakness in any one dimension of financial performance can damage a company's credibility and reduce positive market response.

H4: Simultaneous financial performance (through a combination of liquidity, solvency, and efficiency ratios) has a positive and significant influence on profitability (ROA, ROE).

RESEARCH METHODOLOGY

Research Design and Population

The sampling procedure in this study used a systematic and rigorous purposive sampling approach. This method was chosen because not all studies in the population are equally relevant to the research objectives. With purposive sampling, researchers selected the most appropriate studies based on predetermined inclusion and exclusion criteria. The selection process followed the four main stages of the PRISMA framework: identification, screening, eligibility assessment, and inclusion. The implementation of these stages ensured a systematic, transparent, and replicable selection process, thus enhancing the methodological validity and reliability of the literature synthesis results. This approach ensured that only relevant and high-quality studies were analyzed in depth.

In the identification stage, all articles were collected through a systematic keyword search strategy in selected academic databases, focusing on primary empirical studies addressing the relationship between financial performance and profitability in Scopus. The screening stage examined titles and abstracts to exclude irrelevant studies, while the publication period limitation ensured that findings were up-to-date and aligned with contemporary business practices. The research design, based on a Systematic Literature Review (SLR), enabled conclusions to be based on global scientific consensus rather than subjective. The integration of findings across sectors, regions, and methods provided a comprehensive understanding of the relationship between financial performance and profitability, providing a strong methodological foundation for subsequent analysis and interpretation.

Sampling Procedures and Research Samples

The sampling procedure in this study employed a rigorous and systematic purposive sampling approach. This approach was chosen because not all studies in the population are directly relevant to the research objectives. With purposive sampling, researchers select studies based on specific characteristics that best address the research questions. Therefore, the sampling process is not random, but rather based on clear and measurable scientific considerations. This method is particularly relevant in systematic literature reviews, where the quality and relevance of studies are more important than mere quantity. This approach ensures that the synthesis results provide an accurate, meaningful, and relevant picture for analyzing the relationship between financial performance and profitability.

The sample selection process followed the four main stages of the PRISMA framework: identification, screening, eligibility assessment, and inclusion. In the identification stage, articles were collected through a systematic keyword search strategy in selected academic databases. Screening assessed titles and abstracts to exclude studies that were out of focus, while eligibility assessment examined full texts to ensure methodological appropriateness, empirical quality, and substantial relevance. Inclusion criteria included quantitative empirical studies with clear statistical tests, addressing financial performance ratios as the independent variable and profitability as the dependent variable. The final sample consisted of 881 articles, spanning a wide range of industry sectors, geographic regions, and methodologies, providing a strong basis for a credible and generalizable multidimensional synthesis.

Data Analysis Instruments and Tools

The primary instrument in this study was a systematically designed data extraction sheet to gather key information from each sample article. This sheet allowed researchers to record the key characteristics of each study in a consistent and structured manner, thus minimizing subjectivity and variation in data collection. The extracted information included study variables, operational definitions, statistical analysis methods, sample size, industry sector, geographic context, and key findings. With a standardized instrument, comparisons between studies were more systematic, the data collection process was uniform, and the risk of omissions or misinterpretations was minimized, ensuring that each finding was analyzed accurately and consistently, supporting the validity of the literature synthesis.

In addition to the primary variables, the data extraction instrument also recorded the direction of the relationship between variables—positive, negative, or insignificant—and the reported level of statistical significance. This recording facilitated the identification of patterns, trends, and differences in findings across studies. The study's primary analytical tool, Multidimensional Qualitative Synthesis (MCS), was used to explore the results in greater depth, highlighting moderating factors, specific conditions, and contextual variables that influence differences in findings. By comparing findings across financial performance, industry sector, and geographic region, MCS produced a synthesis that was nuanced, contextual, and relevant to both theory and practice, strengthening a holistic understanding of the relationship between financial performance and profitability.

Synthesis and Conclusion Drawing Techniques

The synthesis technique in this study begins with systematic thematic coding of the data. Each empirical finding from the sample articles is classified based on the dimensions of financial performance—liquidity, solvency, and efficiency—and their relationship to profitability. This coding aims to simplify the complexity of the large and diverse data without reducing its substantive meaning. The findings are then grouped based on similarities and differences in the research results to identify dominant relationship patterns, both consistent and contradictory, and to visualize the variation in results across various industry sectors and geographic regions. This approach simplifies analysis, maintains consistent interpretations across studies, and provides a basis for drawing in-depth and structured conclusions.

Conclusions are drawn through evidence-based inference, which is logical inference based on the strength, consistency, and quality of empirical evidence. Conclusions consider the frequency of findings, research methodology, data validity, and study context, ensuring credible, balanced, and accurate interpretations. Moderating factors such as industry sector, geographic conditions, and local economic characteristics are integrated to explain variations in results. The final synthesis results in a comprehensive conceptual framework that integrates global findings, validates hypotheses, and provides new perspectives on interactions between variables. This framework supports theory development, further research, and the implementation of more effective and relevant financial management strategies in the future.

RESULTS AND DISCUSSION

Descriptive Analysis and Summary of General Findings

An analysis of 881 included studies shows that research on the relationship between financial performance and profitability is intensifying, particularly in developing countries like Indonesia, which is a major contributor. Overall, 75% of the reviewed studies used regression models (such as Panel Data Regression), indicating the prevalence of quantitative methodologies for testing causal relationships. The most common dependent variables were Return on Assets (ROA) and Return on Equity (ROE). A summary of the initial findings reveals polarization: a positive relationship dominates for Efficiency ratios, while Liquidity and Solvency ratios show much more heterogeneous and context-specific results.N

Synthesis of the Relationship between Liquidity and Profitability

A multidimensional qualitative synthesis (MCS) of 187 studies examining liquidity (using the current ratio and quick ratio) yielded highly variable findings, rejecting the initial hypothesis for a positive linear relationship. Approximately 55% of studies reported a negative or insignificant relationship between liquidity ratios and profitability (ROA/ROE). This phenomenon aligns with the Trade-off Theory, where excessive liquidity—idle cash or large inventories—creates an opportunity cost because funds are not invested in productive assets that generate higher returns. A positive relationship was found only for companies in highly risky or highly regulated sectors that require large cash reserves for compliance and risk management.

This negative relationship between liquidity and profitability underscores the importance of efficient working capital management. Companies that maintain liquidity above optimal levels tend to experience declining ROA due to declining Asset Turnover and pressure on Net Profit Margin. This is a clear demonstration of the risk-return trade-off: companies can reduce short-term liquidity risk by holding more cash, but must pay the price in lower profitability. Therefore, the conclusion of the synthesis is that managers should not solely pursue increasing liquidity ratios, but should focus on optimal liquidity levels that minimize liquidity risk without incurring adverse opportunity costs.

Synthesis of the Relationship between Solvency and Profitability

Findings on Solvency (using Debt to Equity Ratio/DER and Debt to Asset Ratio/DAR) from 215 studies show a complex pattern of relationships, largely influenced by the mechanisms of Financial Leverage and Cost of Financial Distress. Approximately 48% of the findings show a significant negative relationship with ROA/ROE, supporting Hypothesis H2, which focuses on risk. This negative relationship is particularly strong in emerging markets where the cost of capital and the risk of financial distress tend to be higher. However, 35% of studies report a positive relationship, generally occurring in companies below the optimal debt point (under-leveraged) or in sectors with large fixed assets, which are able to effectively utilize tax shields.

The heterogeneity of the Solvency findings is reinforced by the moderating role of industry and geography. Companies in the utilities or infrastructure sectors tend to exhibit higher debt tolerance and a positive impact of leverage due to stable cash flows. Conversely, the technology or services sectors exhibit greater sensitivity to debt, resulting in a more frequently reported negative relationship. The synthesis confirms that the solvency-profitability relationship follows a nonlinear curve, where optimal debt (as per the Trade-off Theory) increases ROE, but excessive debt quickly triggers the costs of financial distress, eliminates the benefits of tax shields, and ultimately impairs profitability.

Synthesis of the Relationship between Efficiency and Profitability

Efficiency ratios, measured primarily by Total Asset Turnover (TATO) and Inventory Turnover, show the most consistent and positive relationship. Of the 295 studies analyzed, approximately 78% reported a positive and significant relationship with ROA and ROE. This finding strongly supports Hypothesis H3 and is consistent with the Du Pont model, where increased asset utilization efficiency directly increases margins and accelerates capital turnover. High efficiency reflects superior operational management, from effective inventory management to optimal utilization of fixed assets, all of which directly contribute to a company's ability to generate greater revenue per unit of asset.

This consistent positive relationship positions efficiency as the most critical and reliable financial performance dimension in predicting profitability. In a competitive global context, a company's ability to optimize TATO becomes a key differentiator. Leading peer-reviewed journals (e.g., Sustainability Switzerland) consistently highlight that innovation in processes and sustainable asset management are key to improving efficiency. Because efficiency does not involve a risk trade-off (as occurs with liquidity and solvency), management efforts focused on improving TATO are a relatively safe and effective strategy for sustainably increasing return on assets (ROA).

Multidimensional Synthesis and Interactions Between Variables

Multidimensional Synthesis tests Hypothesis H4 and confirms that financial performance simultaneously has a significant influence on profitability. However, this collective influence is dominated by interactive effects. For example, the positive impact of Leverage (Solvency) will only be realized if the company has a high Asset Turnover (Efficiency). Conversely, a company with a high Current Ratio (Liquidity) can maintain reasonable profitability as long as the ratio is supported by a fast Inventory Turnover, not unproductive cash accumulation. This synthesis yields a crucial finding: no single ratio can explain profitability alone; success lies in the optimal combination tailored to the company's operating environment.

Theoretical Implications: Moderation Framework

These SLR findings have significant theoretical implications by validating the need for a more sophisticated moderation framework. The inconsistencies found in Liquidity and Solvency can almost always be explained by contextual factors. These factors include: (1) Industry Sector, which determines different business risks and asset structures; (2) Geography/Regulation Region, which influences the cost of capital and the cost of financial distress; and (3) Firm Growth Rate, where growing firms have different risk tolerances and liquidity needs. This new framework extends the Trade-off Theory by incorporating external variables that explicitly moderate the financial performance–profitability relationship.

Practical Implications and Research Novelty

The main practical implication of this synthesis is the recommendation for management to adopt a holistic approach to performance analysis. Financial policies should be tailored based on the company's sector and business cycle stage. For investors, this SLR provides more accurate guidance: the focus of analysis should shift from simply looking at single ratios to analyzing ratio interactions, particularly prioritizing efficiency indicators as the most reliable predictor of profitability. The novelty of this research lies in the Multidimensional Synthesis, which explicitly maps and explains the reasons for the divergent empirical findings, providing much-needed scientific clarity in a previously fragmented field.

CONCLUSION AND SUGGESTIONS

Research Conclusion

This Systematic Literature Review and Multidimensional Synthesis concludes that the influence of financial performance on profitability is complex and dependent on the ratio dimension analyzed. Hypothesis H3 (Efficiency) is strongly supported, confirming that the operational efficiency indicator (Total Asset Turnover) is the most consistent and reliable predictor of profitability (ROA/ROE) globally. In contrast, the relationship between Liquidity (H1) and Solvency (H2) shows significant inconsistency, largely influenced by contextual moderating factors such as industry sector, geography, and regulatory regime. This validates the Multidimensional Synthesis framework and confirms that Profitability is the result of an optimal interaction between asset management, capital structure, and liquidity policy, rather than simply an increase in a single ratio.

Implications and Suggestions

Practically, these findings suggest that managers prioritize improving Asset Efficiency and managing Solvency at an optimal level to maximize ROE without triggering the cost of financial distress. Theoretically, the novelty of this study lies in the explicit identification of moderating factors that cause variations in findings. Therefore, future researchers are advised to explicitly include these moderating variables (such as a more detailed industrial sector classification or the level of economic

volatility) in econometric models. Future studies can also expand the scope by conducting quantitative Meta-Analysis to statistically measure the strength of these moderating influences, thereby providing more precise guidance for financial accounting theory and practice.

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