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Determinants of Financial Distress in Indonesian Textile and Garment Companies

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A R T I C L E I N F O

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A B S T R A C T

Focusing on textile and garment firms listed on the Indonesia Stock Exchange from 2021 to 2024, this research evaluates how financial distress is affected by liquidity, leverage, Interest Coverage Ratio (ICR), and firm size. This study employs a quantitative causal design using panel data from 12 listed firms, resulting in 48 firm-year observations selected through purposive sampling. Financial distress was assessed using the Altman Z-Score, while liquidity, leverage, and firm size were represented by the Current Ratio (CR), Debt to Asset Ratio (DAR), and the natural logarithm of total assets, respectively. Panel data estimation identified the Fixed Effect Model (FEM) as the most appropriate model for analysis. Empirical findings reveal leverage as the sole determinant significantly affecting financial distress, whereas liquidity, the Interest Coverage Ratio, and firm size show no significant relationship. These findings suggest that debt used for productive purposes can strengthen firms' financial performance, enabling companies to meet their financial obligations and lowering the likelihood of financial distress

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INTRODUCTION

The Indonesian textile and garment industry plays an important role in the country's economy, particularly in job creation. In 2024, the textile and garment subsector contributed 2.75% of total employment in the manufacturing sector, according to Indonesian Central Bureau of Statistics (2025). Due to its contribution to non-oil and gas exports and employment, this sector has now become one of the important sectors in Indonesia. However, in recent years, the industry has faced increasing financial pressure. Therefore, it is important to identify the factors that can cause companies to experience financial distress.

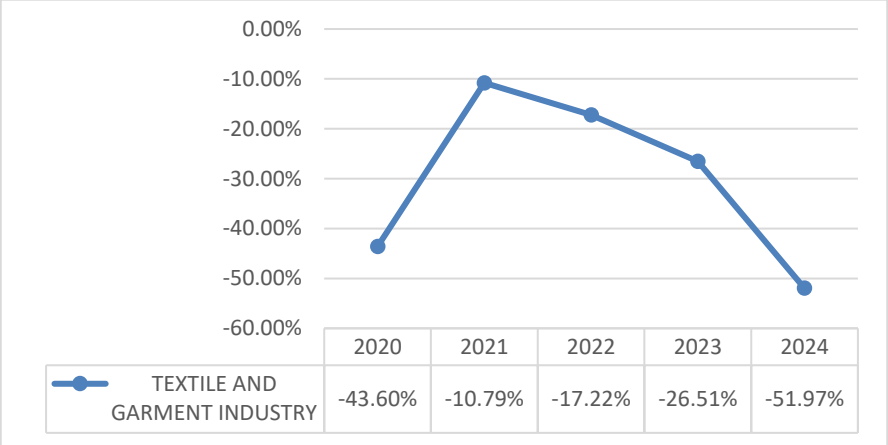

Figure 1. Average ROA of Sample Companies 2020-2024
Source: Indonesia Stock Exchange (2025)

As shown in Figure 1, the average Return on Assets (ROA) of the sampled textile and apparel companies remained negative from 2020 to 2024 and dropped sharply in 2024. This trend reflects weakening profitability and increasing financial pressure in the industry, indicating that many businesses may be facing greater financial distress.

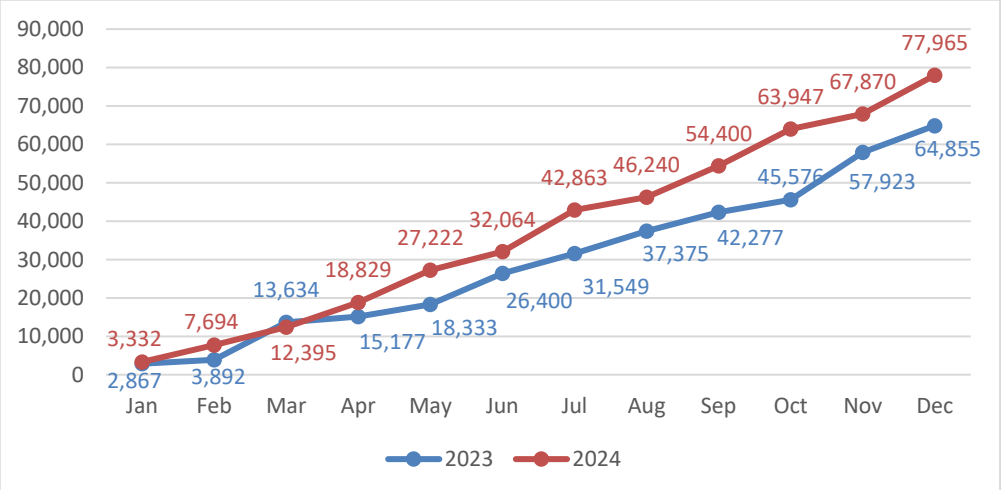

Figure 2. Increase in Manufacturing Layoffs in Indonesia (2023-2024)
Source: Katadata (2025)

The increasing number of layoffs is evidence of the monetary pressures faced by the textile and garment industry. Figure 2 shows data from the Ministry of Manpower of the Republic of Indonesia, published by Pratama (2025), showed that manufacturing layoffs reached 77,965 workers in 2024, representing a 20.2% increase compared with the previous year, with the textile and garment industry contributing the largest share. This trend is consistent with reports that more than 10,000 workers in the textile and garment industry were laid off between January and May 2024 due to declining export demand and the increasing influx of low-priced imported products (Kompas, 2024). One notable example is PT Sri Rejeki Isman Tbk (SRIL), which laid off 10,669 employees before being declared bankrupt after failing to fulfill its debt repayment obligations under a court-approved settlement agreement (Commercial Court at the Semarang District Court, 2024). According to Goh (2023), large-scale layoffs are among the indicators that a company is experiencing financial distress. These conditions highlight the importance of identifying the factors that influence financial distress in Indonesia's textile and garment industry.

Empirical research on the factors that determine financial distress shows very different results. *Arianto & Kurniasih (2023)* and *Delfin & Ferrer (2024)* found a significant negative effect in relation to liquidity. In contrast, Rahayu et al. (2023) and Rinofah et al. (2022) reported a significant positive effect, while *Sihombing & Angela (2024)* and Akil et al. (2024) found no significant relationship between liquidity and financial distress. A similar pattern emerges in leverage studies. Kebede et al. (2024) and Jouali et al. (2024) reported a significant positive influence on financial distress, whereas Efendi et al. (2023) and Cahyana et al. (2025) found a significant negative effect. Meanwhile, Wahab et al. (2026) and *Putri & Artini (2025)* concluded that leverage has no significant effect on financial distress.

Findings on ICR are equally mixed. Suranta et al. (2023) demonstrated a negative significant effect, whereas *Syifa & Idawati (2024)* documented a positive relationship. Conversely, *Setiawan & Sari (2025)* and Ananda et al. (2022) showed no significant effect. Lastly, firm size yields contradictory empirical evidence. Jouali et al. (2024) indicated a positive effect, whereas Jamal (2024) and Aldo et al. (2024) reported a significant negative relationship. Conversely, Nasution et al. (2024) and *Saputri & Santoso (2023)* concluded that firm size does not significantly affect financial distress. These inconsistent findings indicate that further investigation is needed to provide more robust evidence regarding the determinants of financial distress.

This study utilizes this phenomenon and inconsistent prior findings to examine how liquidity, leverage, ICR, and firm size impact financial distress in Indonesian listed textile and garment companies from 2021 to 2024. Effective capital management is essential to support business sustainability against economic shocks. These variables were selected because they systematically capture key financial health dimensions, including operational liquidity, capital structure risk, debt servicing capacity, and operational scale. Ultimately, this research provides practical insights for managers and investors to mitigate financial distress risks in this sector.

LITERATURE RIVIEW

Agency Theory

According to the agency structure, a company is seen as a contract with operational control held by professional management *(Jensen & Meckling, 1976)*. Uncontrolled agency conflicts within corporate finance can drive managers to make decisions that potentially harm the firm, risking financial stability and leading to long-term financial distress. Conversely, if managers operate the company efficiently and align with the owners' interests, the risk of financial distress can be minimized.

Signaling Theory

Signaling theory posits that an imbalance of information exists between corporate executives and external parties, as management maintains deeper insight into actual financial conditions (Spence, 1973). To bridge this gap, companies publish financial statements and operational disclosures, thereby assisting market participants in evaluating risk and opportunity *(Arianto & Kurniasih, 2023)*. According to Purwantini et al. (2023) significant financial ratios serve as important market signals that indicate the dangers of financial distress.

Financial Distress

Financial distress represents a crucial pre-bankruptcy stage wherein operational cash flows fail to fulfill debt commitments. *Platt & Platt (2002)* describe this phenomenon as an impending insolvency condition that demands early detection. Severe cash shortfalls compel organizations to execute extreme operational adjustments such as dividend reductions, staff layoffs, and debt defaults, which ultimately erode liquidity and solvency to accelerate corporate failure (Goh, 2023). Consequently, information regarding financial distress is vital for investors and lenders when assessing exposure to risk, considering that troubled companies frequently experience capital withdrawals and restricted credit access *(Wijaya & Suhendah, 2023)*.

Liquidity

Liquidity reflects a company's ability to cover short term obligations with current assets. Adequate liquid reserves minimize insolvency risks and strengthen creditor confidence regarding the fulfillment of short-term debts *(Sihombing & Angela, 2024)*. This capability fosters trust with key external stakeholders, including creditors and suppliers. Beyond risk mitigation, liquid companies effectively optimize current assets to drive profitability, showcasing operational efficiency and strong overall financial performance *(Jenifer & Muhyarsyah, 2023)*.

Leverage

Financial leverage measures the extent to which an organization utilizes external debt to finance its operations and assets. Higher debt proportions increase fixed financial obligations, raising structural vulnerability and heightening potential distress risks *(Utami & Taqwa, 2023)*.

Interest Coverage Ratio (ICR)

The Interest Coverage Ratio captures an organization's capacity to service its financial debt through operating earnings. Elevated earnings relative to financing costs demonstrate strong debt service capabilities, whereas lower ratios signal earnings distress and vulnerability (Suranta et al., 2023).

Firm Size

Firm size reflects a company's total asset scale and operational stability. Larger firms utilize substantial capital reserves and superior funding access to cover obligations and buffer against distress risks (Syamsuddin et al., 2023).

Theoretical Framework

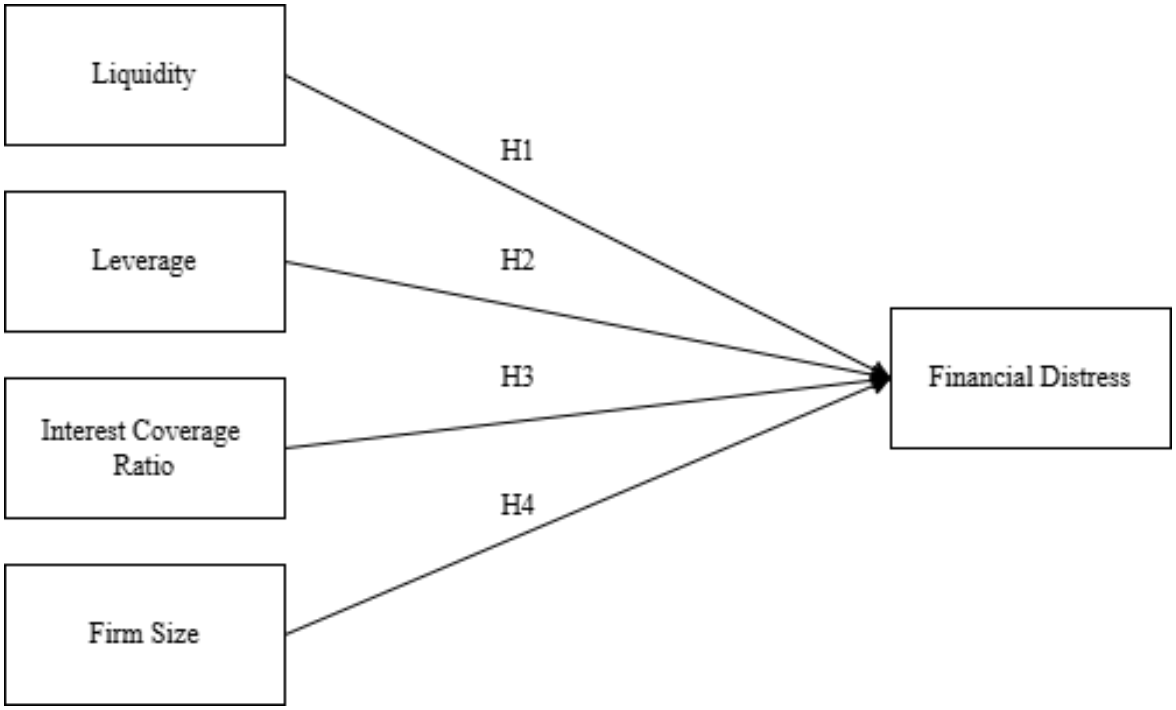

Figure 3. Theoretical Framework

Hypothesis Development

The Effect of Liquidity on Financial Distress

A company's liquidity profile, which provides operational flexibility to reduce default risks, reflects its capacity to meet its short-term obligations using liquid assets. From the standpoint of agency theory, careful handling of liquid assets emphasizes managerial skill in preserving company stability. The hypothesis that increased liquidity reduces the likelihood of encountering insolvency is supported by earlier empirical research by *Arianto & Kurniasih (2023)*, Das (2022), and Suranta et al. (2023).

H1: Liquidity has a negative effect on financial distress.

The Effect of Leverage on Financial Distress

Leverage is the percentage of a company's assets that are financed by borrowing, and larger debt arrangements increase principal repayment requirements and fixed interest obligations, which exacerbates default risk. According to signaling theory, a firm's financial weakness is communicated to the market by disproportionate reliance on debt. Research by Jouali et al. (2024), Kebede et al. (2024), and *Saputri & Santoso (2023)* confirms that increased debt levels significantly increase the likelihood of financial trouble.

H2: Leverage has a positive effect on financial distress.

The Effect of ICR on Financial Distress

The Interest Coverage Ratio (ICR) indicates a company's capacity to cover interest costs with its operating profits. Better debt management skills and less financial hardship are demonstrated by higher ICR values, which subsequently minimize distress exposure. Stronger ICR performance has a negative effect on financial distress, according to research by Suranta et al. (2023).

H3: ICR has a negative effect on financial distress.

The Effect of Firm Size on Financial Distress

Firm size determines both the total asset capacity and the overall scope of operations. Larger corporations are often less vulnerable to insolvency because they have easier access to financial markets, more seamless cash flows, and improved structural resilience against economic shocks. Research by Wahab et al. (2026) and Isayas (2021) shows that firm size reduces the probability of financial difficulty.

H4: Firm size has a negative effect on financial distress.

METHODOLOGY

This study applies a quantitative causal design to examine the effects of liquidity, leverage, interest coverage ratio, and firm size on financial distress. The study population consists of 21 textile and garment companies listed on the Indonesia Stock Exchange from 2021 through 2024. Purposive sampling yielded 12 eligible companies based on two criteria: (1) publishing complete audited annual financial reports, and (2) maintaining continuous subsector listing during the observation period. This process produced a balanced panel of 48 firm year observations. Financial distress is measured via the original Altman Z-Score model, with independent variable operationalization detailed in Table 1.

Table 1. Variable Measurement

No.	*Variable*	*Measurement*	*Reference*
1.	*Financial Distress*	$Z = 1{,}2X_1 + 1{,}4X_2 + 3{,}3X_3 + 0{,}6X_4 + 0{,}99X_5$	*Altman (1968)*
2.	*Liquidity*	$Current\ Ratio = \frac{Current\ Assets}{Current\ Liabilities}$	*Hery (2015)*
3.	*Leverage*	$Debt\ to\ Asset\ Ratio = \frac{Total\ Liabilities}{Total\ Assets}$	*Hery (2015)*
4.	*Interest Coverage Ratio*	$Interest\ Coverage\ Ratio = \frac{EBIT}{Interest\ Expense}$	*Hery (2015)*
5.	*Firm Size*	$Firm\ Size = Ln\ (Total\ Asset)$	*Dewi et al. (2020)*

Source: Processed Data (2025)

Panel data regression was used in EViews 14 to test hypotheses. The Chow, Hausman, and Langrage Multiplier tests were evaluated one after the other in accordance with established econometric methodology. The F-test and coefficient of determination R^2 were used to assess the overall fit and collective explanatory power after descriptive summary analysis. To conclude, partial

effects were analyzed using the t-test, with significance assessed at the 5% level (Ghozali, 2021).

RESULT

Table 2. Descriptive Statistic

	Z SCORE	*CR*	*DAR*	*ICR*	*SIZE (Rp Billion)*
Mean	*7,881*	*1,094*	*1,225*	*-35,765*	*2.192*
Maximum	*31,865*	*5,537*	*10,203*	*50,767*	*13.671*
Minimum	*-0,266*	*0,017*	*0,318*	*-1.131,384*	*190*
Observations	*48*	*48*	*48*	*48*	*48*

Source: Processed data using EViews 14 (2026)

The sample has a mean Altman Z-Score of 7.881, which places the observed entities mostly inside the non-distressed (safe) threshold, as shown in Table 2. PT Asia Pacific Fibers Tbk (POLY) got the highest Z-Score of 31.865 in 2024, while PT Argo Pantes Tbk (ARGO) had the lowest value of -0.266 in 2022, suggesting that the company was in financial distress.

The studied companies were generally in a liquid position and able to fulfill their short-term obligations, as indicated by the CR's average value of 1.094. In 2021, PT Golden Flower Tbk (POLU) had the highest CR (5.537), and in 2024, PT Panasia Indo Resources Tbk (HDTX) had the lowest (0.017).

For the DAR, a distinct pattern is seen. Because total liabilities exceeded total assets in several observations, the average DAR reached 1.225, suggesting that the sample firms were generally in an unsolved state. PT Asia Pacific Fibers Tbk (POLY) reported the highest DAR of 10.203 in 2024, while PT Golden Flower Tbk (POLU) reported the lowest ratio of 0.318 in 2021.

The mean ICR value was -35.765, which suggests that a number of businesses did not make enough money from operations to pay for their interest costs. PT Indo-Rama Synthetics Tbk (INDR) recorded the highest ICR (50.767) in 2021, while PT Panasia Indo Resources Tbk (HDTX) recorded the lowest figure (-1,131.384) in 2022.

In terms of firm size, the tested firms often fell into the large-scale group, with an average total asset worth of Rp 2,192 billion. At Rp 13,671 billion in 2022, PT Indo-Rama Synthetics Tbk (INDR) had the largest total assets, while PT Golden Flower Tbk (POLU) had the lowest total assets, at Rp 190 billion in 2023.

Table 3. Panel Data Model Selection Result

Test	*Test Statistic*	*Statistic Value*	*Prob.*	*Selected Model*
Chow	*Cross-section F*	*11.348*	*0.0000*	*FEM*
Hausman	*Cross-section random*	*26.301*	*0.0000*	*FEM*

Source: Processed data using EViews 14 (2026)

The model selection diagnostic test for panel data regression is summarized in Table 3. The Fixed Effect Model (FEM) performs better than the Common Effect Model (CEM), according to the Chow test, which produced a probability value of 0.0000 < 0.05. Furthermore, the Hausman test confirmed the

superiority of FEM over the Random Effect Model (REM) with a probability value of 0.0000 < 0.05. The FEM was selected to estimate the empirical regression based on these diagnostics.

Table 4. Regression Result

Variable	*Coefficient*	*t-Statistic*	*Prob.*
C	*43.980*	*0.404*	*0.6887*
CR	*-0.693*	*-1.113*	*0.2739*
DAR	*1.722*	*2.651*	*0.0124*
ICR	*-0.000405*	*-0.190*	*0.8505*
SIZE	*-1.353*	*-0.346*	*0.7314*
R-squared	*0.935*		
Adjusted R-square	*0.905*		
F-statistic	*30.798*		
Prob (F-statistic)	*0.0000*		

Source: Processed data using EViews 14 (2026)

Table 4 presents the regression outputs based on the Fixed Effect Model. The model is statistically significant, as indicated by the Prob. (F-statistic) of 0.0000, implying that the independent variables collectively influence financial distress. The model also produces an R-squared value of 0.935, indicating that 93.5% of the variation in financial distress is explained by liquidity, leverage, ICR, and firm size. Among the independent variables, only leverage has a positive and significantly affects the Altman Z-Score ($\beta = 1.722$, $p < 0.05$), whereas liquidity, ICR, and firm size have no significant effect.

DISCUSSION

Repay various obligations, and cover interest expenses. Consequently, high liquidity alone may not be adequate to reduce the likelihood of financial distress. Comparable evidence was reported by Arini et al. (2021) and Akil et al. (2024), who found that liquidity does not significantly affect financial distress. Their studies suggest that financial distress is more closely related to probability and cash flow management rather than the amount of current assets owned. However, this result differs from *Delfin & Ferrer (2024)*, who reported that higher liquidity improves Altman Z-Scores, indicating a lower probability of financial distress.

The Effect of Leverage on Financial Distress

Data analysis reveals that leverage significantly increases the Z Score when measured via the DAR indicator. The reduction in financial distress potential across listed Indonesian textile and garment enterprises from 2021 through 2024 is driven by increased leverage. These findings confirm a significant negative impact of debt utilization on financial distress risk, wherein higher debt financing directly correlates with higher Z Score values as indicators of corporate financial health. This indicates that debt utilization during the research period did not necessarily increase financial distress. Instead, debt can provide benefits when effectively allocated to operational activities and productive investments. Companies that generate sufficient returns from debt financing are more capable of fulfilling their financial obligations and

maintaining financial stability. These findings are consistent with the Static Trade-Off Theory, which explains that debt can increase firm value as long as the benefits obtained exceed financial distress cost (Myers, 1984). According to this theory, firms continue to benefit from debt financing until the costs of financial distress exceed advantages such as the interest tax shield. This implies that during the study period, the tax benefits generated from debt financing were greater than the potential financial distress costs, allowing debt to support business operations while strengthening firms' financial positions. In addition, agency theory argues that debt obligations may encourage managers to improve efficiency and avoid ineffective resource allocation due to creditor monitoring *(Jensen & Meckling, 1976)*. The finding is consistent with Efendi et al. (2023) and Cahyana et al. (2025), who found that leverage reduces financial distress when companies are able to manage debt effectively. In contrast, *Putri & Artini (2025)*, found no significant relationship between leverage and financial distress, explaining that transportation and logistics companies were supported by substantial fixed assets that reduced the financial risk associated with debt.

The Effect of Interest Coverage Ratio on Financial Distress

Analysis of the sample companies indicates that the ICR does not have a significant effect on financial distress. This finding indicates that a company's ability to meet interest obligations is not a primary factor in determining financial distress conditions among textile and garment firms during the observed period. This insignificance largely stems from operating profit (EBIT) volatility rather than structural shifts in financing expenses. While debt servicing obligations remained predictable, wild swings in EBIT across sample firms weakened ICR's direct explanatory power toward distress status. As a result, differences in ICR were insufficient to explain variations in financial distress. In addition, because the Altman Z-Score reflects multiple dimensions of financial performance, the ability to cover interest expenses alone cannot fully represent a company's overall financial condition. This finding is in line with *Setiawan & Sari (2025)* and Ananda et al. (2022), who reported that ICR does not significantly affect financial distress. Their studies emphasized that financial distress is more strongly associated with operational performance and cash flow sustainability rather than merely the ability to cover interest expenses. However, this result contrasts with *Permata & Juliarto (2021)*, who found that a higher ICR reduces financial distress risk because stronger operating earnings enable companies to fulfill interest obligations and minimize financial pressure.

The Effect of Firm Size on Financial Distress

The empirical findings suggest that firm size does not significantly influence financial distress among textile and garment companies listed on the Indonesia Stock Exchange during the 2021-2024 period. This outcome rejects the proposed hypothesis, demonstrating that a larger organizational scale does not automatically shield a company from financial vulnerability. Managing substantial asset portfolios often introduces heavy operational expenses and maintenance overheads. Without efficient resource allocation, sheer asset size fails to guarantee immunity against insolvency risk, as financial stability ultimately relies on a firm's capacity to generate adequate revenue to cover its

operational and debt obligations. Consistent with this view, Wijayanti et al. (2021) and Nasution et al. (2024) observed that large firms in retail and banking still face distress when profitability drops or resources are poorly allocated. Additionally, *Saputri & Santoso (2023)* highlighted that mature, smaller real estate firms can leverage business networks and reputation to maintain financing and operations. Thus, asset size is not a standalone predictor of financial distress. However, this finding contrasts with Wahab et al. (2026), who reported a significant negative effect of firm size on financial distress. Larger enterprises leverage broader asset bases, superior operational resources, and greater financing access to absorb financial pressures and meet liabilities, thereby lowering insolvency risks as firm scale expands.

CONCLUSIONS AND RECOMMENDATIONS

Examining the Indonesian textile and garment sector over the 2021 through 2024 period reveals that leverage alone significantly diminishes insolvency risks, demonstrating the stabilizing effect of productive credit allocation. Conversely, liquidity levels, interest coverage, and firm size fail to exhibit significant statistical effects, indicating that financial resilience relies on asset efficiency rather than raw asset size or immediate liquidity buffers. Hence, sound debt governance stands as the main determinant of corporate longevity.
To prevent financial crises, corporate leadership must direct debt toward revenue generating avenues, while market participants should evaluate how effectively debt is managed rather than total debt volume. Future scholarly inquiry ought to identify the optimal leverage threshold to mark the exact boundary where additional borrowing heightens distress risks.

FURTHER STUDY

This research still has limitations, so further studies are needed on the topic of Determinants of Financial Distress in Indonesian Textile and Garment Companies to improve this research and add insights for the writer and readers.

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