

## DETERMINANTS OF FINANCIAL DISTRESS IN INDONESIAN TEXTILE AND GARMENT COMPANIES EVIDENCE FROM 2017– 2019

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**Abstract:** *This study investigates the determinants of financial distress in Indonesian textile and garment firms listed on the Indonesia Stock Exchange during the 2017–2019 period. Specifically, it examines the effects of profitability (Return on Assets), liquidity (Current Ratio), leverage (Debt-to-Total-Assets Ratio), and activity (Fixed Asset Turnover) on the likelihood of financial distress. Using a quantitative approach, this study analyzes secondary data from 18 firms, resulting in 54 firm-year observations. Financial distress is proxied using the Altman Z-score and transformed into a binary variable. Logistic regression is employed to test both individual and joint effects of the explanatory variables. The findings reveal that liquidity and activity ratios significantly influence financial distress, while profitability and leverage do not exhibit significant individual effects. However, all variables jointly explain financial distress. The model demonstrates acceptable goodness of fit, with a Hosmer–Lemeshow significance of 0.538, classification accuracy of 79.6%, and a Nagelkerke  $R^2$  of 0.476. These results suggest that short-term solvency and asset utilization efficiency play a more critical role than profitability and leverage in explaining financial distress in Indonesian manufacturing firms. This study contributes to the financial distress literature by providing industry-specific evidence from an emerging-market context and highlighting the importance of operational efficiency and liquidity management in asset-intensive industries.*

**Keywords:** *financial distress, liquidity, activity ratio, Altman Z-score, textile industry, Indonesian*

### 1. Introduction

Financial distress is widely recognized as a critical stage of financial deterioration that precedes insolvency and bankruptcy. It reflects a firm's declining ability to meet its financial obligations and sustain operational performance. Early identification of financial distress is essential for stakeholders, including investors, creditors, and managers, as it provides a warning signal that enables timely corrective actions and risk mitigation strategies (Altman, 1968; Platt & Platt, 2002).

Predicting financial distress has been a central topic in financial and accounting research for decades. Early studies, such as Beaver (1966) and Altman (1968), demonstrated that financial ratios could effectively distinguish between distressed and non-distressed firms. Subsequent research has expanded this approach by incorporating various financial indicators, including profitability, liquidity, leverage, and activity ratios, as key determinants of corporate financial health (Ohlson, 1980; Zmijewski, 1984). These ratios provide insight into different dimensions of firm performance, such as earnings generation, short-term solvency, capital structure, and operational efficiency.

Among these indicators, profitability is commonly associated with a firm's ability to generate returns on its assets, which, in theory, reduces the likelihood of financial distress. Liquidity reflects the firm's capacity to meet short-term obligations, making it a crucial factor in preventing financial failure. Leverage indicates the extent of debt financing, which may increase financial risk if not managed properly. Meanwhile, activity ratios capture how efficiently a firm utilizes its assets to generate revenue, which is particularly important in asset-intensive industries (Ross et al., 2019; Brigham & Houston, 2018).

Despite the extensive literature, empirical findings on the determinants of financial distress remain mixed, particularly in emerging markets and specific industries. The textile and garment industry in Indonesia provides a relevant context for this investigation. This sector plays a strategic

role in national economic development through export contributions and employment generation. However, it also faces significant challenges, including global competition, cost pressures, and operational inefficiencies. These challenges increase firms' vulnerability to financial distress, especially during periods of economic downturn.

Recent studies emphasize that industry-specific characteristics may influence the predictive power of financial ratios (Brahmana, 2007; Liou & Smith, 2007). In asset-intensive industries such as textile and garment manufacturing, the efficiency of asset utilization may be more critical than profitability alone. Similarly, liquidity constraints may pose immediate risks even when firms remain profitable on paper. Therefore, examining multiple financial ratios simultaneously is necessary to obtain a more comprehensive understanding of financial distress.

This study aims to analyze the effects of profitability, liquidity, leverage, and activity ratios on financial distress among textile and garment firms listed on the Indonesia Stock Exchange during the 2017–2019 period. Specifically, the study investigates whether Return on Assets (ROA), Current Ratio (CR), Debt-to-Total-Assets Ratio (DAR), and Fixed Asset Turnover (FATO) can predict financial distress, both individually and collectively. By focusing on an emerging-market manufacturing sector, this study contributes to the literature by providing empirical evidence on the relative importance of financial ratios for predicting distress in a developing-economy context.

## **2. Literature Review**

### **2.1 Financial Distress**

Financial distress is a condition in which a firm has difficulty meeting its financial obligations and sustaining its operations. It is widely recognized as an intermediate stage preceding bankruptcy, rather than bankruptcy itself (Platt & Platt, 2002). This distinction is important because firms may remain operational despite experiencing severe financial strain, making financial distress a crucial early warning signal for stakeholders, including investors, creditors, and regulators.

The prediction of financial distress has evolved significantly over time. Early studies, such as Beaver (1966), employed univariate analysis to identify key financial ratios associated with firm failure. Altman (1968) later introduced the Z-score model, which combined multiple financial ratios into a multivariate framework and significantly improved predictive accuracy. Subsequent models, including Ohlson (1980) and Zmijewski (1984), incorporated probabilistic approaches, enhancing model robustness and addressing methodological limitations of earlier studies.

More recent literature has expanded financial distress prediction by incorporating dynamic modeling techniques, market-based variables, and machine learning approaches. For instance, Shumway (2001) demonstrates that hazard models outperform traditional static models by incorporating time-varying information. Similarly, Tinoco and Wilson (2013) highlight the importance of integrating accounting, market, and macroeconomic variables to improve prediction accuracy. Recent studies also show that machine learning methods can provide higher predictive performance, although they often sacrifice interpretability (Liang et al., 2020; Barboza et al., 2017).

Despite these methodological advancements, no single model consistently outperforms others across different contexts. As highlighted by Shumway (2001), financial distress prediction is highly sensitive to model specification, data structure, and time dynamics. Furthermore, empirical evidence suggests that the effectiveness of prediction models varies across institutional environments and industry characteristics (Habib et al., 2020).

In particular, emerging markets present unique challenges due to differences in financial systems, regulatory frameworks, and market efficiency. Studies such as Dang et al. (2021) emphasize that the determinants of financial distress in emerging economies may differ significantly from those in developed markets. Additionally, industry-specific characteristics—such as capital intensity, operational complexity, and working capital dependency—can influence both the occurrence and detection of financial distress.

Therefore, financial distress should be understood as a context-dependent phenomenon. Examining financial distress within a specific industry and an emerging-market setting is essential for providing more accurate, relevant, and policy-relevant insights.

## **2.2 Profitability and Financial Distress**

Profitability reflects a firm's ability to generate earnings from its assets and is commonly measured using Return on Assets (ROA). From a theoretical perspective, profitability is expected to be negatively related to financial distress, as higher earnings enhance internal financing capacity, reduce reliance on external funding, and strengthen a firm's ability to absorb financial shocks.

Empirical evidence generally supports this relationship. Studies in both developed and emerging markets consistently find that profitable firms are less likely to experience financial distress (Tinoco & Wilson, 2013; Habib et al., 2020). Higher profitability improves cash flow generation, enhances creditor confidence, and increases financial flexibility, thereby reducing the probability of distress.

However, several studies report inconsistent findings, particularly in industry-specific contexts. For example, Liang et al. (2020) and Sayari and Muga (2017) argue that profitability is not always a reliable predictor of financial distress, especially when firms face liquidity constraints or operational inefficiencies. In some cases, firms may report positive accounting earnings while simultaneously experiencing financial pressure due to weak cash flow or inefficient resource allocation.

One explanation for this inconsistency is that profitability is an accounting-based measure that may not fully capture a firm's liquidity position or operational performance. Unlike cash flow measures, profitability can be influenced by accounting policies, accrual adjustments, and earnings management practices. As a result, profitability may overstate a firm's actual financial health.

This limitation is particularly relevant in manufacturing industries, where capital intensity and working capital cycles play a crucial role. Firms may maintain profitability through accounting mechanisms while facing challenges in managing inventories, receivables, and production efficiency. In such cases, liquidity and activity ratios may provide more immediate signals of financial distress than profitability alone.

Furthermore, recent studies highlight that the predictive power of profitability depends on its interaction with other financial indicators. Dang et al. (2021) suggest that profitability alone is insufficient to explain financial distress without considering financial constraints and operational efficiency. This implies that profitability should be analyzed within a multidimensional framework rather than as a standalone determinant.

Based on the theoretical arguments and empirical evidence, profitability is expected to reduce the likelihood of financial distress. However, its effect may be conditional on other financial characteristics of the firm.

H1: Profitability hurts financial distress.

## **2.3 Liquidity and Financial Distress**

Liquidity refers to a firm's ability to meet its short-term obligations using its current assets, and it is commonly measured by the Current Ratio (CR). Among financial ratios, liquidity is considered one of the most critical indicators for predicting financial distress because it directly reflects a firm's capacity to maintain short-term operational continuity.

From a theoretical perspective, liquidity plays a fundamental role in determining financial stability. Firms often experience financial distress not because they are unprofitable, but because they lack sufficient cash flow to meet maturing obligations. This aligns with the argument that liquidity constraints serve as an early warning signal of financial failure, as firms with inadequate liquid resources are more vulnerable to default risk and operational disruption.

Empirical studies consistently support the importance of liquidity in predicting financial distress. Prior research shows a significant negative relationship between liquidity and financial distress, indicating that firms with higher liquidity are less likely to experience financial failure (Tinoco & Wilson, 2013; Habib et al., 2020). Higher liquidity enhances a firm's ability to absorb financial shocks, maintain production processes, and fulfill short-term liabilities, thereby reducing distress risk.

However, recent studies suggest that the strength of this relationship may vary depending on institutional and economic conditions. In emerging markets, liquidity becomes even more critical due to limited access to external financing, higher borrowing costs, and greater market volatility.

Firms in such environments rely more heavily on internal liquidity to sustain operations, making liquidity a key determinant of financial resilience.

In addition, industry characteristics further reinforce the importance of liquidity. In sectors such as textile and garment manufacturing, firms are highly dependent on working capital cycles involving inventories, receivables, and production inputs. Inefficient management of working capital can quickly lead to liquidity shortages, even when firms remain profitable. Studies such as Dang et al. (2021) emphasize that firms with weaker liquidity positions are more susceptible to financial distress, particularly in industries with high operational complexity.

Nevertheless, some studies highlight that excessive liquidity may also indicate inefficient asset utilization, suggesting that the relationship between liquidity and financial performance is not always linear. Despite this nuance, the dominant empirical evidence supports liquidity as a primary predictor of financial distress.

Based on these theoretical arguments and empirical findings, liquidity is expected to reduce the likelihood of financial distress.

H2: Liquidity has a negative effect on financial distress.

## **2.4 Leverage and Financial Distress**

Leverage reflects the extent to which a firm finances its assets with debt and is commonly measured by the Debt-to-Total-Assets Ratio (DAR). From a theoretical perspective, leverage is associated with increased financial risk due to fixed obligations, such as interest payments, that must be met regardless of the firm's operating performance. According to the trade-off theory, while debt provides tax advantages, excessive leverage increases the probability of financial distress due to higher default risk.

Traditional financial distress models consistently identify leverage as a key predictor of bankruptcy. Foundational studies such as Ohlson (1980) and Zmijewski (1984) include leverage-related measures as core explanatory variables. Firms with high leverage are generally more vulnerable to economic shocks, earnings volatility, and refinancing risk, thereby increasing the likelihood of financial distress.

However, empirical findings on the relationship between leverage and financial distress remain mixed. Several studies confirm a positive relationship, suggesting that highly leveraged firms face greater financial vulnerability (Tinoco & Wilson, 2013; Habib et al., 2020). In contrast, other studies report insignificant or even negative relationships, particularly in emerging market contexts. This inconsistency suggests that leverage may not always be a direct driver of financial distress.

One possible explanation is that debt can be used productively to finance investment, expand production capacity, and improve operational efficiency. When firms allocate borrowed funds effectively, leverage may enhance firm performance and reduce the risk of financial distress. This argument is consistent with the notion that the impact of leverage depends on the firm's ability to convert debt into productive assets and sustainable cash flows (Dang et al., 2021).

Furthermore, institutional and market conditions also influence the leverage–distress relationship. In emerging markets, differences in financial systems, access to credit, and regulatory environments may weaken the direct impact of leverage on financial distress. Firms may rely on debt as a strategic financing tool rather than a source of financial instability.

Additionally, in asset-intensive industries such as textile and garment manufacturing, leverage may be necessary to support capital investment in machinery and production facilities. In such cases, high leverage does not necessarily indicate financial weakness but may reflect growth strategies and operational expansion.

Therefore, the relationship between leverage and financial distress is not purely linear and should be interpreted within a broader financial and operational context. Despite these nuances, the dominant theoretical expectation suggests that higher leverage increases the likelihood of financial distress.

H3: Leverage has a positive effect on financial distress.

## **2.5 Activity Ratio and Financial Distress**

Activity ratios measure how efficiently a firm utilizes its assets to generate revenue. In this study, activity is proxied by Fixed Asset Turnover (FATO), which is particularly relevant in manufacturing industries where fixed assets constitute a substantial portion of total resources.

From a theoretical perspective, efficient asset utilization enhances productivity, increases revenue generation, and improves overall financial stability. Firms with higher asset turnover are better able to convert their investments into sales, thereby strengthening their operating performance and reducing the likelihood of financial distress.

Compared to profitability, liquidity, and leverage, the role of activity ratios in financial distress prediction has received relatively less attention in the literature. However, recent studies increasingly emphasize the importance of operational efficiency as a critical determinant of financial performance and firm survival. For instance, Wu et al. (2018) and Habib et al. (2020) argue that operational inefficiency is closely associated with declining firm performance and heightened financial vulnerability. Similarly, recent empirical evidence suggests that asset utilization efficiency plays a significant role in predicting financial distress, particularly in asset-intensive industries.

In manufacturing sectors such as the textile and garment industries, the efficient use of fixed assets is crucial due to the high level of capital investment in machinery and production facilities. Inefficient utilization of these assets can lead to underperformance, reduced profit margins, and increased financial vulnerability. Firms with low asset turnover may face higher fixed costs relative to output, making them more susceptible to financial distress during periods of declining demand.

Furthermore, activity ratios provide insights that are not fully captured by profitability measures. While firms may report positive earnings, inefficient asset utilization can indicate deeper operational problems that may eventually lead to financial distress. This supports the argument that operational efficiency should be considered alongside traditional financial indicators when assessing financial health.

Nevertheless, some studies suggest that the relationship between activity ratios and financial distress may vary depending on industry conditions and market dynamics. In highly competitive environments, even firms with relatively efficient asset utilization may experience financial pressure due to external factors such as price competition and cost fluctuations.

Despite these nuances, the dominant theoretical and empirical evidence suggests that higher asset utilization efficiency reduces the likelihood of financial distress.

H4: Activity has a negative effect on financial distress.

## **3. Research Methodology**

### **3.1 Research Design**

This study employs a quantitative research design to examine the relationship between financial ratios and financial distress. Quantitative methods are appropriate for this study because they allow for objective measurement of financial variables and statistical testing of hypotheses. The research uses secondary data obtained from the annual financial statements of textile and garment companies listed on the Indonesia Stock Exchange (IDX).

The study adopts an explanatory approach, aiming to identify the causal relationship between profitability, liquidity, leverage, and activity ratios as independent variables and financial distress as the dependent variable.

### **3.2 Population and Sample**

The population of this study consists of all textile and garment companies listed on the Indonesia Stock Exchange during the 2017–2019 period. Based on the dataset, there were 19 listed firms, from which 18 firms met the sampling criteria, resulting in 54 firm-year observations.

The sampling method used is purposive sampling, with the following criteria:

1. Companies consistently listed on the IDX during the 2017–2019 period.
2. Companies that publish complete financial statements for the observation period.
3. Companies with sufficient data required to calculate all research variables.

Purposive sampling is commonly used in financial distress research to ensure data completeness and consistency across observations (Ohlson, 1980; Zmijewski, 1984).

### 3.3 Data Source and Collection

The data used in this study are secondary data obtained from:

- Annual financial statements published by the Indonesia Stock Exchange (IDX),
- Company financial reports are available through official corporate websites and financial databases.

The data include balance sheets, income statements, and supporting financial information necessary to compute financial ratios and the Altman Z-score.

### 3.4 Variables Measurement

#### 3.4.1 Dependent Variable: Financial Distress

Financial distress is measured using the Altman Z-score model, one of the most widely used models for predicting bankruptcy and financial distress (Altman, 1968).

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 0.99X_5$$

Where:

X<sub>1</sub> = Working Capital / Total Assets

X<sub>2</sub> = Retained Earnings / Total Assets

X<sub>3</sub> = Earnings Before Interest and Taxes / Total Assets

X<sub>4</sub> = Market Value of Equity / Book Value of Debt

X<sub>5</sub> = Sales / Total Assets

The Z-score is then transformed into a binary variable:

0 = Financially distressed ( $Z < 1.8$ )

1 = Non-distressed ( $Z \geq 1.8$ )

The use of a binary dependent variable justifies the application of logistic regression analysis (Hosmer et al., 2013).

#### 3.4.2 Independent Variables

1. Profitability (ROA)

$$ROA = \frac{\text{Net Income}}{\text{Total Asssets}}$$

ROA measures how efficiently a firm generates profit from its assets (Brigham & Houston, 2018).

2. Liquidity (CR)

$$CR = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

CR reflects the firm's ability to meet short-term obligations.

4. Leverage (DAR)

$$DAR = \frac{\text{Total Debt}}{\text{Total Asssets}}$$

DAR indicates the proportion of assets financed by debt.

5. Activity (FATO)

$$FATO = \frac{Sales}{Fix\ Asset}$$

FATO measures how effectively fixed assets are used to generate revenue.

### 3.5 Data Analysis Technique

#### 3.5.1 Logistic Regression Model

Given that the dependent variable is binary, this study employs logistic regression analysis.

$$FD = \beta_0 + \beta_1ROA + \beta_2CR + \beta_3DAR + \beta_4FATO + \varepsilon$$

Where:

FD = Financial distress (dummy variable)

$\beta_0$  = Intercept

$\beta_1$ – $\beta_4$  = Coefficients

$\varepsilon$  = Error term

#### 3.5.2 Model Evaluation

To ensure the reliability and validity of the model, several statistical tests are conducted:

1. Hosmer–Lemeshow Test  
This test is used to evaluate the model's goodness of fit. A significance value greater than 0.05 indicates that the model fits the data well (Hosmer et al., 2013).
2. -2 Log Likelihood (-2LL)  
This statistic is used to compare the initial and final models. A lower value indicates a better model fit.
3. Classification Accuracy  
This measure evaluates the model's ability to classify distressed and non-distressed firms correctly.
4. Pseudo R-Square (Nagelkerke R<sup>2</sup>)  
This statistic indicates the proportion of variance in the dependent variable explained by the model.

#### 3.5.3 Hypothesis Testing

Hypothesis testing is conducted using:

- Wald Test (Partial Test): to evaluate the individual effect of each independent variable
- Omnibus Test (Simultaneous Test): to assess the joint effect of all independent variables

The level of significance used in this study is 5% ( $\alpha=0.05$  \alpha = 0.05 \alpha=0.05).

## 4. Results

This study examines the effect of profitability, liquidity, leverage, and activity ratios on financial distress among textile and garment companies listed on the Indonesia Stock Exchange during the 2017–2019 period. A total of 54 firm-year observations were analyzed using logistic regression.

### 4.1 Descriptive Statistics

The descriptive statistics indicate that the mean value of ROA is -0.0123, suggesting that, on average, firms experienced slight losses during the observation period. The current ratio (CR) has a mean of 1.8914, indicating moderate liquidity, although some firms exhibit extremely low liquidity levels. The average debt-to-total-assets ratio (DAR) is 0.8323, indicating a relatively high reliance on debt financing. Meanwhile, the fixed asset turnover (FATO) has a mean of 4.7062, with considerable variation across firms, indicating differences in asset utilization efficiency.

The mean value of the financial distress variable is 0.44, implying that a substantial proportion of firms experienced financial distress during the study period.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	54	-0.39	0.10	-0.0123	0.07840
CR	54	0.09	6.51	1.8914	1.74328
DAR	54	0.00	5.07	0.8323	1.08659
FATO	54	0.02	113.38	4.7062	15.23431
FD	54	0	1	0.44	0.502
Valid N (listwise)	54				

Source: data 2021

#### 4.2 Model Evaluation

The Hosmer–Lemeshow test yields a significance value of 0.538, indicating that the model fits the data well. Furthermore, the -2 Log Likelihood value decreases from 74.192 in the initial model to 50.445 in the final model, indicating improved model fit.

Table 2. Hosmer and Lemeshow's of fit

Step	Chi-square	df	Sig.
1	6.985	8	0.538

Source: data 2021

Furthermore, the -2 Log Likelihood value decreases from 74.192 in the initial model to 50.445 in the final model, indicating a substantial improvement in model fit after the inclusion of independent variables. This reduction implies that the model with predictors provides a better explanation of financial distress compared to the null model.

The model's classification accuracy is 79.6%, with 80.0% of distressed firms and 79.2% of non-distressed firms correctly classified. This level of accuracy indicates that the model has good predictive power and reliably distinguishes distressed from non-distressed firms.

The Nagelkerke R<sup>2</sup> value of 0.476 indicates that approximately 47.6% of the variation in financial distress is explained by the model's independent variables. This indicates a moderate level of explanatory power, implying that while the model captures a substantial portion of the variation, other factors not included may also influence financial distress.

Table 3. Cox and Snell R Square dan Nagelkerke R Square

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	50.445	0.356	0.476

Source: data 2021

#### 4.3 Regression Results

The logistic regression results show that liquidity (CR) and activity (FATO) have statistically significant effects on financial distress, whereas profitability (ROA) and leverage (DAR) do not.

Table 3. Regression Logistik t-2 Test

	B	S.E.	Wald	Sig.	Kesimpulan
Step 1 ROA Ak	2.825	3.259	0.751	0.386	Supported
CR	0.728	0.305	5.697	0.017	Supported
DAR Ak	-2.911	1.605	3.289	0.070	Not Supported
FATO Ak	3.017	1.401	4.641	0.031	Supported
Constant	-3.218	2.032	2.507	0.113	

Source: data 2021

$$FD = -3.218 + 2.825 ROA + 0.728 CR - 2.911 DAR + 3.017 FATO + \varepsilon$$

The regression results indicate that liquidity and activity ratios have a statistically significant effect on financial distress, while profitability and leverage do not show significant individual effects.

The coefficient of profitability (ROA) is positive ( $B = 2.825$ ) but not statistically significant ( $p = 0.386$ ), indicating that profitability does not have a meaningful impact on financial distress. This suggests that higher profitability does not necessarily reduce the likelihood of financial distress in the sample firms.

Liquidity (CR) has a positive and statistically significant coefficient ( $B = 0.728$ ;  $p = 0.017$ ). This result indicates that liquidity plays a crucial role in determining financial distress. Firms with stronger liquidity positions are better able to meet short-term obligations, thereby reducing financial vulnerability.

Leverage (DAR) has a negative coefficient ( $B = -2.911$ ) but is not statistically significant ( $p = 0.070$ ). This finding suggests that leverage does not significantly affect financial distress, implying that debt levels alone are insufficient to explain financial instability among the sample firms.

The activity ratio (FATO) shows a positive and statistically significant coefficient ( $B = 3.017$ ;  $p = 0.031$ ), indicating that asset utilization efficiency significantly influences financial distress. Firms with better asset turnover tend to have stronger operational performance, which reduces the likelihood of financial distress.

Overall, the results indicate that liquidity and operational efficiency are more important determinants of financial distress than profitability and leverage.

## **5. Discussion**

The findings of this study reveal that liquidity and activity ratios are significant determinants of financial distress, whereas profitability and leverage do not exhibit significant individual effects. These results highlight the multidimensional nature of financial distress and suggest that short-term solvency and operational efficiency play a more critical role than traditional profitability measures.

### **Profitability and Financial Distress**

The results indicate that profitability does not have a significant effect on financial distress. This finding suggests that accounting-based earnings may not adequately reflect a firm's actual financial condition. Firms may report positive profits while simultaneously experiencing liquidity constraints or operational inefficiencies, thereby increasing financial vulnerability.

This result is consistent with prior studies that argue profitability alone is insufficient as an early warning indicator of financial distress (Liang et al., 2020). In the textile and garment industry, firms may maintain accounting profitability despite challenges in managing working capital and asset utilization. Therefore, profitability does not appear to be a primary determinant of financial distress in this sector.

### **Liquidity and Financial Distress**

Liquidity has a significant effect on financial distress, indicating that firms with weaker liquidity positions are more likely to experience financial difficulties. This finding reinforces the argument that firms often fail not because they are unprofitable, but because they lack sufficient cash flow to meet short-term obligations.

This result is consistent with prior empirical studies (Tinoco & Wilson, 2013; Habib et al., 2020), which identify liquidity as one of the strongest predictors of financial distress. In emerging markets, where access to external financing is limited, liquidity becomes even more critical for sustaining operations and ensuring financial stability.

### **Leverage and Financial Distress**

Leverage does not have a significant effect on financial distress in this study. This suggests that debt levels alone are insufficient to explain financial distress among the sample firms. Instead,

the effectiveness of debt utilization appears to be more important than the magnitude of leverage itself.

In asset-intensive industries such as textile and garment manufacturing, debt is often used to finance capital investment and support production capacity. Therefore, leverage may not necessarily lead to financial distress when it is managed efficiently and generates productive returns. This finding supports the view that the relationship between leverage and financial distress is context-dependent.

#### Activity Ratio and Financial Distress

The activity ratio (FATO) has a significant effect on financial distress, highlighting the importance of operational efficiency. Firms with inefficient asset utilization are more likely to experience financial distress due to lower productivity and higher operational costs.

This finding is consistent with studies emphasizing the role of operational efficiency in financial performance (Habib et al., 2020). In asset-intensive industries, inefficient use of fixed assets can significantly weaken financial stability and increase exposure to financial risk.

#### Simultaneous Effect

The significant omnibus test result indicates that profitability, liquidity, leverage, and activity ratios jointly influence financial distress. This finding confirms that financial distress is a multidimensional phenomenon that a single financial indicator cannot explain.

Overall, the results suggest that financial distress arises from the interaction of multiple financial dimensions, particularly liquidity constraints and operational inefficiencies, rather than from isolated financial factors.

## 6. Conclusion

This study examines the determinants of financial distress in Indonesian textile and garment companies by analyzing the effects of profitability, liquidity, leverage, and activity ratios. The findings reveal that liquidity and activity ratios have a significant influence on financial distress, while profitability and leverage do not show significant individual effects. However, all variables jointly affect financial distress, confirming its multidimensional nature.

The results highlight that short-term solvency and operational efficiency are more critical in explaining financial distress than profitability and capital structure. This suggests that firms may remain profitable on paper but still experience financial difficulties due to liquidity constraints and inefficient asset utilization.

#### Practical Implications

The findings of this study provide several important implications:

First, managers should prioritize liquidity management to ensure the firm's ability to meet short-term obligations and maintain operational stability.

Second, improving asset utilization efficiency is essential, particularly in asset-intensive industries such as textile and garment manufacturing.

Third, investors and creditors should not rely solely on profitability indicators, but also consider liquidity and activity ratios when assessing financial health and risk.

#### Theoretical Contribution

This study contributes to the financial distress literature by providing industry-specific evidence from an emerging market context. It demonstrates that the predictive power of financial ratios is context-dependent and highlights the importance of liquidity and operational efficiency over traditional profitability measures.

#### Limitations and Future Research

This study has several limitations. First, the sample size is relatively small and limited to one industry, which may affect the generalizability of the findings. Second, the study relies solely on financial ratios and does not incorporate macroeconomic or market-based variables.

Future research is recommended to extend the observation period, include additional variables such as cash flow and firm size, and examine different industries or cross-country comparisons to enhance the robustness of financial distress prediction models.

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