

The Case of the Sluggish Indonesian Textile and Garment Industry Viewed from the Perspective of Financial Distress

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Abstract

The companies studied are the textile and garment industry in Indonesia due to its recent downturn, reviewing the impact of financial distress during the 2019-2023 research period. The population was 23 companies and the sample was 8 companies. The sampling technique used purposive sampling. Data were tested using the classical assumption test, multiple regression analysis, and moderated regression analysis using EViews 11. The results of this study indicate that liquidity has no effect on financial distress. Meanwhile, operational leverage has an effect on financial distress. Profitability is unable to moderate the relationship between liquidity and operational leverage on financial distress. Simultaneously, liquidity and operational leverage have a significant effect on financial distress. Based on these results, investors should be wise in making decisions, especially in investing their funds in the textile and garment industry.

Keywords: Liquidity, Operational Leverage, Financial Distress, Profitability.

INTRODUCTION

Industry 4.0 has intensified business competition. This has had a significant impact on the textile and apparel sector. According to information from the Ministry of Industry (Kemenperin.go.id) (2019), the textile and garment industry has continued to grow over the past five years. However, the Chairman of the Indonesian Textile Experts Association (IKATSI), as quoted by Reaktor.co.id (2019), stated that some believe the national textile and apparel industry is in good condition. This is due to the large number of imported textile products, including fabrics, entering the country to meet domestic demand. In the

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apparel production sector, Indonesia faces significant competition from other countries, including developing countries in Latin America and especially Asia. China has advantages in mass production, including resources such as labor and raw materials, greater economies of scale (although this declines with rising wages), and a wide variety of products. On the other hand, if we look at Vietnam and Bangladesh, both countries have focused on the low-end segment from the start. Both have advantages in terms of international cooperation. Vietnam has a cooperation agreement with Europe through the Vietnam-EU Free Trade Agreement signed in 2012, while Bangladesh has obtained a scheme for exporting textiles and textile products to the United States through the Generalized System of Preferences (GSP), although the specific tariff scheme for this product was frozen in 2013 due to issues with labor standards.

Recently, the textile sector has focused more on the local market than on exports. Furthermore, the local-focused textile industry has not yet met the quality standards required for export. Meanwhile, imported fabrics at lower prices make it difficult for local products to compete. The statement by the chairman of IKATSI aligns with that of the Indonesian Fiber and Filament Yarn Producers Association (APSyFI) in Indonesia. go.id (2019). Currently, the fiber, yarn, and fabric industry is experiencing a decline, especially for small factories. Companies that cannot compete can lead to losses and even bankruptcy. According to APSyFI data, fabric usage is currently only 50%, down from 60% in 2017. Meanwhile, yarn usage has decreased from 76% to 70%, and fiber products have also decreased from 70% to 65%-67%. However, ready-to-wear clothing products can still compete with a high percentage of around 85%. Therefore, it is natural that the textile and textile industry continues to show good performance, as evidenced by its GDP growth. The Indonesian Textile Association (API) in Tempo.co (2019) noted that around 70% of the machines used in the textile industry are old machines manufactured in the 1990s.

Companies that are about to go bankrupt usually start with financial problems. Wahyu in Faradila & Aziz (2019) states that increasingly fierce competition between companies increases costs. This negatively impacts company performance, and if a company is unable to compete, it will experience losses, which can ultimately lead to financial problems. If these financial problems are allowed to persist, they can lead to bankruptcy. Platt & Platt in Gobenvy (2014) explain that financial problems are the stage of financial decline before a company experiences bankruptcy or liquidity problems. Meanwhile, according to Pulungan et al. (2017), a company is considered bankrupt or



financially failed if the rate of return obtained is less than the total costs incurred in the long term.

Bankruptcy is not immediately felt by a company. Early symptoms of bankruptcy usually appear when a company experiences business difficulties. Business difficulties are a condition that continues from financial problems, and at this point the company can be said to be bankrupt. This condition is often referred to as distress. There are two types of distress: economic distress and financial distress. Because financial distress is more complex, it better represents the company's condition. To determine whether a company is healthy or in distress, many studies use the Altman Z-Score. Furthermore, financial ratios are also used as indicators that influence financial distress.

Several studies examining the impact of liquidity, profitability, and leverage in predicting financial distress have yielded mixed results. These studies found that liquidity, profitability, and leverage can have either a positive or negative impact on predicting financial distress. Some researchers also stated that liquidity, profitability, and leverage have neither a positive nor a negative impact on predicting financial distress. Alipudin et al. (2019) in their study on the influence of the Debt to Assets Ratio (DAR), Current Ratio (CR), and corporate governance in predicting financial distress in state-owned enterprises listed on the Indonesia Stock Exchange found that the current ratio has a significant positive influence in predicting financial distress. This study is also supported by Ginting (2017) who examined the influence of the Current Ratio (CR) and Debt to Equity Ratio (DER) on financial distress in property and real estate companies listed on the Indonesia Stock Exchange. The results of this study indicate that the current ratio has a positive effect on financial distress. However, the results of this study contradict the findings of Erayanti (2019) who examined the influence of liquidity, profitability, and leverage on predicting financial difficulties, and found that the current ratio did not have a negative impact on financial difficulties.

LITERATURE REVIEW

Signaling Theory

According to Brigham & Houston (2011), signaling theory refers to actions taken by a company's management to provide investors with clues about how they assess the company's future. According to Atmaja (2008), as cited in Hoesada (2021), managers are generally motivated to convey positive information about their company to the public as quickly as possible, such as through press conferences. However, people outside the company are unaware of the accuracy of the information conveyed. A signal that has a

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positive impact is a signal of transparency, which is evident in the quality of financial reports. One way to reduce information asymmetry is to provide signals to external parties, for example, positive and reliable financial information, which can reduce uncertainty about the company's future and increase its credibility and success (Rahmadiani & Barry, 2020).

Liquidity

According to Harun (2020), liquidity is a company's ability to meet its short-term obligations. If a company has inconsistent liquidity, it may be unable to pay its debts and could be at risk of bankruptcy, which will certainly affect stock price movements. Many companies and investors use this ratio to determine a company's ability to meet one of the requirements when purchasing shares. Sari (2016) states that liquidity reflects a company's ability to meet short-term obligations smoothly and on time. The better a company's cash position, the greater its ability to pay dividends. However, having too much cash is usually ineffective, so if the current ratio is too high, it indicates a lot of idle cash (with little activity), which can impact the company's growth. Therefore, companies need to maintain an ideal level of liquidity, neither too high nor too low.

Operating leverage

Operating leverage arises from the use of assets with fixed costs or fixed expenses to support a company's operational activities. These fixed costs include depreciation, production costs, and fixed marketing costs. This aligns with Riyanto's (2010) view, which states that operating leverage is the use of assets with fixed costs in the expectation that the revenue generated from these assets will be sufficient to cover both fixed costs and variable costs. Meanwhile, according to Syamsudin (2011), operating leverage can indicate how well a company utilizes fixed operating costs in its activities to increase operational sales.

Financial Distress

Financial distress is a situation that begins with disorganized or chaotic financial management within a company. This financial distress arises from increasing liquidity pressures over time, leading to a decline in asset value, making it impossible for the company to meet its various financial obligations. The threat of bankruptcy is not only about bankruptcy itself but also the problems that arise, such as the departure of key employees, suppliers refusing to provide credit, customers seeking other, more stable

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companies, and lenders charging higher interest rates and imposing stricter terms in loan contracts (Zulaecha & Mulvitasari, 2018).

Profitability

Profitability ratios are tools for assessing a company's profitability and measuring the rate of return on investments. They also indicate how effectively management is operating. To use profitability ratios, we compare various elements within financial statements, particularly the balance sheet and income statement. The goal is to assess a company's performance over a specific period, whether it's increasing or decreasing, while also identifying the causes of these changes (Kasmir, 2017). A company's profitability indicates its ability to generate profits by using its existing capital to pay off both short-term and long-term debts and to provide dividends to investors (Harun & Jeandry, 2018).

HYPOTHESIS DEVELOPMENT

The Relationship between Liquidity and Financial Distress

A study by Widati (2015) showed that liquidity, as measured by the Current Ratio, negatively impacts financial distress. According to Shanjaya & Marlius (2017), the current ratio is the ratio between readily liquidated assets and liabilities that must be paid immediately. This ratio illustrates a company's ability to repay its short-term debt using its assets. The greater the collateral available to cover potential losses, the lower the risk of experiencing financial distress. Ijaz et al. (2013) found in their study that the use of the current ratio and Z-Score are good indicators for assessing the financial health of sugar companies listed on the Karachi Stock Exchange. Then on this basis the following hypothesis is proposed:

H1. There is a positive influence between Liquidity and Financial Distress

The Relationship between Operational Leverage and Financial Distress

Companies that rely too heavily on debt will face greater future liabilities, potentially putting them at risk of financial distress. The lower the debt used, the better and more secure the company's position, thus avoiding potential financial distress. This suggests that debt usage positively impacts financial distress. If a company relies heavily on debt for funding, it risks future repayment difficulties due to debt exceeding its assets. If this situation is not properly addressed, the likelihood of financial distress increases. This statement is supported by a study by Christon & Wiwin (2017), which showed that the

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use of operational debt contributes to financial distress. Then on this basis the following hypothesis is proposed:

H2. There is a positive influence between Operational Leverage and Financial Distress

The relationship between liquidity and financial distress moderated by profitability

The liquidity ratio is a measure used to assess how well a company utilizes its assets to meet short-term obligations. A high liquidity ratio indicates that the company can meet its short-term obligations and continue operating. This reduces the likelihood of the company facing financial problems. When a company generates high profits, its assets increase, both liquid and long-term. By increasing liquid assets, the company will be better able to meet its short-term obligations and avoid financial problems. Then on this basis the following hypothesis is proposed:

H3. There is a moderating influence of profitability on the relationship between liquidity and financial distress

The relationship between Operational Leverage and Financial Distress moderated by Profitability

Leverage assets can help us understand the extent to which a company uses debt or third-party funding by looking at the company's capital. Research by Kade (2016) shows that the leverage ratio can influence the likelihood of financial distress. This means that the higher a company's debt, the greater the likelihood of financial distress. Kade (2016) research also shows that the higher a company's profitability, the lower the likelihood of financial distress, and vice versa. Then on this basis the following hypothesis is proposed:

H4. There is a moderating influence of profitability on the relationship between operational leverage and financial distress

Based on the results compiled from various theories that have been described, the framework for thinking is a synthesis of the relationships between variables. It is then analyzed critically and systematically, resulting in a synthesis of the relationships between the variables studied. The framework for thinking in this study is as follows:



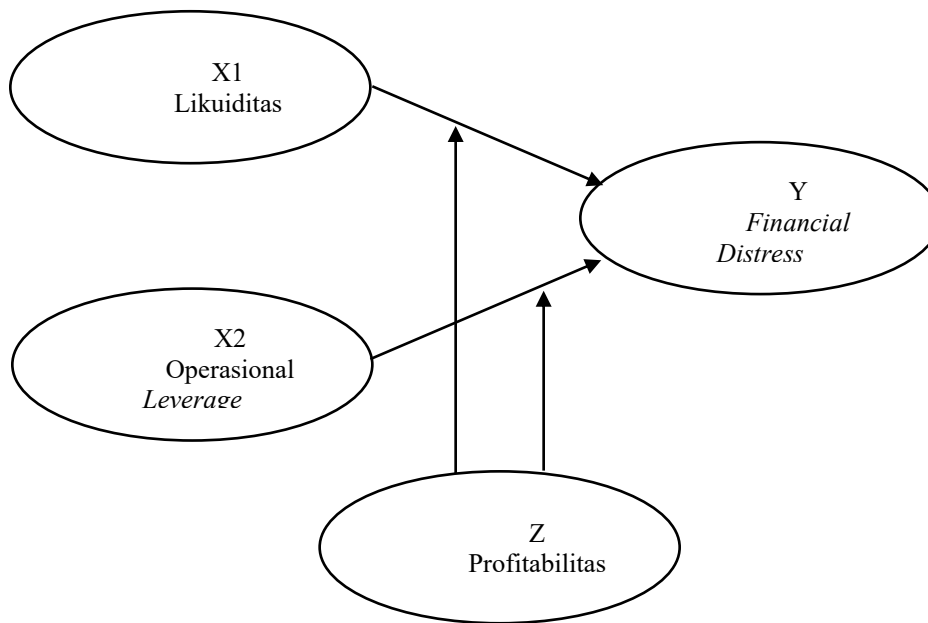


Figure 1. Research Framework

RESEARCH METHODS

In this study, the author uses a descriptive research type with a quantitative approach method. This research is an explanatory study with the aim of identifying the influence of variables, namely liquidity, operational leverage, financial distress and profitability. In its implementation, this study uses a survey where the researcher will build research hypotheses, conduct tests through data taken from the Indonesia Stock Exchange with a total of 40 data periods 2019-2023 and other data collection tools using group data analysis units used are groups of financial companies in the textile and garment subsector listed on the Indonesia Stock Exchange. Based on the implementation time, this study uses combined implementation time (panel data). According to Basuki & Prawoto (2019: 275), panel data is a combination of time series data and cross-section data from the Eviews application. Testing is carried out by conducting analysis or tests, namely descriptive statistics, Classical assumption tests, determining the Panel Data Regression Estimation model and panel data regression analysis, as well as hypothesis testing.

RESULT AND DISCUSSION**Descriptive Statistical Test**

According to Ghozali (2016), descriptive statistics provide a snapshot or description of data, based on the minimum, maximum, average, and standard deviation values. The following are the results of the descriptive analysis in this study:

Table 1. Descriptive Statistical Result

	Y	Z	X1	X2
Mean	1.561475	2.664725	1.840025	0.040425
Median	1.426500	2.827000	1.319500	0.038000
Maximum	2.562000	9.340000	5.859000	0.120000
Minimum	0.667000	0.069000	0.667000	0.000000
Std. Dev.	0.582880	1.924245	1.403158	0.026695
Skewness	0.240541	0.964040	1.996848	0.484510
Kurtosis	1.914224	4.649218	5.549964	3.275049
Sum	62.45900	106.5890	73.60100	1.617000
Sum Sq. Dev.	13.25022	144.4060	76.78519	0.027792
Observations	40	40	40	40

Source: Processed Eviews data.

The liquidity variable, which is the independent variable has a maximum value of 5.86, a minimum value of 0.67, an average value or mean of 1.840 and a standard deviation of 1.40316. The operational leverage variable, which is the independent variable, has a maximum value of 0.12, a minimum value of 0.00, an average value or mean of 0.0404 and a standard deviation of 0.026. The financial distress variable, which is the independent variable, has a maximum value of 2.56, a minimum value of 0.67, an average value or mean of 0.5615 and a standard deviation of 0.58288. The profitability variable, which is the independent variable, has a maximum value of 9.34, a minimum value of 0.07, an average value or mean of 2.6647 and a standard deviation of 1.92424.



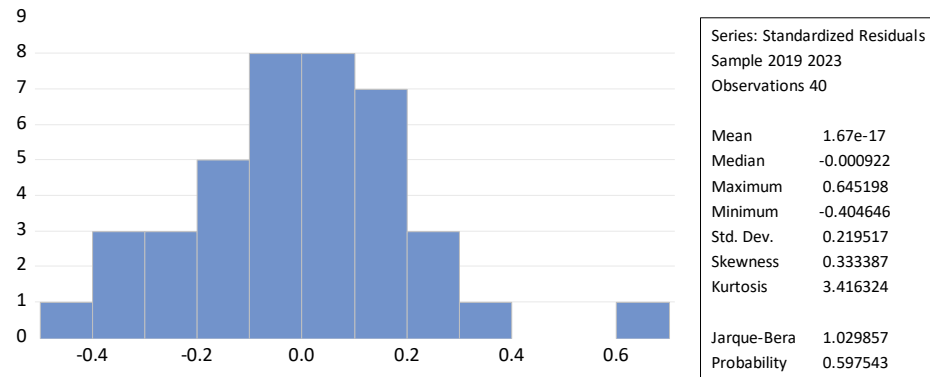
Classical Assumption Test**Normality Test**

Figure 2. Normality test Result
Source: Processed Eviews data.

In the normality test, it is said to be good if the data is normal or close to normal, where in this test displays the resulting p-value with a predetermined level of 0.05. If the $p\text{-value} > 0.05$ then the data obtained is said to be normal (Ghozali, 2016). The following graph shows that the probability value is 0.5975, so the results of the normality test show that the probability value is more than the predetermined significance level, namely > 0.05 , so that the normality test in this study produces normal data.

Multicollinearity Test**Table 2. Multicollinearity Test Results**

	X1	X2	Y	Z	X1Z
X1	1.000000	-0.137664	-0.240332	-0.232145	0.469882
X2	-0.137664	1.000000	0.513524	0.349808	0.286428
Y	-0.240332	0.513524	1.000000	0.077173	-0.010625
Z	-0.232145	0.349808	0.077173	1.000000	0.604515
X1Z	0.469882	0.286428	-0.010625	0.604515	1.000000
X2Z	-0.103830	0.756289	0.247764	0.760418	0.506635

Source: Processed Eviews data.

Based on the table above, the correlation coefficient value of X1 and X2 is $-0.137 < 0.90$. Thus, it can be concluded that this study is free from multicollinearity problems.



Heteroscedasticity Test

Ghozali (2016) explain that one of the assumptions that must be met for parameter measurements in a regression model to be BLUE (Best Linear Unbiased Estimator) is to have a residual value or error that is homoscedastic or has the same variance. In this study, the heteroscedasticity test uses a residual graph with the condition that it does not exceed the limits (500 and -500).

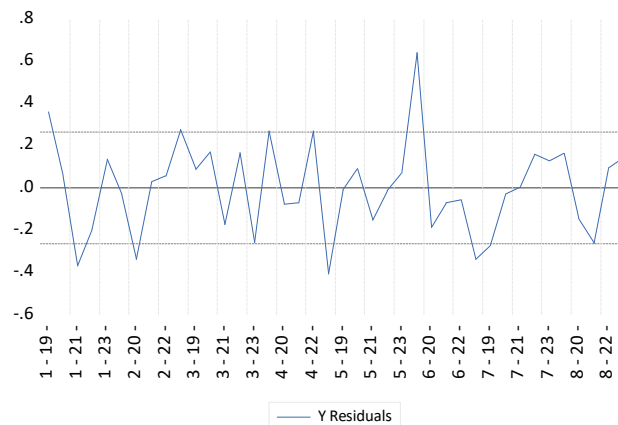


Figure 3. Heteroscedasticity test results graph
Source: Processed Eviews data.

In the residual graph, it can be seen that the residual values do not cross the limits (500 and -500), meaning that the residual variances are the same. Therefore, it can be concluded that there is no heteroscedasticity problem in this study.

Selection of Panel Data Model

Chow Test

Several tests were conducted first to determine the best model. The Chow test was conducted to determine whether the common effects model was superior to the fixed effects model. The following hypotheses were used to determine the best model: H0: Common effects model and H1: Fixed effects model

If the probability of the redundant F-value is >0.05 , the selected model is CEM. However, if the probability of the redundant F-value is <0.05 , the selected model is FEM.

Table 3. Chow Test Results

Effects Test	Statistic	d.f.	Prob.
Cross-section F	14.029703	(7,27)	0.0000
Cross-section Chi-square	61.365554	7	0.0000

Source: Processed Eviews data.

Based on the table above, the probability value is $0.000 < 0.05$. Therefore, the model selected in this study is the Fixed Effect Model (FEM).

Regression Analysis with Fixed Effect Model

Table 4. FEM Panel Data Regression Test Results

Variable	Coefficient
C	1.051565
X1	-0.059721
X2	17.50879
Z	0.036069
X1Z	-0.001868
X2Z	-1.407416

Source: Processed Eviews data.

From table above, the following regression equation is obtained:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 Z + \beta_4 X_1 * Z + \beta_5 X_2 * Z + \varepsilon$$

$$Y = 1,05 - 0,59 + 17,50 + 0,03 - 0,001 - 1,40 + \varepsilon$$

Value of 1.16; meaning that if liquidity and operational leverage are zero (0), then financial distress will be worth 1.05 units. Value of 0.59; meaning that if liquidity increases or increases by one unit and other variables are constant, then financial distress will decrease by -0.59 units. 17.50; meaning that if operational leverage increases or increases by one unit and other variables are constant, then financial distress will increase by 17.50 units. 0.001; meaning that if liquidity moderated by profitability increases or increases by one unit and other variables are constant, then financial distress will increase by -0.001 units. Profitability has a strengthening nature in moderating the relationship between liquidity and financial distress. -1.40; meaning that



if operational leverage moderated by profitability increases or increases by one unit and other variables are constant, then financial distress will decrease by -1.40 units. Profitability has a weakening nature in moderating the relationship between operational leverage and financial distress.

Hypothesis Testing

Table 5. Hypothesis Test Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.051565	0.431606	2.436398	0.0202
X1	-0.059721	0.110455	-0.540684	0.5923
X2	17.50879	6.264775	2.794799	0.0085
Z	0.036069	0.123629	0.291748	0.7723
X1Z	-0.001868	0.045366	-0.041180	0.9674
X2Z	-1.407416	1.240704	-1.134369	0.2646
R-squared	0.342273	Mean dependent var		1.561475
Adjusted R-squared	0.245548	S.D. dependent var		0.582880
S.E. of regression	0.506285	Akaike info criterion		1.614047
Sum squared resid	8.715031	Schwarz criterion		1.867379
Log likelihood	-26.28094	Hannan-Quinn criter.		1.705644
F-statistic	3.538633	Durbin-Watson stat		0.537871
Prob(F-statistic)	0.011064			

Source: Processed Eviews data.

The liquidity variable shows a t-value of -0.540 with a p-value of 0.5923. Because the p-value (sig) α or $0.5923 > 0.05$, H1 is rejected, meaning liquidity does not have a negative effect on Financial Distress. The Operational Leverage variable shows a t-value of 2.794 with a p-value of 0.0085. Because the p-value (sig) α or $0.0085 < 0.05$, H2 is accepted, meaning Operational Leverage has a positive and significant effect on Financial Distress. And in the F test, namely the hypothesis, the F count value is 3.538633 with a significance of $0.011064 < 0.05$, so the regression model can be used to



return decisions or it can be said that liquidity and operational leverage have a significant influence on financial distress.

DISCUSSION AND CONCLUSION

This study aims to determine the effect of liquidity and operational leverage on financial distress, with profitability policy as a moderating variable in textile and garment companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2023 period. The results indicate that liquidity has no negative effect on financial distress, operational leverage has a positive and significant effect on financial distress, profitability does not moderate the effect of liquidity on financial distress, and profitability does not moderate the effect of operational leverage on financial distress.

The liquidity variable used in this study is the Current Ratio (CR). Hypothesis testing results show that liquidity does not negatively impact financial distress. Liquidity/Current Ratio is the ratio between current assets and current liabilities. A company with a high liquidity value indicates a good condition, as the company is deemed capable of paying off its short-term obligations using its current liabilities. However, high or low liquidity does not affect investor interest in investing their funds, so it has no effect on financial distress. In fact, it has a negative value because the faster or slower a company pays its debt obligations, the lower the financial distress.

These results support previous research conducted by Mawarni (2020) and Herdyanti et al. (2021), which stated that liquidity does not impact firm value. These results align with research by Andre (2013) and Ayu (2017), which states that the Current Ratio (CR) can be used to predict financial distress. This research disagrees with research by Ardian (2016), which states that the Current Ratio (CR) can be used to predict financial distress. A company with a low CR value is not necessarily categorized as experiencing financial distress, and a company with a high CR value is not necessarily categorized as a company without financial distress. The results of the above study contradict those of Sudana (2011), who stated that the liquidity ratio measures a company's ability to meet short-term financial obligations. If a company is able to adequately fund and repay its short-term obligations, the company's potential for financial distress is reduced. Therefore, the lower the liquidity level, the greater the likelihood of a company experiencing financial distress.

The operational leverage variable used in this study was the Degree of Operational Leverage (DOL). The analysis shows that operational leverage has a significant effect on financial distress. This means that operational leverage is directly proportional to financial



distress. The lower the leverage, the better and safer a company is, preventing the risk of financial distress. Based on this, it can be concluded that leverage has a positive effect on financial distress. Operational leverage, which causes a company to incur fixed costs in the form of depreciation, can influence financial distress.

This is in line with research conducted by Christon & Wiwin (2017) that found that leverage influences financial distress. If a finance company uses more debt, this risks future payment difficulties due to debt exceeding its assets. If this situation is not addressed effectively, the potential for financial distress increases.

The results of this study indicate that profitability is unable to moderate the effect of liquidity on financial distress. Based on the pecking order theory, the higher the leverage ratio, the greater the company's risk of being unable to meet its obligations. This indicates poor financial performance and the potential for financial distress, which can reduce the company's value.

This finding is supported by research conducted by Kazemian et al. (2017) and Lisiantara & Febrina (2018), which states that leverage has a positive effect on financial distress. Liquidity is often associated with financial distress because it reflects the extent to which a company can meet its obligations (Kazemian et al., 2017). Companies with low liquidity ratios are at high risk of experiencing difficulties in servicing their debts due to their inability to repay them.

The results of this study indicate that profitability is unable to moderate the effect of operational leverage on financial distress. The liquidity ratio is used to measure a company's effectiveness in using its assets to meet its short-term obligations. A company with a high liquidity ratio is considered to have the ability to pay its short-term obligations and maintain business continuity, therefore, reducing the likelihood of experiencing financial distress.

This research is supported by Saidah (2023) who stated that high operating leverage can increase a company's risk of financial distress. This is due to the high fixed costs the company must bear. The higher the operating leverage, the greater the fluctuation in sales, which will affect profits. These profit fluctuations reflect the company's risk. Meanwhile, profitability and liquidity are considered indicators that can reduce the risk of financial distress. Financial distress occurs when a company is unable to meet its payment obligations or when cash flow projections indicate that the company will soon be unable to meet its financial obligations.



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