

CHAPTER I

INTRODUCTION

1.1 Background

The economic resilience of Indonesia was relatively good during 2020-2025. National Gross Domestic Product (GDP) growth has consistently been better than 5% in the face of challenges including global pressures, including the COVID-19 pandemic, commodity price volatility and geopolitical tensions (Bank Indonesia, 2025). The overall national economy had a rate of growth of 5.03% in 2024, with continued growth in household consumption and investment inflows.

This overall macroeconomic strength, however, did not appear across all industrial sectors. The apparel and luxury goods subsector was especially hard hit despite the overall economy's performance. During that time, the apparel and luxury goods subsector on the Indonesia Stock Exchange (IDX) remained under financial pressure. This subsector includes manufacturers of ready-made garments, underwear, fashion accessories, and other clothing products within the Textile and Textile Products (TPT) industry. In August 2024, the TPT industry employed around 3.97 million people, or about 19.9% of total manufacturing employment in Indonesia (Balai Besar Standardisasi dan Pelayanan Jasa Industri Tekstil, 2025). This situation raises broader social and economic implications for the financial condition of companies in this subsector.

There were multiple factors contributing to pressures in this sub-sector. The first major stressor was the COVID-19 pandemic which started in early 2020. Frequent public activities were so tightly regulated that retail stores for clothing were closed in different cities. The drop in purchasing power that has followed the pandemic further depressed demand. Apparel and luxury goods subsector products are considered income-elastic goods, which typically see more substantial decreases in demand in times of economic hardship. Companies heavily dependent on direct sales channels (offline) and export markets experienced the most significant revenue declines (Oktavia & Komara, 2025).

Entering the recovery phase, the subsector faced additional structural pressure from low-priced imports, imported used clothing, and cross-border digital

commerce. These developments intensified price competition for domestic producers whose margins were already narrow. The Ministry of Trade issued Regulation No. 31 of 2023 to govern business licensing, advertising, guidance, and supervision in electronic commerce, including social-commerce activities. Separately, Regulation No. 8 of 2024 amended Regulation No. 36 of 2023 concerning import policy and regulation. Because these instruments address different regulatory domains, Regulation No. 8 of 2024 should not be described as repealing Regulation No. 31 of 2023 (Kementerian Perdagangan Republik Indonesia, 2023, 2024). BPS (2024) reported that the textile and wearing-apparel industry contracted by 0.03% year-on-year in the second quarter of 2024, compared with national economic growth of 5.05% in the same period. The social impact was also substantial, with approximately 13,800 textile and garment workers reportedly affected by layoffs between January and June 2024 (CNN Indonesia, 2024).

U.S. tariff policy became an additional external issue near the end of the observation period. President Donald Trump introduced a reciprocal-tariff policy in April 2025, and the subsequent U.S.– Indonesia arrangement maintained a 19% reciprocal tariff for most Indonesian goods. The agreement signed on February 19, 2026 also provided for a mechanism under which a specified volume of Indonesian textile and apparel products could receive a 0% reciprocal tariff, with the eligible volume linked to Indonesia's use of U.S.-produced cotton and man-made-fiber textile inputs (The White House, 2026; Office of the United States Trade Representative [USTR], 2026). Because the final agreement postdates the 2020–2025 panel, it is treated in this study as subsequent policy context rather than as a tested cause of the observed financial-distress outcomes.

This financial pressure was reflected not only in aggregate data, but also in the financial condition of several issuers listed on the IDX. PT Pan Brothers Tbk (PBRX), one of Indonesia's largest garment export producers and supplier to global brands such as Uniqlo and Adidas, faced Suspension of Debt Payment Obligations (PKPU) proceedings in 2024. This condition was triggered by the company's debt accumulation reaching approximately Rp8.6 trillion. PBRX management acknowledged that the company's revenue declined significantly from 2020 to 2023

due to the pandemic and working capital limitations, resulting in severely limited ability to service obligations to creditors (Bisnis.com, 2024). The Central Jakarta Commercial Court ultimately issued a homologation ruling on December 23, 2024, ending the PKPU through a debt restructuring agreement approved by more than 90% of creditors (Tempo, 2024).

Similar conditions were also identified in other issuers in the same sub-sector. PT Ricky Putra Globalindo Tbk (RICY), producer of GT-Man brand underwear, recorded a net loss of Rp111 billion throughout 2024, increasing from a loss of Rp75 billion in 2023 (IDX Channel, 2024). The widening losses have been persistent, suggesting that there are structural pressures on RICY's profitability. In the meantime, the PT Argo Pantes Tbk (ARGO) has recorded a cumulative loss of Rp2.91 trillion, including with persistent losses, so that the company has experienced serious erosion of its equity (FAC Securities, 2024). The conditions of these three issuers taken together show that the financial difficulties in this subsector are not isolated cases of financial trouble. This phenomenon is a symptom of wider structural pressures on the sub-sector as a whole and therefore represents a specific need for the empirical study of this phenomenon.

The financial circumstances of these three issuers have a strong relationship with the financial distress concept from a financial management viewpoint. Financial distress is a state of affairs in which a company is having trouble in paying off its financial obligations before the situation is deemed as bankruptcy. (Balasubramanian et al., 2019). It is a gradual onset condition. The deterioration of financial ratios is the first sign, which is followed by a steady decline. If not addressed in a suitable manner, this condition may escalate to non-payment of debts and eventually, lead to bankruptcy. (Hidayat, 2024). Identifying financial trouble quickly has a great strategic value. If investors can spot early warning signs of distress, then they can make a timely re-evaluation of portfolio risk. This situation is the management's basis for taking corrective actions before the situation worsens. Large-scale strategic industries have significant impacts on jobs and the economy for creditors and regulators, as well as on companies.

A pre-analysis was performed on a sample of three companies, ARGO, PBRX, and RICY, using the Modified Altman Z'' -Score, a quantitative model that relies on book-value accounting information rather than market value of equity, making it applicable to companies in emerging markets such as Indonesia regardless of manufacturing classification. The Z'' -Score combines four financial ratios weighted by empirically-derived coefficients; higher scores indicate financial health, while scores below 1.1 signal distress. This model is used to prove the indicators of financial distress empirically in this sub-sector for the years 2020 to 2025. The model was created specifically with companies in emerging markets in mind and is not dependent on market value data, so is applicable for use with companies listed on the IDX. (Elia et al., 2021). The classification of the model is based on the conditions in companies, which are divided into three zones: safe zone ($Z'' > 2.6$), grey zone ($1.1 < Z'' \leq 2.6$), and distress zone ($Z'' < 1.1$). Clearly, the Z'' is a measure of financial difficulty risk, not a bankruptcy ruling. The actual bankruptcy is strongly dependent on the actions of the management, the creditors and the conditions of the markets. (Balasubramanian et al., 2019). The pre-analysis results are presented in Table 1.1 below.

Table 1. 1Average Z'' -Score of ARGO, PBRX, and RICY by Year (2020–2025).

Year	ARGO	PBRX	RICY	Average	Zone
2020	-18.1470	5.0030	1.9148	-3.7431	Distress Zone
2021	-18.1778	3.6284	3.8331	-3.5721	Distress Zone
2022	-16.9802	7.2504	1.4854	-2.7481	Distress Zone
2023	-8.7649	6.0661	1.2481	-0.4836	Distress Zone
2024	-8.2977	-19.6028	-2.0258	-9.9755	Distress Zone
2025	-7.5660	2.8706	0.9890	-1.2355	Distress Zone

Source : Refinitiv Eikon, processed by the author (2026).

Although the average Z'' -Score of the three issuers remained within the distress zone throughout the observation period, the financial conditions of the individual companies differed considerably. ARGO consistently remained in the

distress zone, while PBRX and RICY moved between the safe, grey, and distress zones during 2020-2023. The sharp deterioration in 2024 was primarily driven by the substantial decline in PBRX's Z"-Score and the worsening financial condition of RICY.

At the level of the three companies, the trend of decline in Z" varied across years and the companies were in the same sub-sector and under similar external pressures. This pattern variation may mean that the factors that affect the macro economy are not the only ones that can cause distress. In addition, there are internal factors that differ from company to company that will influence how far into this risk area the company may be. These internal factors are the key to the identification of this research.

Profitability is among the factors that are most directly related to financial distress risk. The profitability indicator used in this study is the Return on Assets (ROA) that shows the ability of the company to create profits from all assets owned by the company. The high ROA usually implies that the business is operating efficiently and has sufficient operational capacity to service its financial needs. Negative or low ROA in contrast indicates that the firm is not earning enough returns from the assets used for operations. In the sub-sector which has thin profit margins as a result of pressure of import competition, even a moderate fall in ROA can rapidly increase the financial distress risk. (Erawati et al., 2024).

Signaling Theory provides a theoretical basis for explaining the relationship between profitability and financial distress. Under this theory, managers possess more information about the company's condition and prospects than investors and creditors. To reduce this information asymmetry, companies communicate their financial condition through observable information in financial statements. According to Goh (2023), management may convey positive or negative signals through reported financial performance. A positive and increasing ROA may signal efficient asset utilization and stronger capacity to meet financial obligations. Conversely, continuously declining profitability may provide a negative signal that weakens investor and creditor confidence and may restrict access to additional financing (Hidayat, 2024).

In addition to profitability, sales growth is an internal indicator that also has a significant role in the financial distress risk. Sales growth is an indicator of a company's capacity to drive revenue gains from one period to another. Positive and consistent growth suggests that the company is able to hold on to market share and create sufficient liquidity from the operations to meet any liquidity shortfalls, thereby limiting its need to raise external funds as debt. (Mafiroh & Mu'arif, 2025). This variable is highly pertinent for the apparel and luxury goods subsector because the acceptance of fashion products in the market is dependent on the capability of the company to adapt itself to the changing trends in the market.

On the other hand, if sales are stagnate or falling, businesses are forced to reduce their fixed expenses, which are costs that do not change quickly with a drop in sales, like rent on their stores, labor wages, marketing budgets and so on. In this condition, companies tend to increase debt to cover cash flow gaps, and this debt accumulation ultimately increases financial distress risk. PBRX acknowledged that this pattern occurred in the company: sales declined consistently from 2020 to 2023, driving dependence on continuously swelling debt (Bisnis.com, 2024).

Capital structure is the third internal factor of this research which was measured by Debt-to-Equity Ratio (DER). Capital structure is a measure of the debt and equity in a company's capital structure. Companies with high DER bear large fixed interest obligations and principal debt installments that must be met regardless of operational cash flow conditions that may be weakening. This condition creates structural vulnerability directly related to financial distress risk. (Erawati et al., 2024)

Theoretically, Trade-Off Theory explains the relationship between debt financing and financial distress. According to Sari (2017), an optimal capital structure reflects a balance between the tax benefits of debt and the increasing financial-distress and agency costs associated with leverage. Debt can provide tax-shield benefits, but these benefits are limited because higher leverage also increases fixed interest and principal obligations. When the costs associated with additional debt exceed its benefits, leverage may increase a company's financial vulnerability. Companies with higher business risk should therefore use debt cautiously because

fixed financing obligations can absorb earnings and increase the likelihood of financial difficulty.

Empirically, Aini et al. (2025) found that the capital structure positively and significantly influences financial distress on IDX market: the more leveraged the company is, the higher the financial distress risk will be. Erawati et al. (2024) found a similar relationship in manufacturing companies. Oktaviani & Zulvia. (2025) also confirmed that profitability negatively affects debt ratios: more profitable companies tend to borrow less. This is relevant for explaining why companies that continuously suffer losses tend to accumulate debt, thereby deepening distress conditions cyclically.

Although these three variables are theoretically and empirically relevant as explanators of financial distress, previous research has not produced consistent findings. Several studies confirm a significantly negative effect of profitability on financial distress, while other studies specifically focused on the apparel and luxury goods sub-sector on the IDX found no significant effect. Similar inconsistencies are found in sales growth and capital structure. The direction and significance of their impacts differ by sector, indicator and period observed. Overall, these inconsistent results indicate that there are contextual factors not yet fully accounted for in previous research. One of the most relevant contextualization factors to identify is firm size (firm size).

Empirical facts show that companies of different scales respond differently to the same financial pressures. PBRX, as a large-scale producer with approximately 27,000 employees, successfully negotiated the restructuring of Rp8.6 trillion in debt with the majority of its creditors, a strategic option that is generally unavailable to smaller-scale companies. Theoretically, large companies possess several structural advantages that function as financial buffers, including a more diversified asset base that can serve as collateral, more established banking relationships, and broader access to capital markets. Octavia (2023) explains that large companies generally face lower bankruptcy risk, enjoy easier access to capital markets, and experience smaller information asymmetry, while Aini et al. (2025) confirm that firm size positively affects debt ratios, reflecting the relative ease with

which larger companies obtain external financing. These buffers give large firms stronger fundamental resilience against financial distress, enabling them to absorb operational and financial shocks more effectively. Conversely, small-scale companies that lack adequate asset reserves and credit access tend to be more vulnerable to financial deterioration of the same magnitude (Oktavia & Komara, 2025). Firm size is therefore an important factor that must be taken into account when analysing the determinants of financial distress.

Failure to account for Firm Size may confound the estimated relationships between Profitability, Sales Growth, Capital Structure, and Financial Distress because companies of different scales may respond differently to the same industry pressures. Previous studies indicate that the determinants of financial distress may vary across firms with different operating scales (Oktavia & Komara, 2025; Aini et al., 2025; Wibin & Yanti, 2023). Accordingly, Firm Size is included as a control variable to adjust for systematic differences between larger and smaller companies. This allows the coefficients of Profitability, Sales Growth, and Capital Structure to be interpreted after company scale is taken into account.

This research analyses apparel and luxury goods sub-sector companies listed on the IDX for the period 2020 to 2025, based on the industry phenomenon, empirical evidence, and research gaps presented above. Four considerations underlie the choice of this object and period. First, this sub-sector is of national strategic importance, yet its financial distress is real and persistent. Second, the pre-analysis conducted with the Modified Altman Z"-Score model reveals that the sample issuers fall within the high-risk zone throughout the 2020 to 2025 observation period. Third, no previous study has simultaneously examined the effects of profitability, sales growth, capital structure, and firm size on financial distress in this sub-sector for this period. Fourth, the 2020 to 2025 period spans the pandemic shock, the recovery phase, and the structural crisis arising from trade liberalisation, a span that has not yet been addressed by prior research. Taking these considerations into account, the following research was undertaken: **The Impact of Profitability, Sales Growth, and Capital Structure on Financial Distress in**

Indonesia's Apparel and Luxury Goods Subsector: Firm Size as a Control Variable (2020–2025)”

1.2 Problem Formulation

According to the above background information, the problem formulations in the above research are:

1. Does profitability have a significant effect on financial distress?
2. Does sales growth have a significant effect on financial distress?
3. Does capital structure have a significant effect on financial distress?

1.3 Research Objectives

In accordance with the problem formulations above, the objectives of this research are:

1. To examine empirically the effect of profitability on financial distress.
2. To examine empirically the effect of sales growth on financial distress.
3. To examine empirically the effect of capital structure on financial distress.

1.4 Research Contributions

This research is expected to provide contributions to various parties, both theoretically and practically.

1.4.1 Theoretical Contributions

This study makes an academic contribution to the financial management literature by providing additional empirical evidence on the determinants of financial distress in the apparel and luxury goods subsector of the IDX. Specifically, this study provides empirical evidence on the effects of Profitability, Sales Growth, and Capital Structure on Financial Distress over the 2020–2025 period, while controlling for systematic differences in company scale through the inclusion of Firm Size. These findings are expected to help address existing inconsistencies in the empirical literature and to enrich the body of evidence supporting the application of Signaling Theory and Trade-Off Theory within the context of labor-intensive industries in emerging markets.

1.4.2 Practical Contributions

1. For Company Management. This research provides strategic insights regarding the importance of maintaining profitability, driving sales growth,

and managing debt composition prudently. Research findings are expected to become the basis for evaluation in making financial and operational decisions to enhance company resilience against financial distress risk.

2. For Investors and Creditors. This study can be used as a guide in the process of carrying out fundamental analysis prior to making investment decisions or extending credit to issuers of apparel and luxury goods sub-sector. Understanding the controlling effect of firm size can support more differentiated risk assessment across issuers of different scales.
3. For Regulators and Policy Makers. The inclusion of Firm Size as a control variable provides relevant policy implications by distinguishing the financial vulnerability of companies with different operating scales without treating Firm Size as a separately hypothesized determinant. Small-scale companies in this sub-sector may require greater attention from regulators when industry pressures increase, given their limited financial buffers compared to large-scale companies.

