

CHAPTER V

CONCLUSIONS AND RECOMMENDATIONS

This chapter presents the conclusions derived from the empirical analysis, followed by the theoretical and practical implications, research limitations, and recommendations for relevant stakeholders and future research.

5.1 Conclusions

This study examined the effects of Profitability, Sales Growth, and Capital Structure on Financial Distress in 18 Apparel and Luxury Goods sub-sector companies listed on the Indonesia Stock Exchange during the 2020–2025 period, with Firm Size included as a control variable. The study used 108 firm-year observations in a strongly balanced panel. Financial Distress was measured by the Modified Altman Z"-Score, Profitability by ROA, Sales Growth by annual revenue growth, Capital Structure by DER, and Firm Size by the natural logarithm of total assets in rupiah. Based on the final Random Effects Model with firm-clustered robust standard errors, the conclusions are as follows:

1. Profitability has a positive and statistically significant association with the Modified Altman Z"-Score (coefficient = 19.1166; $p = 0.048$). Because a higher Z"-Score indicates a lower risk of financial distress, the positive coefficient implies that higher Profitability is associated with a lower financial-distress risk. H1 is therefore supported, although the evidence is marginal because the probability value is close to the 5% significance threshold.
2. Sales Growth has a positive but statistically insignificant effect on the Z"-Score. The direction is consistent with a lower risk of financial distress, but the evidence is not statistically sufficient. H2 is therefore not supported. Revenue growth alone does not necessarily improve financial health when it is not accompanied by profitability, liquidity, and effective cost management.
3. Capital Structure has a positive and statistically insignificant effect on the Z"-Score. The coefficient direction is opposite to the negative sign on Z" expected under H3, and the effect is not significant. H3 is therefore not supported. The highly dispersed DER values, including negative and extremely large ratios

caused by negative or near-zero equity, limit the ability of DER to represent leverage risk linearly across the sample.

4. Firm Size, as a control variable, has a positive but statistically insignificant relationship with the Z"-Score. Company scale does not independently guarantee protection from financial distress after Profitability, Sales Growth, Capital Structure, and company-specific random effects are controlled.
5. Profitability, Sales Growth, and Capital Structure are not jointly significant, as shown by $\chi^2(3) = 5.58$ and $p = 0.1337$. The overall model including Firm Size is also not jointly significant ($\chi^2(4) = 5.61$; $p = 0.2299$). Thus, the financial-distress condition of the sub-sector is associated with factors beyond the variables included in this study, while persistent company-specific characteristics remain important.

5.2 Theoretical Implications

The significant Profitability result provides partial empirical support for Signaling Theory. ROA functions as a financial signal that reflects management's ability to use assets efficiently and generate earnings. A stronger profitability signal is associated with a higher Z"-Score and therefore a lower financial-distress risk. The result reinforces the relevance of profitability information for investors, creditors, and other external parties evaluating the financial health of companies in an emerging-market, labor-intensive industry.

The insignificant Sales Growth result shows that not all positive operating signals have the same informational content. Growth can be more accurately measured by profitability than revenue, especially if growth comes at low profit margins, or if a lot of working capital is dedicated to supporting growth. This discovery further advances Signaling Theory by revealing that it is not just growth that matters but the quality of growth, and that this explains financial health.

The result of the Capital Structure does not provide a support for the implication of the Trade-Off Theory in the final model. This does not necessarily mean that the theory is incorrect, it just indicates that the empirical proxy and the financial status of the sample population influences the observed relationship.

When the equity is negative or near to zero, it becomes challenging to interpret DER. Going forward, theory applications need to be made to differentiate between normal leverage and leverage ratios from equity impairment.

5.3 Practical Implications

For company management, The findings underscore the importance of boosting profitability as a key element of financial distress prevention for them. Expansion in sales volume should not be the only target for management; it is also important to make sure that the growth in sales results in sufficient margins, operating cash flow and working-capital efficiency. It is important, therefore, that cost control, product-mix improvement, pricing discipline and asset productivity should all be managerial concerns.

For managers and creditors, DER should be read in conjunction with the absolute amounts and the signs of liabilities and equity. Negative equity does not mean low leverage, or low risk. Likewise, a very high DER can be indicative of a very small equity base. Consequently, credit analysis needs to be complemented by the debt-service capacity, interest coverage, operating cash flow, debt maturity, and equity trend.

Profitability should not be the only indicator investors use to identify a warning sign; it can also be a valuable early-warning indicator. The tests of the models are not significant and the overall R^2 value is low, suggesting a wider fundamental analysis is required. It is advisable for investors to use ROA along with the "Z" factors, the liquidity, the cash-flow, the debt composition, and the company specific information to make an investment decision.

An increase in the number of observations recorded in distress area in 2024 and 2025 suggests continued monitoring of the sub-sector by the regulators/policymakers. The scale of companies is not the only criteria to be taken into account when assessing the policy while profitability, equity position, working capital, employment, import exposure, and the ability to restructure financial obligations are also important considerations to make.

Export-oriented companies should also incorporate U.S. tariff exposure into budgeting, pricing, sourcing, and liquidity planning. Firms that can document eligible use of U.S. cotton or man-made-fiber inputs may be better positioned to use the textile quota mechanisms, while firms outside the eligibility criteria may face a higher landed-cost burden in the U.S. market. Regulators and industry associations should therefore monitor firm-level export dependence and provide current implementation guidance because tariff exclusions and quota rules may change (USTR, 2026).

5.4 Research Limitations

1. This study spans the course of 18 companies for 6 years. The panel is full with fairly good balance, but the length of time is relatively low, which is not conducive to the reflection of longer financial cycles and structural changes.
2. The Z"-Score, ROA, and DER values have very extreme values but are valid. These observations are actual financial conditions and have been preserved but have an impact on the precision of the coefficients and introduce skewness into the observations.
3. Only Modified Altman Z"-Score is used to measure Financial Distress. The model does not directly account for legal default, or cash insolvency, or restructuring results or market-based distress.
4. DER is used for measuring the capital structure. If the observations have a negative or close to zero equity, DER might not be a monotonically increasing measure of economic leverage and the estimated relationship may be weaker.
5. The final model has low overall explanatory power, non-significant joint tests. Other factors like liquidity, operating cash flow, working-capital efficiency, interest coverage, corporate governance, exchange-rate exposure, macroeconomic and regulatory shocks were not accounted for.

6. The results are for Apparel and Luxury Goods sub-sector companies listed on the Indonesia Stock Exchange and cannot be automatically extended to other sectors, private companies and other countries.
7. The Modified Altman Z"-Score contains accounting components, particularly EBIT-to-Total-Assets and Book-Equity-to-Total-Liabilities, that are conceptually related to Profitability measured using ROA and Capital Structure measured using DER. Consequently, part of the estimated association may reflect shared accounting information between the dependent and independent variables rather than a fully independent empirical relationship. The results should therefore be interpreted as conditional statistical associations rather than definitive causal effects
8. The cluster-robust inference in this study is based on 18 company clusters. Because the number of clusters is limited, results that are close to the conventional significance threshold, particularly the Profitability coefficient, should be interpreted cautiously.
9. The study period ends in 2025 and therefore does not capture the firm-level effects of the U.S.–Indonesia Agreement on Reciprocal Trade finalized in February 2026 or the separate Section 301 tariff action implemented in July 2026. Accordingly, the discussion of these policies is included only as post-observation context and should not be interpreted as evidence that the policies caused the financial-distress outcomes observed during 2020–2025

5.5 Recommendations

1. Company management should prioritize sustainable profitability rather than sales growth alone. Growth strategies should be evaluated based on contribution margins, cash conversion, working-capital requirements, and their ability to improve debt-service capacity.
2. Investors and creditors should interpret DER cautiously when equity is negative or very small. Credit and investment assessments should combine

leverage ratios with operating cash flow, interest coverage, debt maturity, and changes in book equity.

3. Regulators should ensure that they continue to carry out early-warning surveillance over the sub-sector, especially firms that have negative profitability, decreasing Z"-Score, poor equity and insufficient working capital. Support and intervention must be based on the financial situation of the individual firm, not its size.
4. Future studies should extend the observation period, increase the number of sample companies or clusters, and consider alternative financial-distress proxies. Additional explanatory variables may include liquidity, operating cash flow, working-capital turnover, interest coverage, corporate governance, export dependence, and exchange-rate exposure.
5. Future studies should use leverage measures that remain economically interpretable when equity is negative or close to zero, such as liabilities-to-assets, net debt-to-assets, interest coverage, or other debt-service indicators. Future research should also conduct additional robustness tests using alternative distress and leverage measures to assess whether the findings remain stable across model specifications.
6. Since the result of Profitability is significant but weak, the main variables are not jointly significant and thus, future researchers should repeat the study with other samples, over other time periods, and with different specifications before making a general causal statement.
7. Future studies should extend the panel beyond 2025 and include U.S. export intensity, tariff exposure, customer concentration, and sourcing of U.S.-origin textile inputs to test whether the new tariff regime affects profitability, sales growth, leverage, and financial-distress severity.