



The Influence of Liquidity ratio and Leverage ratio on Financial Distress in The Apparel and Luxury Goods Sub-sector

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ABSTRACT

This research seeks to explore the impact of the Current Ratio and Debt to Equity Ratio on Financial Distress. With a sample six (6) companies from the apparel and luxury goods subsector that listed on the Indonesia Stock Exchange in 2019 until 2023, a quantitative methodology was employed. The hypotheses were evaluated using panel data regression analysis. The findings reveal that the suitable regression approach is a random effects model, and the hypothesis testing results show that both the Current Ratio and Debt to Equity Ratio together affect financial distress.

INTRODUCTION

In the 20th century, Indonesia's textile industry started to grow quickly, thanks to government policies and investments from foreign countries. Many textile factories were set up, making a wide range of clothing, both traditional and modern. According to a report from CNBC in 2024, the Central Statistics Agency (BPS) stated that the textile and clothing industry subsector expanded by 7.43% year over year in the third quarter of 2024. This growth was higher than the national economic growth of 4.95% during the same period. The subsector contributed 0.99% to the national Gross Domestic Product (GDP) in the third quarter, which totaled IDR 5,638.9 trillion at current prices. This performance was better than the second quarter of 2024, when the industry had a slight decline of 0.03%. The growth of companies in the apparel and luxury goods subsector is driven not only by higher consumer demand but also by innovations in design and production technology. Indonesian brands are now better able to compete with international brands, thanks to their creativity in blending local culture with global trends. The availability of raw materials and government support for the creative industry are also helping this growth. Based on observations from the idx.co.id website, there are 22 companies listed in the apparel and luxury goods subsector on the Indonesia Stock Exchange. However, companies still face challenges, especially due to economic changes and shifting consumer preferences. Therefore, companies need to keep adapting and manage their finances well to avoid financial difficulties in a competitive market.

A company's financial health is important for many stakeholders, such as investors, managers, policymakers, and industry participants. It shows the company's ability to stay in business and maintain the confidence of those relying on its performance. Bankruptcy is a serious risk and a major challenge for companies. This threat can come from poor financial management, global economic pressures, and the unpredictability of a changing business environment (Tron, 2021). Financial distress is the early stage of a financial crisis before bankruptcy. It is usually marked by difficulty in paying financial obligations, especially short-term ones, which show the company's liquidity and solvency. Financial distress can happen at any time. It is usually caused by poor financial conditions that make it hard for a company to fund its operations, which can lead to the company being unable to survive for a certain period (Hendrayanti, 2024).

Fred Weston, as cited in Kasmir (2021:129), explains that the liquidity ratio is a measure of a company's ability to pay its short-term obligations, or debts. This means that if a company is required to pay its debts, it should be able to do so, especially those that are due. According to Kasmir (2021:153), the solvency ratio, also known as the leverage ratio, measures how much of a company's assets are funded by debt. It shows the relationship between the company's debt and its assets. In a broader sense, the solvency ratio is applied to assess a company's ability to meet both its immediate and long-term obligations, if the business was to be liquidated or dissolved.

Several previous studies have shown that the current ratio and debt to equity ratio have an impact on financial distress. For example, Nugraha and

Nursito (2021) conducted research titled "The Effect of Current Ratio, Debt to Equity Ratio, and Return on Equity on Financial Distress." Similarly, Mitha Christina Ginting (2017) studied "The Effect of Current Ratio and Debt to Equity Ratio (DER) on Financial Distress in Property & Real Estate Companies on the Indonesia Stock Exchange." Karimah and Sukarno (2023) also explored "Analysis of the Effect of Current Ratio, Total Asset Turnover, Return on Assets and Debt to Equity Ratio on Financial Distress – a case study of automotive and component companies listed on the Indonesia Stock Exchange (IDX) in 2018-2021." These studies together show that the current ratio, total asset turnover, return on assets, and debt to equity ratio all have an effect on financial distress. However, Vynda Myliariza's (2021) research, titled "The Effect of Financial and Macroeconomic Ratios on Financial Distress of Consumer Goods Industry Companies Listed on the IDX for the 2015-2019 Period," found that financial ratios, including profitability ratios (ROA and ROE), liquidity ratios (CR), and leverage (DAR and DER), do not have impact on financial hardship.

Founded on the above discussion, author selected the research title "The Effect of Current Ratio and Debt to Equity Ratio on Financial Distress in the Apparel and Luxury Goods Subsector" for the period 2019-2023.

LITERATURE REVIEW

Signal Theory

According to Prasetya and Oktavianna (2021), as cited in Annastasya (2023), financial distress serves as a signal for investors when making investment decisions.

Financial distress has been widely discussed in economic literature as a harmful condition, and the likelihood of its occurrence is important in determining a company's best capital structure. Financial distress, according to Goh (2023:19), is the phase of a company's financial collapse that occurs before to bankruptcy or liquidation. When a business cannot fulfill its obligations, especially short-term obligations like liquidity and solvency-related debts, financial troubles begin. Financial distress can be identified through a company's performance, which is mainly assessed using financial ratios over a specific time period. Evaluating company performance is essential for the company, as it helps determine whether the company's goals have been achieved and whether stakeholders' interests are met. Kasmir (2021:135-142) explains that the current ratio is a financial ratio that measures a company's ability to pay short-term liabilities when they become due. In simpler terms, it shows how much of the current assets of the company are available to pay of it immediate obligation. Meanwhile, according to Kasmir (2021:158-164), The debt-to-asset ratio, on the other hand, is a kind of debt ratio that assesses the connection between a company's total debt and total assets. Put differently, Stated differently, it illustrates the extent to which a company's assets are financed by debt and the extent to which debt influences asset management.

A conceptual framework is closely connected to the research problem and acts as a guide for developing hypotheses (Bisri in Sari et al. 2023).

In this study, the conceptual framework can be described as follows:

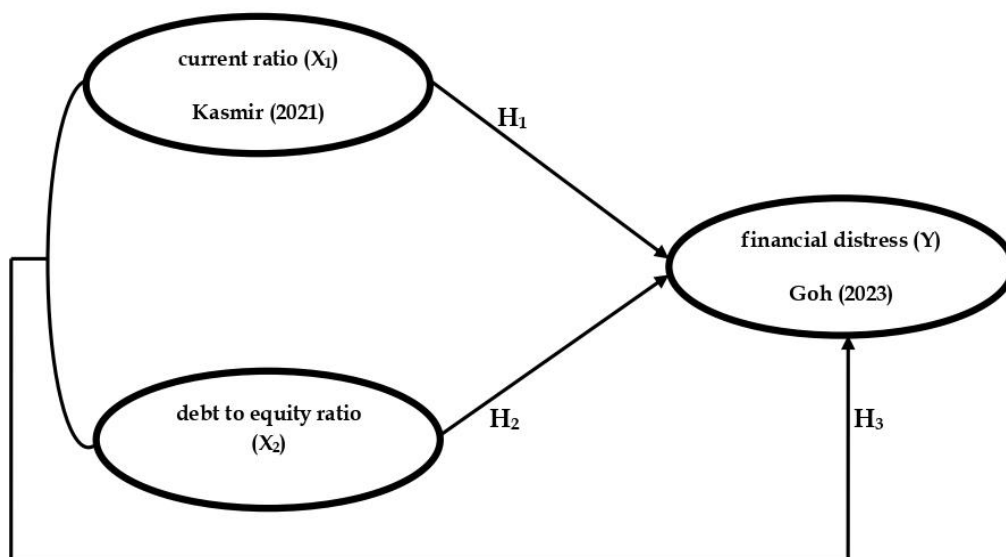


Figure 1. Conceptual Basis

In light of the conceptual basis discussed earlier, the theories listed below are proposed for this study:

H1: From 2019 to 2023, the Indonesia Stock Exchange-listed clothing and luxury goods industry's financial crisis is influenced by the current ratio.

H2: For the years 2019 through 2023, the debt-to-equity ratio affects financial distress in the fashion and luxury goods industry as listed on the Indonesia Stock Exchange.

H3: Financial distress in the clothing and luxury goods industry listed on the Indonesia Stock Exchange between 2019 and 2023 is influenced by both the current ratio and the debt-to-equity ratio. H₁: The current ratio has an impact on financial distress within the apparel and luxury goods sector, which is listed on the Indonesia Stock Exchange, during the period from 2019 to 2023.

METHODOLOGY

In this study, a quantitative approach was employed, focusing on 22 companies operating within the apparel and luxury goods sub-sector that are listed on the Indonesia Stock Exchange between 2019 and 2023. To select the sample, a purposive sampling method was used, based on specific criteria set by the researcher. These criteria included companies that had fully disclosed their financial reports for the same period, had their initial public offering (IPO) registered no later than 2019, used the rupiah currency, and experienced a decline in profits from 2019 to 2023. As a result, six companies were selected as the sample.

For data collection, the researcher used online sources, including the official website of the Indonesia Stock Exchange (www.idx.co.id), the websites of the selected companies, as well as research journals and news articles related to the apparel and luxury goods sub-sector.

The operational variables were implemented in this research:

1. Current Ratio (X₁) : This is a liquidity ratio that measures a company's ability to meet its short-term obligations.

Formula: $CR = (\text{Current Assets} / \text{Current Liabilities}) \times 100\%$

Source: Kasmir, 2021

2. Debt to Equity Ratio (X_2) : This is a solvency ratio that shows the proportion of debt to equity in a company's capital structure.

Formula: $DER = (\text{Total Debt} / \text{Equity}) \times 100\%$

Source: Kasmir, 2021

3. Financial Distress (Y) : This was measured using the Altman Z-score method.

Formula: $(Z\text{-score}) = 1.2T_1 + 1.4T_2 + 3.3T_3 + 0.6T_4 + 0.99T_5$

Source: Goh, 2023

Description:

$T_1 = \text{Net Working Capital} / \text{Total Assets}$

$T_2 = \text{Accumulated Profit} / \text{Total Assets}$

$T_3 = \text{EBIT} / \text{Total Assets}$

$T_4 = \text{Market Value to Equity} / \text{Book Value to Total Liabilities}$

$T_5 = \text{Turnover} / \text{Total Assets}$

According to the Altman Z-Score classification, if the score is above 2.99, the company is considered to be in the "Safe Zone" and is unlikely to face financial distress.

If the score falls between 1.81 and 2.99, the company is in the "Gray Area," indicating potential financial difficulties but not yet in distress. If the score is below 1.81, the company is considered to be in financial distress.

For data analysis, the Eviews 12 software was used.

The following statistical tests were conducted:

1. ****Descriptive Statistics****

This method helps in presenting, summarizing, and organizing data in a clear and simple manner, making it easier to understand. It is not intended for making decisions or drawing formal conclusions, but rather for describing the data as it is (Ghozali & Ratmono, 2017:30).

2. Panel data regression

According to Ghozali & Ratmono (2017:196), panel data offers several advantages:

- a. Panel data enables researchers to collect a larger number of observations, which increases the degrees of freedom. The high variability in panel data also helps reduce the correlation between independent variables, leading to more accurate and dependable econometric results.
- b. Panel data provides a broader range of information that cannot be obtained through cross-sectional or time series data alone. By combining both spatial and temporal aspects, panel data allows for a more thorough analysis.
- c. Panel data is better suited for understanding how variables change over time compared to analyses based solely on cross-sectional data. This allows researchers to monitor and interpret the development of variables across different periods.

To develop a panel data regression model, researchers need to follow these steps:

- a. First, estimate the model using the common effects model, fixed effects model, and random effects model, before:
 - b. Choosing the appropriate regression model through the Chow test, Hausman test, and Lagrange multiplier test.
3. Classical assumption tests

To ensure that a linear regression model built applying the Ordinary Least Squares (OLS) technique is valid and reliable, it must be carried out several classical assumption tests as part of the research process. These assumptions include the normal distribution of data, the absence of multicollinearity among independent variables, the absence of heteroscedasticity, and the absence of autocorrelation in the residuals. The classical assumption tests—covering normality, multicollinearity, autocorrelation, and heteroscedasticity—help confirm whether these conditions are met, ensuring that the parameter estimates from the OLS model are unbiased and efficient. However, it is important to note that not all of these tests are always required for every linear regression model using the OLS approach, depending on the specific features of the data and the nature of the research, as explained by (Basuki & Prawoto 2016:297).

Here are some reasons why not all classical assumption tests are used in panel data regression:

- a. Since the model is assumed to be linear, linearity tests are rarely applied to linear regression models.
 - b. The BLUE (Best Linear Unbiased Estimator) criteria do not include normality testing, and some viewpoints do not require this condition to be fulfilled.
 - c. Performing autocorrelation tests on non-time series data, such as cross-sectional or panel data, is generally not useful because autocorrelation typically only occurs in time series data.
 - d. When a linear regression model uses multiple independent variables, it is necessary to conduct a multicollinearity test.
 - e. Heteroscedasticity is commonly found in cross-sectional data, as panel data is more similar to cross-sectional data than to time series data. From the above explanation, this study only performed multicollinearity and heteroscedasticity tests.
4. Partial (t-test) and simultaneous (F-test) hypothesis testing.

The t-test, as described by Ghazali (2018:98), is used to assess the significance of each independent variable and to explain the variance of the dependent variable in part. The decision in this test is based on a significance and confidence level of 5% or 0.05.

Decision-making using the t-table is as follows:

- a. If the calculated t-value is less than the t-table value, then H_0 is accepted and H_a is rejected, which means the independent variable does not have a partial effect on the dependent variable.

- b. If the calculated t-value is greater than the t-table value, then H_0 is rejected and H_a is accepted, indicating that the independent variable has a partial effect on the dependent variable.

Decision-making based on significance is as follows:

- a. The independent variable does not have a partially significant effect on the dependent variable if the significance value is more than 0.05, in which case H_0 is accepted and H_a is rejected.
- b. The independent variable has a partially significant impact on the dependent variable if the significance value is less than 0.05, in which case H_a is accepted and H_0 is rejected.

The F-test is used to demonstrate that the dependent variable is impacted by all of the independent variables in the model.

Decision-making based on the F-table is as follows:

- a. If F_{count} is less than F_{table} , then H_0 is accepted and H_a is rejected, meaning the independent variables together do not have an effect on the dependent variable.
- b. If F_{count} is greater than F_{table} , then H_0 is rejected and H_a is accepted, indicating that the independent variables together have an effect on the dependent variable.

Decision-making based on probability values is as follows:

- a. H_0 is accepted and H_a is rejected if the significance value is higher than 0.05, indicating that the independent factors taken together do not significantly affect the dependent variable.
- b. The alternative hypothesis is accepted and the null hypothesis is rejected if the significance value is less than 0.05, suggesting that the independent factors collectively have a substantial impact on the dependent variable.

Determination Coefficient

This assessment measures model's ability to explain how the independent variables collectively influence the dependent variable, and this is shown by the adjusted R-Square value.

RESEARCH RESULT

Table 1. random effect model

Included periods: 5

It contained six cross-sections.

30 total panel (balanced) observations

Arora and Swamy's component variance estimator

Variable	Coefficient	Std.Error	t-Statistic	Prob.
C	-2.465039	0.548710	-4.492429	0.0002
X1	0.011180	0.004693	2.382174	0.0263
X2	0.000325	0.000364	0.891224	0.3825
Effects Specification				
			S.D.	Rho
Cross-sectionfixed(dummyvariables)	0.000000			0.0000
Periodrandom				
Idiosyncraticrandom		1.188499		1.0000
Weighted Statistics				
R-squared	0.938274	Meandependentvar	-	1.215568
Adjusted squared	R-0.918633	S.D.dependentvar		4.316338
S.E. of regression	1.231227	Sumsquaredresid		33.35026
F-statistic	47.77315	Durbin-Watsonstat		1.028030
Prob (F-statistic)	0.000000			
UnweightedStatistics				
R-squared	0.938274	Meandependentvar	-	1.215568
Sumsquaredresid	33.35026	Durbin-Watsonstat		1.028030

Source: Eviews 12 Output (Data processed, 2025)

In Table 9, the results reveal that the chosen regression is a random effects model (REM) with regression equation $Z\text{-Score (FD)} = -2.465039 + 0.011180 (\text{CR}) + 0.000325 (\text{DER})$. The t-value for the CR variable is 2.382174, which is higher than the t-table value of 2.051. The probability value is 0.0263, which is less than 0.05, so it can be concluded that CR has a significant effect on financial distress. The t-value for the DER variable is 0.891224, which is lower than the t-table value of 2.051. The probability value is 0.3825, which is greater than 0.05, so it can be concluded that DER does not have a significant effect on financial distress. The F-value is 47.77315, it exceeds the 3.35 F-table value. Both the current ratio and the debt to equity ratio have an impact on financial distress, as indicated by the likelihood value of 0.000000, which is less than 0.05. The adjusted R-squared value is 0.918633, indicating that the current ratio and debt to equity ratio contribute 91.8633% to financial distress, while the remaining 8.1367% is influenced by other factors not included in this study.

DISCUSSION

The findings from the hypothesis test in this study show the fact that both the debt-to-equity ratio and the current ratio affect financial distress. This aligns with the work of Mitha Christina Ginting (2017) but goes against the findings of Nugraha and Nursito (2021). When considering the simultaneous test results, both the current ratio and the debt-to-equity ratio are found to influence financial distress. This outcome agrees with the studies by Nugraha and Nursito (2021), Mitha Christina Ginting (2017), and Karimah and Sukarno (2023), but it differs from the conclusions of Vynda Myliariza (2021).

The above explanation shows that hypothesis test results can vary even when the same variables are used.

This variation may result from several factors, including differences in sample groups, varying significance levels, errors during data collection, measurement inaccuracies, or differences in how the tests are conducted. Additionally, natural variability within the data itself can also lead to different outcomes across various tests.

CONCLUSIONS AND RECOMMENDATIONS

Based on the discussion and research findings, the following conclusions can be made:

1. Financial difficulty is influenced by the current ratio.
2. Financial strain is also influenced by the debt-to-equity ratio.
3. Together, the current ratio and debt-to-equity ratio have a significant influence on financial distress, explaining 91% of the variation.

ADVANCED RESEARCH

There are certain limitations to this study that could affect the outcomes and insights gained, such as:

1. The use of a quantitative approach focuses mainly on numerical data, which may not allow for a deeper exploration of underlying factors.
2. Only two independent variables – Current Ratio and Debt to Equity Ratio – are considered, which might not fully capture all elements that can affect a company's financial difficulties.
3. The research relies solely on secondary data from publicly released annual financial reports. Since access to internal company information is limited, the findings might not accurately represent the true situation.

Considering these limitations, it is hoped that future studies can build upon this research by incorporating a broader range of independent variables, examining different locations, and using more detailed supporting data beyond secondary sources.

Additionally, exploring various research methods could provide a more comprehensive understanding of the topic.

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