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Research Article

Factors Influencing Financial Distress : Evidence from Indonesia Consumer Cyclical Companies

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Abstract: This research investigates the key factors influencing companies registered on the Indonesia Stock Exchange (IDX) that is experiencing financial distress between the years 2021 to 2023. In this study, 353 data points were selected from the target population using purposive sampling. Three key financial ratios were utilized as indicators of financial distress: Profitability can be measured by Return on Assets (ROA), while the Current Ratio (CR) is used to measure liquidity. Meanwhile, The Logarithm of Natural to Total Assets (LnTA) is a metric for evaluating a company's size. Multiple regression analysis is performed utilizing SmartPLS 4.0 software to analyze the connection between these factors and the probability of experiencing financial distress. The findings indicate a significant negative association between liquidity (CR) and company size (LnTA) with financial distress. In contrast, profitability (ROA) demonstrates an insignificant negative correlation with financial distress. This study contributes to the literature by providing a comprehensive analysis of the factors influencing financial distress in Indonesia consumer cyclical companies employs signaling theory to interpret the relationships discovered.

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Keywords: Company, Size, Current, Ratio, Financial.

1. INTRODUCTION

Indonesia has various types of businesses, creating complex and competitive economic dynamics. In this situation, companies need to adapt to face market challenges and compete effectively. From 2022 to the fourth quarter of 2023, economic growth continued to develop positively every quarter. However, vigilance against a potential recession is still needed. The global situation characterized by the COVID-19 pandemic, geopolitical conflict between Russia and Ukraine, high inflation, and increasing key interest rates has significantly impacted the stability of nations.

Financial distress occurs when a company faces substantial financial strain and cannot manage its obligations effectively. This condition is caused by various economic factors, both on a large and small scale [2]. Common symptoms of financial distress are decreased sales volume, reduced profits, and high debt levels [3]. According to Mujianto & Hariyanto, (2024) companies in the consumer cyclical sector often experience significant fluctuations in

revenue. This is due to consumer demand, which is strongly influenced by economic conditions. The following graph illustrates the condition of companies from various sectors that are delisted:

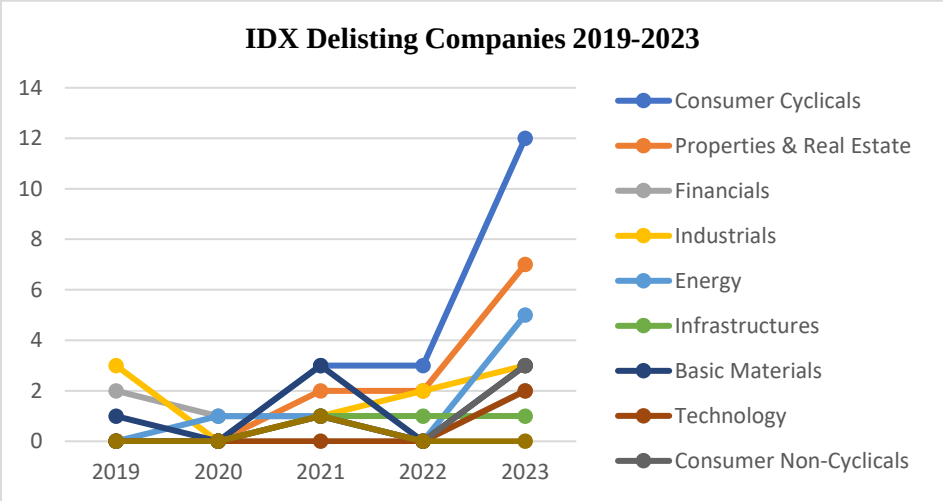

Figure 1. Companies Delisting

Graph 1 demonstrates a considerable rise in the number of companies encountered by IDX in the consumer cyclical sector between 2019 and 2023. In 2021 and 2022, three companies were delisted. The peak occurred in 2023, with 12 companies. This high fluctuation indicates that companies in this sector face serious operational challenges, leading to delisting from the IDX. Economic conditions significantly affect cyclical consumer companies in retail, hospitality, and entertainment. When the economy experiences recession or uncertainty, demand for these goods and services tends to decrease, leading to a significant drop in revenue, which can lead to financial problems and delisting. The decline in performance can be an early symptom of financial distress.

The non-primary consumer goods sector (consumer cyclical) is an industrial sector comprised of companies that manufacture and distribute goods and services that are usually purchased by customers as cyclical goods or secondary goods so that the demand for goods and services correlates with economic growth. Businesses in retail, apparel and luxury goods, retail, automotive, hospitality and travel, and entertainment industries. Meanwhile, the primary consumer goods sector or consumer non-cyclical is an industrial sector that experiences growth in line with population growth and increasing income. The higher the number of non-cyclical consumer needs, the higher the level of market competition so that non-cyclical consumer companies will continually improve their performance [5].

This study utilizes the Altman Z-Score model as an analytical framework, as this method is recognized for its effectiveness in identifying companies at risk of financial distress, particularly during economic uncertainty. The Altman Z-score model is utilized to evaluate a company's financial stability. By integrating multiple financial performance metrics, this model can provide a more accurate picture of bankruptcy risk and can be applied to various types of

companies [4]. Research conducted by [6] Altman Z-Score model has more accurate results in detecting financial distress than the Grover model. Financial distress influences several factors, including profitability, liquidity, and company size. This study examines these three variables to evaluate their effects on bankruptcy risk.

Profitability measures how much profit a company makes and how efficiently its management functions. High profitability indicates that a company successfully carries out its business activities. According to Dirman, (2020) companies with high profitability are generally more financially secure and have less chance of experiencing financial distress. Research by Junaidi & Widajantie, (2023) reveals that profitability positively influences financial distress. A company may achieve high profits, but this does not inherently ensure its economic stability. The reason is that high profits can come from large amounts of uncollectible receivables. Research conducted by [4], [8] indicates that financial distress is not much influenced by profitability.

According to Christella & Osesoga, (2020) Liquidity is a company's capacity to satisfy its immediate financial obligations as it matures. Management must ensure liquidity to facilitate timely payment of such obligations. Wijaya & Suhendah, (2023) found in their research that liquidity significantly positively impacts financial distress. This finding contrasts with studies [1], [8], [10] which concludes that liquidity does not affect financial distress.

The total value of its assets can determine company size. Tumbelaka et al., (2024) highlight notable differences in financial risk between small and large companies. Small companies with limited assets risk experiencing financial distress, while large companies with many assets tend to have strong economic conditions, healthy cash flow, and better long-term prospects. Based on research conducted by [3], [11] reveals that financial distress are influenced by the size of the business. This opinion differs from [7] which indicates that company size negatively impacts financial distress.

This research investigates the key factors influencing financial distress within the consumer cyclical sector to resolve discrepancies found in prior research. It specializes in analyzing the impact of profitability, liquidity, and company size on financial distress over a three-year period (2021-2023).

2. LITERATURE REVIEW

Signaling Theory

According to Michael Spence in [12] Signaling theory explains how one party's actions can provide quality to the other by reducing information asymmetry. In a company, information is derived from financial statements. Signals are sent to external parties when the company performs well financially. Information provided by a company can be either good or bad news. Good news can include earnings reports, dividend payments, and good company conditions. Bad news can consist of losses incurred by a company that cannot

pay profits or excessive debt, leading to bankruptcy. These signals are very important because they provide information about management actions to meet the owner's wishes [3].

Financial Distress

Friska & Pudjolaksono, (2023) define financial distress as the deterioration company's condition before bankruptcy. Indicators of financial difficulties can be detected through cash flow analysis, assessment of the company's strategy, and review of financial reports. The Altman Z-Score model is a metric for financial distress in this research [14]:

$$\boldsymbol{Z = 0,717X_1 + 0,847X_2 + 3,107X_3 + 0,420X_4 + 0,998X_5}$$

Description:

Z = Overall Index

X_1 = Working Capital/Total Assets

X_2 = Retained Earnings/Total Assets

X_3 = Earnings Before Interest and Tax/Total Assets

X_4 = Book Value of Equity/Book Value of Total Liabilities

X_5 = Sales/Total Assets

The cut-off values of the method for calculating the Altman Z-Score score:

1. Z value > 2,90 = *Safe zone.*
2. 1.20 < Z > 2,90 = *Gray zone.*
3. Z < 1,20 = *Danger zone.*

Profitability

Profitability measures the success of a company in generating profits from its operational periods [15]. A business will be considered successful in its operations if it can produce significant profits. A company that makes a lot of money can stay out of danger of going bankrupt. Conversely, there is a greater chance that the business may face financial difficulties if it cannot generate substantial earnings or even lose money. The efficiency of a company's profit relative to its total assets is reflected by the return on assets (ROA). The formula used to measure profitability is:

$$\boldsymbol{ROA = \frac{Net\ Profit}{Total\ Asset}}$$

Liquidity

A company's ability to meet short term obligations is indicated by its liquidity ratio. The current ratio (CR) is one such measure of the company's liquidity. A liquid company can effectively utilize its current assets to generate substantial profits [16]. If the company can pay off its current debt with its assets, it will have better liquidity and avoid financial

distress conditions. Conversely, if the company has a low liquidity ratio, it will inevitably result in financial difficulties. In addition, a good level of liquidity can make the company get support from suppliers and creditors. The formula used to measure liquidity is:

$$\boldsymbol{CR = \frac{Current\ Asset}{Current\ Liabilities}}$$

Company Size

A company size is determined by its total assets. Larger companies have an advantage in raising funds for business development and are more appealing to external parties. In contrast, smaller companies often encounter challenges related to resources, reputation, and access to funding [10]. Furthermore, company size is a variable that may contribute to a firm's financial distress. The formula for calculating company size:

$$\boldsymbol{Company\ Size = Ln\ (Total\ Assets)}$$

Conseptual Framework

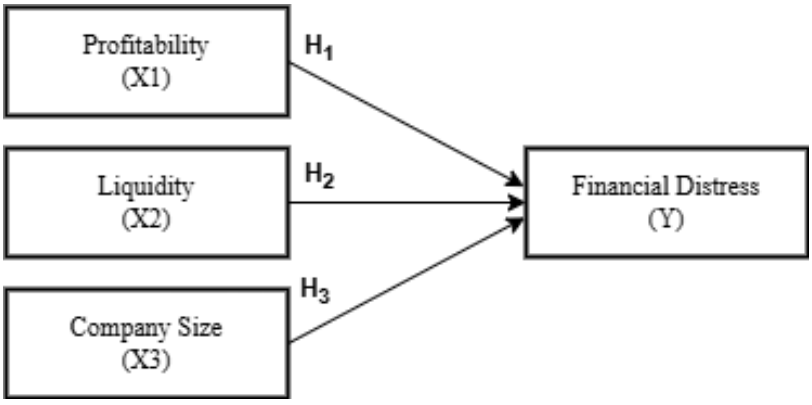

Figure 2. Conceptual Framework

The Effect of Profitability on *Financial Distress*

Profitability reflects the efficiency of the company in generating income from its resources. Substantial profits generally indicate sound performance, while weak profits may signal underlying problems [17]. Profitability is measured using return on assets (ROA). The relationship between profitability and financial distress is based on signaling theory which means that high profitability provides a positive signal that the company is in a stable condition. In contrast, low profitability can be a warning of potential financial distress. Prior studies offer mixed results Arifin et al., (2021); Fatmayuni et al., (2024); Savery et al., (2024) identified a significant negative correlation between profitability and financial distress. Conversely, Junaidi & Widajantie, (2023) reported a positive relationship between profitability and financial distress. Therefore, the following hypothesis is proposed:

H_1 : Profitability has negative impact on *financial distress.*

The Impact of Liquidity on *Financial Distress*

Liquidity is a company's capacity to use its current assets to cover immediate debts. The currents ratio (CR) is the metric used to evaluate liquidity in this study. A higher CR signifies more excellent capability to fulfill financial obligations, while a low CR indicates potential financial difficulties. Companies with a higher CR tend to attract investors due to their effective financial management. The relationship between the current ratio and financial distress is based on signaling theory, which emphasizes that the signal of whether a company is healthy or not is based on its ability to meet its obligations. A company can avoid financial problems if it pays off its short-term obligations on time. Another story if the company does not fulfill its short-term obligations, financial distress will arise. Research by Indrawan & Sudarsi, (2023); Purwaningsih & Safitri, (2022); Savery et al., (2024) the result of this study indicates that liquidity has a negative and significant impact on financial distress. Conversely, Wijaya & Suhendah, (2023) found that liquidity lowers financial distress. Therefore, the following hypothesis is formulated:

H_2 : Liquidity has negative impact on *financial distress.*

The Effect of Company Size on *Financial Distress*

"Company size" refers to the size of an organization, as measured by its total assets. According to signaling theory, company size can indicate the strength and stability of a firm [23]. Larger companies tend to be more appealing to investors seeking lower-risk opportunities. The signaling theory that determines the relationship between company size and financial distress defines a company's finances based on its total assets. Good firm size growth indicates that the firm size is increasing, and the tendency for financial problems to occur is decreasing. Studies by Dirman, (2020); Mevania et al., (2022); Utami et al., (2023) suggest that financial distress is negatively correlated with the size of the business. However, Asysyafa & Putri, (2023) find a significant relationship between financial distress and company size. Given these results, the subsequent hypothesis is suggested:

H_3 : Company Size has negative impact on *financial distress*.

3. RESEARCH METHOD

Population and Sample

Companies in the consumer cyclical sectors listed on the Indonesia Stock Exchange (IDX) from 2021-2023 are the target population in this research. This researchers employed purposive sampling method intended to collect information from this population. 353 company samples were utilized, each fulfilling three years of observation requirements. The criteria for the sample in this study include:

Table 1. Research Sample Characteristics

Description	2021	2022	2023	Total
Companies operating in the *consumer cyclical* sector and registered on the Indonesia Stock Exchange (IDX) during the 2021-2023 period.	141	142	153	436
Consumer cyclical companies listed on the Indonesia Stock Exchange (IDX) between 2021 and 2023 that did not submit complete financial reports.	(30)	(24)	(29)	(83)
Total sample	111	118	124	353

Data Types and Sources

This study adopts a quantitative research methodology. The analysis examines consumer cyclical firms recorded between 2021 and 2023, utilizing secondary data, especially financial statements and annual reports accessed through the IDX's official website (www.idx.co.id).

Data Analysis Technique

This study investigates the association between a dependent variable and several independent variables, this research uses multiple regression analysis implemented in SmartPLS 4.0. Statistical significance is assessed using the F test and T test. The F-test evaluates the combined explanatory quality of independent variables compared to dependent variables, while the T-test examines the individual influence of each predictor variable. The following multiple regression analysis model is utilized in this study:

$$\boldsymbol{Y = \alpha + \beta 1 X1 + \beta 2 X2 + \beta 3 X3 + e}$$

Description:

Y = Financial Distress

α = Constant

X1 = Profitability (ROA)

X2 = Liquidity (CR)

X3 = Company Size (Ln (Asset)

β = Regression Coefficient

e = Other factors outside the model

4. RESULTS

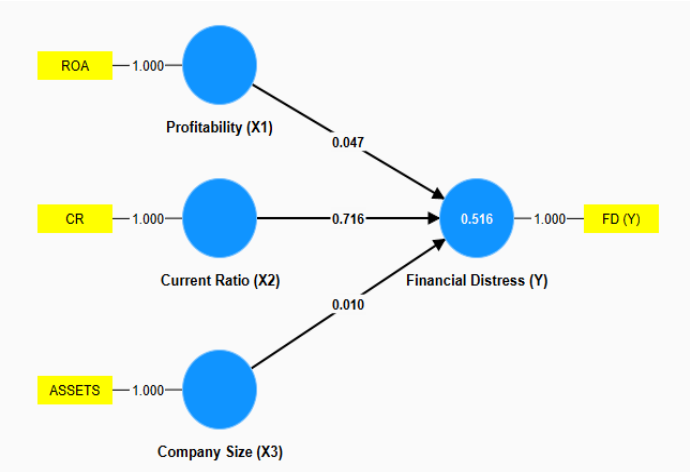

Figure 3. PLS-SEM Algorithm Results

Altman Z-Score

From a total sample of 352 companies, applying the *Altman Z-Score* method shows that 89 companies are in a healthy condition *(safe zone)* with a Z-Score value > 2,90. Other results show that 167 companies are in gray conditions or not experiencing bankruptcy and cannot be declared healthy *(gray zone)* with a value of 1,20 < Z > 2,90. Additionally, 97 companies fall within the bankruptcy *(danger zone)* category with a Z-Score value < 1,20.

Descriptive Statistics

Descriptive analysis is a method for examining data that provides a detailed description or visual representation of the data obtained. These analyses include the sample size (n), the lowest and highest values, the average, and the standard deviation. The outcomes of these analyses are summarized in Table 2.

Table 2. Descriptive Statistic Test Results

	N	Minimum	Maximum	Mean	Std. Deviation
Profitability (X1)	353	-1.133	0.294	0.006	0.115
Liquidity (X2)	353	0.010	113.910	3.456	8.766
Company Size (X3)	353	34.000	62.913.000	3.911.703	7.613.090
Financial Distress (Y)	353	-3.407	160.359	3.487	12.753

Source: Data Processed, SmartPLS 4.0

In 2023, Pembangunan Graha Lestari Indah Tbk. (PGLI) return on assets reached a minimum value of -1.133. In 2023, Sari Kreasi Boga Tbk. (RAFI) 's return on assets reached a maximum point of 0.294. Return on Assets shows a standard deviation of 0.115 and an average of 0.006.

In 2021, the Current Ratio owned by PT Planet Properindo Jaya Tbk. (PLAN) reached a minimum value of 0,010. In 2021, the Current Ratio owned by PT Yeloo Integra Datanet Tbk. (YELO) reached a maximum point of 113.910. An average of 3.456 and a standard deviation of 8.766 are shown on the Current Ratio.

In 2021, Arkadia Digital Media Tbk. (DIGI) owned the company size reached a minimum value of 34.000, and In the year 2023, the Company Size was owned by Indomobil Sukses Internasional Tbk. (IMAS) reached a maximum point of 62.913.000. The company size has 3.911.703 average values and 7.613.090 standard deviations.

In 2023, the financial distress was owned by Pembangunan Graha Lestari Indah Tbk. (PGLI) the lowest recorded value was -3.407. Occurring in 2022, the *financial distress* owned by PT Surya Permata Andalan Tbk. (NATO) reached a maximum point of 160.359. *Financial Distress* has an average score of 3.478 and a standard deviation of 12.753. A score above 0 indicates that the sample of companies in this study is experiencing financial distress.

Multiple Regression Analysis

Multiple regression analysis is a statistical test that aims to find out how accurate the relationship between several independent variables and dependent variables is in a regression model. Financial distress is a research-dependent variable, and profitability, liquidity, and company size are independent variables.

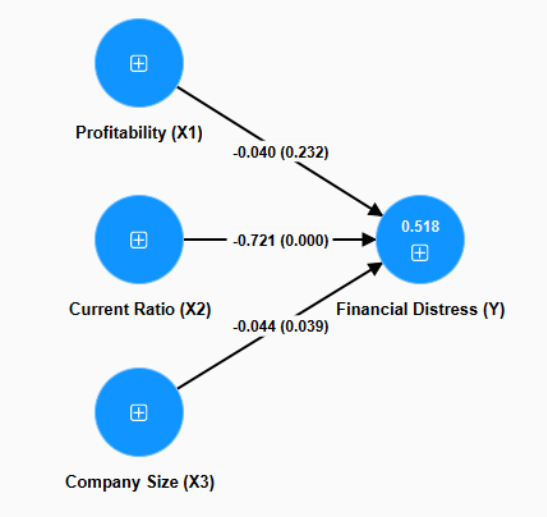

Figure 4. Multiple Regression Analysis with Bootstrapping

Table 3. Multiple Regression Analysis Results

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)
Profitability (X1) -> Financial Distress (Y)	-0.040	-0.056	0.055
Liquidity (X2) -> Financial Distress (Y)	-0.721	-0.712	0.177
Company Size (X3) -> Financial Distress (Y)	-0.044	-0,042	0.025

Source: Data Processed, SmartPLS 4.0

Table 3 illustrates the regression equation employed in this study:

FD = -0.040 X1 – 0.721 X2 – 0.044 X3

From the regression model, the following interpretations can be made:

1. The profitability regression coefficient is -0.040, indicating that a one-percent decrease in profitability results in an increase in *financial distress* by 0.040 points and vice versa.
2. The liquidity regression coefficient is -0.721, suggesting that a one-unit decrease in liquidity leads to an increase in *financial distress* by 0.721 points and vice versa.
3. The regression coefficient for company size is -0.044, which indicates that a company size decrease by one rupiah increases financial distress by 0.044 points, and vice versa.

F-Square

F-Square aims to show the magnitude factors that affect dependent variables in a structural model. F-Square values below 0,02 indicate a weak influence, values between 0,02 and 0,15 indicate moderate influence, and a value of more than 0,15 indicates a significant impact.

Table 4. F Square Test Results

	Profitability (X1)	Liquidity (X2)	Company Size (X3)	Financial Distress (Y)
Profitability (X1)				0.003
Liquidity (X2)				1.061
Company Size (X3)				0.004
Financial Distress (Y)				

Source: Data Processed, SmartPLS 4.0

From the correlation analysis, profitability (X1) revealed a weak correlation with financial distress (Y) attaining a coefficient of 0.003. Conversely, liquidity (X2) shows a robust correlation with financial distress (Y), characterized by a correlation coefficient 1.061. Furthermore, company size (X3) revealed a weak correlation with financial distress (Y) at 0.004, indicating that financial distress (Y) is not much influenced by the size of company (X3).

Determinant Coefficient (R^2)

The R-square (R^2) value assesses how well independent variables explain the variation of dependent variables. Smaller R^2 values suggest minimal explanatory power, whereas larger values indicate substantial explanatory power.

Table 5. Determinant Coefficient Test (Adj R^2)

	Value
R-square	0.518
R-square adjusted	0.514

Source: Data Processed, SmartPLS 4.0

Table 5 reveals an adjusted R-squared of 0.514, signifying that profitability, liquidity, and company size explain 51,4% of the variability in the dependent variable (Y). other unmodeled factors account for the remaining 48,6%.

Individual Parameter Significance (T-Test)

The effects of the dependent variable on individual independent variables are evaluated using the T-test. A *p-value* above 0,05 denotes a lack of significant influence, while a *p-value* below 0,05 indicates a statistically significant impact on the dependent variable.

Table 6. Individual Parameter Significance Test Results

	Original Sample (O)	Sample Mean (M)	*Prob.*	Test Decision
Profitability (X1) -> Financial Distress (Y)	-0.040	-0.056	0.232	H1 rejected
Liquidity (X2) -> Financial Distress (Y)	-0.721	-0.712	0.000	H2 accepted
Company Size (X3) -> Financial Distress (Y)	-0.044	-0.042	0.039	H3 accepted

Source: Data Processed, SmartPLS 4.0

The results of the T-test for profitability (X1) are shown in Table 4 reveal a probability value of 0.232 (>0.05), suggesting that profitability (X1) has a negative but insignificant impact on financial distress (Y). The T-test results for the liquidity variable (X2) show a probability value of 0.000 (<0.05), indicating that liquidity (X2) adversely affects financial distress (Y). Meanwhile, the T-test results for the company size variable (X3) yield a probability value of 0.039 (<0.05), implying that company size (X3) significantly negatively impacts financial distress (Y).

5. DISCUSSION

Effect of *Profitability* on *Financial Distress*

The result of the first hypothesis indicated that profitability, as measured by ROA, obtained a significance value of 0.232, which means that the value is much greater than the

probability value (>0.05). Then, the result was H1 rejected, and H0 accepted, namely, the ROA variable has no effect on financial distress.

Results from the study indicate a lack of a significant relationship between ROA and financial distress within the observed companies. This implies that a decrease in ROA does not directly lead to *financial distress*, which may be attributed to the characteristics of the consumer cyclical sector, known for its rapid asset turnover. Thus, investors in this sector pay less attention to a decrease in ROA as an early sign of *financial distress*. In addition, this result contradicts the signaling theory, where companies cannot signal to investors about their profitability. Despite a reduction in profitability, companies may still manage to fulfill obligations and cover costs through internal and external funding sources, rendering this variable less reliable for predicting *financial distress*.

These findings align with the research of Asmarani & Purbawati, (2020); Hakim et al., (2022); Mujianto & Hariyanto, (2024) which states that profitability does not impact financial distress. In contrast, this study's results are inconsistent with the findings of Aslamiah et al., (2023); Junaidi & Widajantie, (2023) which asserts that profitability positively impacts financial distress.

The Impact of *Liquidity* on *Financial Distress*

The findings of the second hypothesis show that liquidity (measured by CR) obtained a significance value of 0.000 (<0.05) with a negative regression coefficient value of -0.721. Then, the results accept that H2 and the CR variable negatively impact financial distress. This research supports the signal theory, which explains how an entity can send positive information to users of financial statements as a form of signal about the company's condition. For example, entities with high liquidity will send positive signals through financial reports issued to external parties.

The findings of this research align with studies conducted by Arifin et al., (2021); Indrawan & Sudarsi, (2023); Purwaningsih & Safitri, (2022), which indicates that liquidity significantly negatively affects unstable financial distress. Meanwhile, these results are inconsistent with the research by Hidayat et al., (2020); Wijaya & Suhendah, (2023) That states liquidity has a positive effect on financial distress.

The Effect of *Company Size* on *Financial Distress*

The third hypothesis shows that company size, measured by the natural logarithm of total assets, has a significance value of 0.039 < 0.05 with a negative regression coefficient of -0.044. Then, the results accept that H3 and the Company Size variable significantly negatively affect financial distress.

This study supports signaling theory as there is a relationship between company size and financial distress, which describes a company's finances based on its total assets. Large and developed companies are different and growing companies compared to their total assets. Good growth in firm size indicates that the size of the business increases, and the possibilities financial problems is getting lower.

These results align with the research of Dirman, (2020); Mevania et al., (2022) Company size has a negative correlation with financial distress. In contrast, the findings diverge from those of Prastyatini & Novikasari, (2023) who claim that larger company sizes have a positive effect on financial distress.

6. CONCLUSION AND SUGGESTION

The profitability, liquidity, and company size against financial distress were factors influencing this study. After applying sampling criteria, 353 data points were identified. The findings indicate that profitability negatively impacts *financial distress*, but the effect is insignificant, while liquidity and company size have a significant negative relationship with *financial distress*.

Some limitations of this study include: 1) This study exclusively focuses on consumer cyclical companies on the Indonesia Stock Exchange (IDX). 2) The sample is restricted to three years, from 2021 to 2023. 3) This research only considers three independent variables: profitability, liquidity, and company size. The suggestions for future research include : 1) Predicting a company's level of financial difficulty using techniques other than Altman Z-Score, including Springate and Zmijewski. 2) Adding a period in further research to obtain a more significant number of samples and employ more financial ratios, like liquidity ratios (such as Quick Ratio) and leverage ratios (such as Debt to Equity Ratio). 3) Factors outside this research should be added to gain a more exact formulation of the variables that impact financial hardship, such as good corporate governance and corporate social responsibility (CSR).

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