Prediction modelling the financial distress using corporate governance indicators in Indonesia

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ABSTRACT

We examine whether the indicators of company governance procedures are associated with the risk of bankruptcy or financial distress in Indonesia. An empirical study we conducted using a causal model of corporate governance indicators in forecasting financial distress. The data used in this study is panel data. Using samples from assembling companies registered on the Indonesia Stock Exchange during the 2017-2019 period, we obtained as many as 105 observations selected by the purposive sampling method. Our results indicate that financial distress can be predicted by corporate governance mechanisms, although statistically it is only proven by a few indicators in our study. Specifically, our results demonstrate that institutional ownership, managerial ownership, and independent commissioners do not affect financial distress. Furthermore, our study shows evidence of a significant influence between the size of the board of directors and audit committee on financial distress. Our interpretation is that research on financial distress prediction models using corporate governance indicators has provided empirical evidence.
INTRODUCTION

Financial distress has become a threat to all companies, because this financial problem can attack any type of company, both small and large companies. Financial distress is a phase of deterioration in an exceedingly company's condition, before bankruptcy. This condition is generally characterized by, among others, delays in delivery, decreased product quality, and delays in payment of bills from banks (Couwenberg, 2015; Elkamhi et al., 2012; Koh et al., 2015). If a corporation is already in a very state of financial distress, the corporate's management should use caution in creating choices, and management is asked to take action to resolve these financial problems so as to prevent bankruptcy.

According to Mafiroh & Triyono (2016), a company is categorized as encountering monetary adversity if the company has negative achievement (reflected in operating profit), negative book value of equity, negative net income, and the company carries out a business merger. Another thing that shows the company is encountering financial difficulties could be observed from the company's liquidity ratio. The decline in the company's capability to meet its responsibilities to creditors indicates that the company is getting closer to financial distress. The debt crisis in these companies basically originates from bad corporate governance. The management of companies at that time was not based on principles that took into account the interests of share holders and stake holders.

The dominant role of private corporates and State-Owned Enterprises (SOEs) in determining the direction of the back and forth of the Indonesian economy is a sign that the role of Good Corporate Governance (GCG) can no longer be ignored. Some experts argue that one of the main sources that led to the collapse of the economy of Indonesia and other Asian countries was due to the weak implementation of good corporate governance. A study conducted by the World Bank (Djalil, 2000) shows that the weak implementation of corporate governance is a determining element in the severity of the crisis in Asia. Specifically, the implementation of bad corporate governance will have an impact on company bankruptcy.

Predicting company failure or monetary difficulties has become a dynamic theme in the world of business. This theme has also accepted full concern in academia and practical world. The implementation of good corporate governance will affect the company's bankruptcy or financial distress, and therefore need to be predicted accurately. There are many things of articles on failure forecaste models, such as accounting-based models using financial ratios (Altman, 1968; Bonfim, 2009) and market-based models using stock prices (Milne, 2014; Campbell et al., 2008). However, there is little literature that examines or predicts this model based on good corporate governance mechanisms. Our paper is a study that aims to comprehend the role of corporate governance and its impact on financial distress, which is recapped in the following part of this paper. We base our hypotheses on research that have established the influence in the midst of financial distress and corporate governance.

Our research adds to the body of knowledge in a variety of ways. The impact of corporate governance on corporate bankruptcy has been studied in the past (Lajili & Zeghal, 2010; Li et al., 2008; Mangena & Chamisa, 2008; Shahwan, 2015) and their results documented the significant influence between strong corporate governance systems on the probability of business failure. We argue that this study is a form of contribution to academics and practitioners in providing information about the position of managerial ownership, institutional ownership, the size of the independent commissioner, the size of the board of directors, and the independence of the audit committee are all very significant in predicting company bankruptcy in the difficult situation before bankruptcy.

This is relevant to the assumptions of Agency Theory (Eisenhardt, 1989; Linder & Foss, 2015; Shapiro, 2005; Wiseman et al., 2012), which implicitly explains that corporate governance mechanisms are factors that can reduce conflicts of interest that arise between stockholders. For the case in Indonesia, our study tries to explore the relationship between all indicators in the corporate governance mechanism and the possibility of financial difficulties. We argue that this study is a form of contribution to academics and
practitioners in providing information and resources, especially in the scope of corporate governance. In other words, our paper can help bridge the gap between theory and practice in companies in all industries in Indonesia. Furthermore, this paper offers empirical evidence on the connection between corporate governance and financial distress.

LITERATURE REVIEW

Agency Theory

Many research on GCG are based on agency theory. Jensen & Meckling (1976) came up with this idea, which states that the desires of the owner and management are diametrically opposed. The key concept of this theory is that the party giving the authority (principal), namely the owner, and the party receiving the authority (agent), namely the manager, have a working relationship. This working relationship is based on the fact that each party tries to increase his own profit. Economists use agency theory to investigate risk sharing among a number of people or groups who are interested in economic activity. The issue that emerges in this risk sharing is that a variety of interested parties have differing perspectives on the risk. This is because the central principle of this viewpoint sees the company as a contract nexus (Jensen & Meckling, 1976a). The arrangement in question is one between the investor (principal) and the business manager (agent).

To reduce agency conflicts, the manager (agent) is responsible for maximizing the returns of the investors (principal) and in return will receive a fee according to the contract. This theory assumes that the agent is motivated to maximize the fees received as a means to meet their economic and psychological needs. The principal does not have enough details about the agent’s results, according to the agency theory. Meanwhile, agents have more information on their own capacity, performance environment, company as a whole and prospects in the future compared to the principal. This is what causes the imbalance of information held by the principal and agent. This imbalance is known as information asymmetry (Auronen, 2003; Cai et al., 2015; Elbadry et al., 2015; Li & Zhao, 2008). This information asymmetry results in the manager (agent) hiding some information that is unknown to the principal. This encourages the agent to give the principal false information, especially if the information is relevant to the manager’s performance evaluation.

The topic of corporate governance is influenced by agency theory, which argues that when a company’s management is removed from its ownership, agency issues occur (Dey, 2008; Homayoun & Homayoun, 2015). A company’s board of commissioners and directors, who serve as agents for the shareholders, are granted authority to control the company’s operations and make decisions on their behalf. Because of their power, the manager has the potential to behave against the owner’s best interests due to a conflict of interest. In other words, management has interests that are different from those of the owner (Dey, 2008; Dhaliwal et al., 1982; Homayoun & Homayoun, 2015). The fundamental concept of managing agency theory offers a fresh look at corporate governance. The corporation is depicted as a partnership between the principal (shareholders or business owners) and the agent (management). Because of management’s vested interests, a check and balance system is needed to reduce the risk of misuse of power by management.

Financial Distress

Financial distress is a term used to describe the state of a business that is having financial problems (Couwenberg, 2015), meaning that the company is in danger of going bankrupt or failing. One of the causes of financial distress is the presence of a series of mistakes, poor decision-making, and intertwined vulnerabilities that can lead directly or indirectly to management, as well as a lack of efforts to track financial conditions so that capital is not used as much as it should be. A company’s financial distress will
result in payment failure (default) that is not in compliance with the contract. Failure to make these payments prompts the debtor to negotiate a settlement with the creditor, which can be accomplished through a financial restructuring involving the company, creditors, and investors (Avramov et al., 2013).

Previous researchers have their own description in defining financial distress. According to O’Neill et al (2006), before bankruptcy or liquidation, a person’s financial situation deteriorates to the point of financial distress. The difference in defining the concept of financial distress depends on how each researcher is measured. Companies in financial distress have an interest coverage ratio of less than one (Claessens et al., 2003; Wurgler et al., 2002). Companies in financial distress, according to Almilia & Kristijadi (2003), are those that have had negative net operating profits for many years and have failed to pay dividends for more than one year. Ross et al (2003) state that a situation in which operating cash flow is insufficient to meet current commitments is referred to as financial distress (such as trade credit or interest expenses), while Baldwin & Mason (1983) stated that financial distress occurs when a corporation is unable to fulfill its financial commitments due to violations of loan covenants and the elimination or reduction of dividend funding.

Managerial Ownership and Financial Distress

Managerial ownership is one of the corporate governance tools that can help improve reporting consistency by acting as a monitoring tool (Meckling & Jensen, 1976). The percentage of shares held by management who actively engages in company decision-making, such as commissioners and directors, is known as managerial ownership (Wirawardhana & Sitardja, 2018; Yusra et al., 2019). Managerial ownership of an organization may be an attempt to minimize agency issues with managers and balance managers’ and shareholders’ interests (Homayoun & Homayoun, 2015; Mustapha & Ahmad, 2011). In addition, managerial ownership makes supervision of the company’s financial fraudulent practices decrease because within the company there are company owners which result in direct supervision by the owner.

The relationship between managerial ownership and firm valuation is linear. The output of an organization demonstrates this linear relationship. It would be possible to promote a decrease in future financial problems by increasing managerial ownership (Elloumi & Gueyié, 2001; T. S. Lee & Yeh, 2004; Md-Rus et al., 2013). This would be able to bring together the needs of both shareholders and management, reducing the risk of financial difficulties. This is consistent with Widiastuti (2014) research which found that financial distress is exacerbated by managerial ownership. The first hypothesis was developed based on previous studies as follows:

H1: Managerial ownership has a significant negative effect on the possibility of financial distress

Institutional Ownership and Financial Distress

An institution’s, corporate entity’s, or organization’s institutional ownership is the amount of company shares it owns (Aguilera et al., 2018; Chung & Zhang, 2011). Institutional ownership is one of the factors that affect the performance of a company. Institutional ownership is believed to have better capabilities than individual ownership (Gillan & Starks, 2005). The organization can be more effective in using assets as company capital in its activities thanks to the monitoring role performed by institutional owners. Management decisions are often stronger, more accountable, and more in favor of the owner’s interests when institutional owners supervise the business, preventing the company from choosing wrong tactics that can result in losses.

Ownership by institutional investors results in management that focuses on company performance (Elloumi & Gueyié, 2001). The ability to control a corporation is shown by large institutional ownership (more than 5%). The more institutional ownership there is, the more effective the company’s assets are used, lowering the risk of financial difficulties. This is because the higher the institutional ownership, the
more closely the company is monitored, and the less future financial problems that will arise within the company would be encouraged (Chung & Zhang, 2011; Md-Rus et al., 2013). This argument is backed by the findings of Barclay & Holderness (1991) study, which found that there is a rise in management turnover and gains as a result of outsiders purchasing shares. According to research conducted by Aritonang (2013), institutional investors who hold shares in a company would be able to better supervise management in carrying out operations, protecting them from financial distress. This is because, with institutional investors as shareholders, they will closely supervise management in presenting financial statements, making it more difficult for management to conceal their active performance and reporting net profits in the financial statements. Cinantya (2015) conducted research that found that institutional ownership has a negative impact on financial distress. The second hypothesis, based on the previous analysis, was formulated as follows:

H2: Institutional ownership has a significant negative effect on financial distress.

Independent Commissioner Size and Financial Distress

Independent commissioners are members of the board of commissioners that are unaffiliated with management, other commissioners, or controlling shareholders, and who are free of any business or other connections that could impair their ability to operate individually or exclusively for the company’s gain (National Committee for Governance Policy (KNKG), 2011). The Independent Commissioner’s position and the presence of the Board of Commissioners as the supervisory board in the organizational framework are critical in sorting and supervising any policy that the Board of Directors, as the executive board, will take (Butar Butar, 2019; Lutfi et al., 2014). As independent commissioners, they are in charge of representing the interests of independent shareholders, and they have the authority to do so. In carrying out their duties and obligations as company supervisors, they must also be involved, examine decisions and take action regarding compliance, the legal responsibility of the board of directors for any decisions, information and behavior related to financial management and the company’s business (Nurfatimah, 2018; Silitonga, 2020).

The board of commissioners must be composed in such a way that it can make accurate, precise, and fast decisions (Butar Butar, 2019). They must also be able to function independently in the sense that they must be able to carry out their duties independently and objectively in relation to one another and to directors. The board of commissioners’ position in a corporation is more focused on the monitoring mechanism of the company’s board of directors’ policies, with the goal of reducing the risk of financial distress (Radifan & Yuyetta, 2015). According to the findings of Bodroastuti (2009), the size of the board of directors of commissioners has an effect on financial distress. As a result, the third hypothesis is as follows:

H3: The size of the Independent Board of Commissioners has a significant negative effect on the possibility of financial distress.

Board of Directors Size and Financial Distress

In the short and long term, a company’s board of directors will decide the strategies to be implemented or the company’s strategy. According to the board of directors, they must be able to formulate strategies so that the business can run effectively and efficiently with turbulence in internal and external conditions (Erhard et al., 2003; Klein, 2002; F. Li & Srinivasan, 2011). The board of directors may not be able to do a good job if they only prioritize self-interest and ignore the interests of stakeholders (Freeman & David, 1983). As a result, members of the board of directors must have a strong moral integrity as well as professional expertise to help them. As a result, a high level of professionalism is expected when selecting members of the board of directors. The board of directors has an obligation to maintain transparency in carrying out company operations. The principle of transparency is reflected in the delivery of information
honestly to all stakeholders. Management must be able to provide relevant information to directors, supervisors and shareholders. According to Roche (2005), companies must consider board size in order to determine the effectiveness of the number of boards the company has. Effective board size can facilitate effective decision making.

Wardhani (2007) states that the more directors a company has, the more likely it is to face financial difficulties. However, different results occur in the research DP (2007) which states that the more boards of directors there are, the lower the likelihood of financial difficulties. He went on to say that the company benefited from the size and diversity of the board of directors because it created networks with outsiders to ensure the availability of resources. As a result, the board of directors is one of the most important corporate governance mechanisms, as its existence determines the company’s performance. Evidence for the effectiveness of board size is mixed due to differences in findings. Based on these findings, it is possible to conclude that the size of the board of directors has an impact on the company’s performance, particularly its financial condition. This assumption has been proven by Widyasaputri (2012) in his research on the analysis of corporate governance mechanisms in financially distressed companies. He discovered that the board of directors’ size has a significant impact on financial distress. This is in line with the findings of Bodroastuti (2009), who discovered that the number of directors on a board has a significant positive impact on financial distress. A fourth hypothesis is constructed based on the above description:

H4: The number of the Board of Directors has a significant positive effect on the possibility of financial distress.

Audit Committee Independence and Financial Distress

The audit committee, which is formed by the board of commissioners and works professionally and independently, has the task of assisting and strengthening the board of commissioners’ supervisory function over the financial reporting process, risk management, audit implementation, and corporate governance implementation in companies (Chrisdianto, 2013). In the European Accounting Review, Collier & Gregory (1996) explained that the audit committee provides benefits for improving the supervisory system and also on GCG. T. Lee & Stone (1997) revealed that the function of the audit committee can be specifically identified into three interrelated aspects, namely relating to accounting and financial reporting, auditor and auditing, and company organization.

According to agency theory, good supervision can reduce managers’ opportunistic behavior as agents. Supervisors who are independent members can help to reduce information asymmetry and bridge the gap between owners and management. Independent members can be considered good supervisors because they are seen as more objective and critical of management policies. In addition, independent members have an interest in enhancing their reputation as good supervisors. Masak & Noviyanti (2019) have proven that the audit committee’s independence has a significant impact on the financial distress that the company is experiencing. Carcello & Neal (2003) have also provided evidence that an independent audit committee has a negative impact on a company’s ability to continue operating in the face of financial difficulties. The lower the likelihood that the financially distressed company will receive a going concern opinion from the external auditor, the greater the audit committee’s independence. As a result, independent members will decrease the likelihood of financial distress. The fifth hypothesis is constructed as follows:

H5: Audit committee independence has a significant negative effect on financial distress.
METHOD

Data and Sample
Manufacturing companies listed on the Indonesia Stock Exchange are preferred because they are more well-known and dominant among large companies in other industries. The research sample of 35 manufacturing companies with 105 observations was obtained from the 176 manufacturing companies listed on the Indonesia Stock Exchange between 2017 and 2019. The criteria used in determining this sample are 1) Manufacturing companies that were listed on the Indonesia Stock Exchange at the end of the 2019 period; 2) companies that published annual financial reports during the observation period, which was from 2017 to 2019; and 3) companies with information on managerial and institutional ownership, board of commissioners and board of directors size, and audit committee independence during the observation period.

Operational Definition of Variables
The purpose of this research is to look into the impact of Corporate Governance on financial distress. There were two types of variables in this study: independent and dependent variables. Indicators in corporate governance make up the independent variable, which is made up of five explanatory variables. While the dependent variable is Financial Distress (FD) (Hermawan, 2015). Whereas the independent variables used are Managerial Ownership (MO), Institutional Ownership (IO), Board of Commissioners Size (CB), Board of Directors Size (DB), and Independence of the Audit Committee (AK) (Poluan & Nugroho, 2015; Yanti, 2018)

Data analysis
The research data were analyzed using commonly used statistical procedures, including the classic assumption test (normality test, multicollinearity test, heteroscedasticity test), multiple linear regression analysis, and hypothesis testing with the t-test. The regression equation below will be used to test the main hypothesis when looking at the impact of each corporate governance indicator on financial distress. This study uses the following empirical model to test the hypothesis:

\[ FD = \alpha + \beta_1 MO + \beta_2 IO + \beta_3 CB + \beta_4 DB + \beta_5 AK + \varepsilon \]
Where FD stands for financial distress, MO for managerial ownership, IO for institutional ownership, CB for board of commissioner’s size, DB for board of directors’ size, AK for independent audit committee size, and is the standard error.

RESULT AND DISCUSSION

Normality Test Results

Normality testing is carried out to determine the variance variance patterns that make up each of the research variables. Normality testing is done by using the Jarque-Bera test. Based on the results of the processing that has been done, the following results are obtained:

![Histogram of residuals](image)

**Figure 2. Normality Test Results**

The image above depicts the Jarque-Bera value of 3.883606 with a probability value of 0.1434, which is higher than 0.05. As a result, the research model can be concluded to be normally distributed, allowing for the completion of additional data processing stages.

Multicollinearity Test Results

This multicollinearity test aims to ensure that each independent variable is not correlated with one another or is free from multicollinearity. Multicollinearity testing is carried out using Variance Inflation Factor (VIF). Symptoms of multicollinearity will not occur if each independent variable has a Center VIF coefficient value <10. The following outcomes are obtained as a result of data processing:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient Variance</th>
<th>Uncentered VIF</th>
<th>Centered VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>MO</td>
<td>2.758147</td>
<td>40.34695</td>
<td>1.380803</td>
</tr>
<tr>
<td>IO</td>
<td>2.758147</td>
<td>40.34695</td>
<td>1.380803</td>
</tr>
<tr>
<td>CB</td>
<td>9.092094</td>
<td>25.66043</td>
<td>1.036569</td>
</tr>
<tr>
<td>DB</td>
<td>1.267308</td>
<td>3.652926</td>
<td>1.095377</td>
</tr>
<tr>
<td>AK</td>
<td>11.41508</td>
<td>24.41810</td>
<td>1.099230</td>
</tr>
</tbody>
</table>
Table 1 shows that all independent variables have a Variance Inflationary Factor (VIF) coefficient below 10. As a result, all of the independent variables used are free of multicollinearity symptoms, allowing the next data processing stage to proceed.

**Heteroscedasticity Test Results**

This heteroscedasticity test aims to determine whether each research variable has been supported by constant variants or is free from heteroscedasticity. Heteroscedasticity testing was carried out by using the Glejser test. A summary of the results is obtained based on the results of the data processing that has been performed, as shown in Table 2 below.

**Table 2. Heteroscedasticity Test Results**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>MO</td>
<td>-0.482180</td>
<td>0.653920</td>
<td>-0.737369</td>
<td>0.4626</td>
</tr>
<tr>
<td>IO</td>
<td>0.795590</td>
<td>0.935590</td>
<td>0.850362</td>
<td>0.3972</td>
</tr>
<tr>
<td>CB</td>
<td>2.919883</td>
<td>1.698669</td>
<td>1.718924</td>
<td>0.0888</td>
</tr>
<tr>
<td>DB</td>
<td>2.232364</td>
<td>0.634188</td>
<td>3.520036</td>
<td>0.1007</td>
</tr>
<tr>
<td>AK</td>
<td>-4.979074</td>
<td>1.903340</td>
<td>-2.615967</td>
<td>0.1103</td>
</tr>
</tbody>
</table>

It is known that each of the independent variables used has a probability value above the error rate of 0.05 based on the results of heteroscedasticity testing. As a result, it can be concluded that none of the independent variables used in this study showed signs of heteroscedasticity.

**Multiple Regression Analysis**

The goal of multiple regression analysis is to determine the magnitude and direction of the influence formed between the independent and dependent variables. A summary of the results was obtained based on the test results, as shown in the table below:

**Table 3. Summary of Hypothesis Testing Results**

<table>
<thead>
<tr>
<th>Model</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>MO</td>
<td>0.148363</td>
<td>1.160774</td>
<td>0.127814</td>
<td>0.8986</td>
</tr>
<tr>
<td>IO</td>
<td>2.267019</td>
<td>1.660767</td>
<td>1.365044</td>
<td>0.1753</td>
</tr>
<tr>
<td>CB</td>
<td>0.310442</td>
<td>3.015310</td>
<td>0.102955</td>
<td>0.9182</td>
</tr>
<tr>
<td>DB</td>
<td>2.452502</td>
<td>1.125748</td>
<td>2.178535</td>
<td>0.0317</td>
</tr>
<tr>
<td>AK</td>
<td>-8.630442</td>
<td>3.378621</td>
<td>-2.554428</td>
<td>0.0122</td>
</tr>
</tbody>
</table>

In accordance with the results of t-statistical testing using the managerial ownership variable, the regression coefficient value is positive as big as 0.148363. This value is proven statistically with a probability value of 0.8986. These results show that the probability value is greater than the 0.05 error level, indicating that H1 is rejected. As a result, managerial ownership has no influence on the likelihood of financial distress in manufacturing companies listed on the Indonesia Stock Exchange.

The institutional ownership variable was also used to test the second hypothesis, and the results yielded a positive regression coefficient of 2.267019. With a probability value of 0.1753, this value is statistically proven. The results show that the probability value is greater than the 0.05 error level, indicating that H2 is rejected. As a result, institutional ownership has no discernible impact on the likelihood of financial distress in manufacturing companies listed on the Indonesia Stock Exchange.

The regression coefficient value is positive as big as 0.310442 based on the results of testing the third hypothesis using the size variable of the board of commissioners. With a probability of 0.9182, the coefficient value is clearly proven. The obtained results show that the probability value is greater than the
0.05 error level, indicating that the decision is H3 rejected. As a result, it can be concluded that the board of commissioners’ size has no influence on the likelihood of financial distress in manufacturing companies listed on the Indonesia Stock Exchange.

The regression coefficient for the variable size of the board of directors of 2.452502 is positive at the stage of testing the fourth hypothesis. The obtained results are backed up by a probability value of 0.031. As a result, the probability value is less than the 0.05 error level, and the decision is H4 accepted. As a result, it can be concluded that board size has a positive and significant impact on the likelihood of financial distress in manufacturing companies listed on the Indonesia Stock Exchange.

The regression coefficient for the independent audit committee variable of 8.630442 is negative, according to the final hypothesis testing. The obtained results are backed up by a probability value of 0.012. These findings suggest that the independent audit committee has a negative and significant impact on the likelihood of financial distress in Indonesian manufacturing companies. The probability value is less than 0.05. As a result, the study’s fifth hypothesis is accepted.

Discussion

The Effect of Managerial Ownership on Financial Distress

The first hypothesis test reveals that managerial ownership has no impact on financial distress in manufacturing companies listed on the IDX. These findings suggest that managerial ownership has no influence on the occurrence of financial distress, particularly in manufacturing companies listed on the Indonesia Stock Exchange. We believe that this situation arises as a result of a poorly planned monitoring process by managerial investors, given that the majority of managerial investors are company employees. As a result, they will tend to protect their own internal interests, ensuring that their presence has no discernible impact on financial distress.

Based on the findings of (Yosua & Pamungkas, 2019; Widyasaputri, 2012), it was concluded that Managerial Ownership had no effect on Financial Distress Conditions. This demonstrates that the higher the managerial share ownership, the less likely it is that the company’s managerial ownership has a greater influence in determining decisions when the company is in financial distress. However, whether the company is owned by a large or small group of people, it cannot be ruled out that the company will run into financial difficulties and go bankrupt.

The Effect of Institutional Ownership on Financial Distress

According to the second hypothesis, institutional ownership has a significant impact on financial distress. Institutional ownership has no significant effect on financial distress in manufacturing companies listed on the Indonesia Stock Exchange, according to the results of hypothesis testing. This finding suggests that institutional ownership has no influence on the occurrence of financial distress, particularly among manufacturing companies listed on the Indonesia Stock Exchange.

This supports our belief that institutional investors’ monitoring is also unplanned and not carried out continuously (as is managerial ownership), resulting in institutional investors’ existence becoming invisible in an effort to reduce the risk of financial distress. Furthermore, the findings suggest that there are other factors that influence financial distress, particularly in manufacturing companies listed on the Indonesia Stock Exchange. Debt default, company size, business risk, and other factors are among them.

Our findings, which are supported by research (Astuti & Yuniarto, 2019; Yosua & Pamungkas, 2019), show that institutional ownership has no influence on financial distress. To put it another way, institutional ownership has no influence on the likelihood of a company’s financial difficulties.
The Effect of the Independent Board of Commissioners on Financial Distress

The board of commissioners has no significant effect on financial distress in manufacturing companies listed on the Indonesia Stock Exchange, according to the third finding of our research. The findings show that the size of the board of commissioners (particularly the independent board of commissioners) has no influence on the likelihood of financial distress. Because an increase or decrease in the number of members of the board of commissioners is still unable to create transparency of information for interested parties, particularly investors, the relationship between these two variables is insignificant. As a result, the size of the board of commissioners cannot be used to predict the likelihood of financial distress.

According to research (Ningrum & Hatane, 2017; Yosua & Pamungkas, 2019), the board of commissioners had no significant impact on financial distress. Furthermore, these findings suggest that other factors, such as debt default, company size, business risk, and so on, play a role in financial distress.

Effect of Board of Directors Size on Financial Distress

According to our fourth hypothesis, the size of the board of directors has a significant impact on financial distress in manufacturing companies listed on the Indonesia Stock Exchange. The test results show a significant finding as well as a positive trend. This means that the larger the board of directors, the greater the risk of financial difficulty. This situation arises because the larger the board of directors, the higher the company’s expenses will be. Furthermore, as the number of boards of directors grows, there will be more conflicts of interest among the directors. As a result, financial distress is more likely to occur, particularly in manufacturing companies listed on the Indonesia Stock Exchange.

This discovery is relevant to studies conducted by (Hasniati et al., 2017). They also discovered that the size of the board of directors has a positive and significant impact on financial distress. As a result of this finding, it can be deduced that an audit committee comprised of members with a higher educational background and work experience and who are more suitable will be able to control the company’s operational and financial conditions from a young age. A competent audit committee will be able to make corrections to the company’s financial condition, which management can use as a guide to make improvements until the end of the fiscal year.

The Effect of the Audit Committee on Financial Distress

The findings suggest that the audit committee has a significant impact on financial distress in Indonesian manufacturing companies. Based on these findings, it can be concluded that the size of the audit committee can support the effectiveness of the audit committee’s performance, thereby reducing the risk of financial distress. In other words, as the number of independent audit committee members grows, the risk of financial distress decreases, especially among manufacturing companies listed on the Indonesia Stock Exchange. This situation arises because the presence of an independent audit committee member reduces fraud in the company by maintaining information transparency, which reduces all forms of risk associated with financial distress.

This is in line with the findings of (Hasniati et al., 2017), who discovered that the audit committee’s size has a negative impact on financial distress. He also stated that the Audit Committee’s expertise can help the company avoid financial distress.

CONCLUSION

Based on the findings of the research, it can be concluded that corporate governance mechanisms (Board of Directors Size and Audit Committee Size) have a significant impact on the risk of financial distress, particularly in manufacturing companies listed on the Indonesia Stock Exchange. Managerial ownership, institutional ownership, and the Independent Board of Commissioners, on the other hand, have no effect.
on the likelihood of financial distress. Corporate governance (especially aspects of the Board of Directors Size and Audit Committee Size) significantly able to predict financial distress. These empirical results directly address the issues of effective monitoring, business prosperity, and prevention of corporate collapse, and thus have important implications for financial stability in practice. This information is also very helpful for company management in preventing potential losses. It is also relevant to the corporate governance responsibilities of shareholders and stakeholders and the regulators that oversee companies listed on the Indonesia Stock Exchange.

The independent variables used in this study are limited to the Corporate Governance mechanism consisting of Managerial Ownership, Institutional Ownership, Independent Commissioners, Board of Directors Size, and Audit Committee to explain the possibility of financial distress. Other independent variables such as Board Meetings and CEO Duality should be investigated further in future research. In addition, the springate model and the interest coverage ratio as a proxy for financial distress are recommended for further research in measuring the financial distress variable. Future research could look into how boards and management work together, change, make decisions, and manage their reputation and careers in both financial distress and normal business situations to produce a more comprehensive study.

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