

Determinants of Financial Distress on Retail Companies in Indonesia



Tri Pujadi Susilo

Department of Accounting, Bakrie University, Jakarta, Indonesia

ABSTRACT: This study aims to examine the effect of board size on financial distress with the proportion of independent commissioners as a variable that moderates the relationship between board size and financial distress. The population in this study are retail companies listed on the Indonesia Stock Exchange (IDX) in 2018-2021 with the total population is 116. The sampling technique in this study used purposive sampling. The sample size obtained based on this method is 84. The analytical method used is moderate regression analysis. The results of this study indicate that the size of the board of directors has a positive effect on financial distress. Meanwhile, the proportion of independent commissioners as a moderating variable has no effect on financial distress.

KEYWORDS: Financial distress, the proportion of independent commissioners, and the size of the board of directors

I. INTRODUCTION

Financial distress is a stage of decline in the company's financial condition before bankruptcy or liquidation [18]. A company can be categorized as experiencing financial distress if the company experiences negative operating profit for two consecutive years [1]. Financial distress can be shared by various types of companies, both large and small companies, which are caused by factors that cause financial distress which can come from internal companies and external companies. Therefore, the financial distress model needs to be developed for the benefit of a company in order to know the condition of financial distress, so that the company is alert and takes action in order to protect the company from entering the bankruptcy trap. One of the factors causing financial distress is several mistakes that occur within the company such as inappropriate decision-making and weaknesses that are directly or indirectly related to the company's management, as well as other causes, namely due to a lack of efforts to control the condition financial so that the use of company funds is not in accordance with what is needed [16].

One of the external factors that can affect the company's financial condition because of the Covid-19 outbreak or commonly refer to as the coronavirus. This coronavirus is a natural disaster that has caused a weakening of the world economy, especially in Indonesia. In dealing with the Covid-19 outbreak, the Government of Indonesia made a policy regarding Large-Scale Social Restrictions in several regions. The existence of social restrictions or community activities has resulted in almost no visitors in several places such as shopping centers, restaurants, and tourist attractions, this of course has an impact on all business sectors. The weakening of the economy in Indonesia greatly affected various business sectors, especially retail companies. Declining economic conditions resulted in decreased consumption of household needs which ultimately impacted declining company profits and impacted company operational activities. This condition makes retail companies have to think hard in developing strategies to deal with this pressure in order to survive [7].

Based on data from Bank Indonesia (BI), the retail industry experienced a significant decrease in average sales growth in 2017 reaching 2.93%, 3.73% in 2018, 3.97% in 2019, and 4.8% in 2020. Based on the financial reports that have been published on the Indonesia Stock Exchange, several retail companies have shown a decline in sales, even reaching a minus figure. The decline in sales volume has resulted in a decline in the finances of a number of retail companies and they have even recorded business losses from their operational activities. The phenomenon of financial distress in this study can be seen in companies that have a negative Return on Assets (ROA). ROA shows the strength of the company to generate net profits. If the ROA value is negative then the company is experiencing financial distress, and if the ROA is positive then the possibility of the company experiencing financial distress is low [5].

Based on the IDX 2021, it shows that the industrial sector which has the largest negative ROA value is the Consumer Cyclical industry where there are 181 companies during 2018-2022. In the consumer cyclical during the 2018-2021 period which had

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the most negative ROA, namely retail companies, one of the reasons was the Covid-19 outbreak and restrictions on people's mobility so that the economy declined, and people's purchasing power weakened. Several retail companies from 2018 to 2021 have experienced a decrease in revenue and have closed their outlets. One example of a company closing its outlets is HERO and Matahari Department Store. These things happened because the economic conditions continued to decline, the many competitors that gave rise to tough competition, and the declining purchasing power of consumers. So that outlets that cannot reach the target and cannot finance their operations are forced to close. Based on the phenomena above, it is explained that the topic of financial distress, especially in retail companies, is interesting to study.

One of the factors that can affect financial distress is the size of the board of directors and the proportion of independent commissioners. The size of the board of directors has a significant positive effect on financial distress [2]. The proportion of independent commissioners has a positive influence on financial distress [9]. Each member of the board of directors plays an important role as a company decision-maker to be able to increase profits and ensure the sustainability of the company's business.

II. LITERATURE REVIEW

2.1 Agency Theory

Agency Theory is a theory that states that there is a working relationship between parties who give authority, namely the principal with the party receiving the authority, namely the agent for making the best decision for the principal. The principal referred to in the agency theory is the owner/shareholder/investor, while the agent is the management who manages the owner's assets in the company [11]. In this case, the principal wants to improve the company's financial performance in the form of return on investment that has been given to the company, while the management has its own interests, namely getting compensation for the results of its performance. Both parties have their own interests while the agent has more information than the principal. This relationship can lead to an imbalance of information called information asymmetry [14]. The emergence of potential conflicts that occur due to information asymmetry can affect the company's financial condition, resulting in the possibility of financial distress.

2.2 Financial Distress

Financial distress is a stage of decline in the company's financial condition before bankruptcy or liquidation [18]. To detect company financial distress from an early age, a financial distress model needs to be developed, because it is hoped that it can anticipate events that lead to company bankruptcy. In addition, predictions about companies experiencing financial distress are an important analysis for several parties such as creditors, investors, government, and management [3]. Financial distress can be seen when a company is experiencing financial difficulties in fulfilling its debt payment obligations. This shows that the company's financial condition is not healthy, but has not yet experienced bankruptcy. Measurement of final distress. can be done using several methods, namely Altman (1968), Springate (1978), Zwimjewski (1983), and Grover (2001). The Altman Z-score method is the most popular and widely used method.

2.3 The Size of The Board of Directors

The size of the board of directors is the board of directors in the company, the more boards in the company will provide a form of oversight of the better performance of the company [4]. The board of directors is a very important mechanism in corporate governance, where its existence determines the company's performance [25]. Based on Authority Circular Letter Number 32/SEOJK.04/2015 concerning Guidelines for Public Company Governance, the determination of the number of members of the board of directors takes into account the condition of the Public Company and its effectiveness in decision-making. Determination of the number of directors must be based on the need to achieve the aims and objectives of the Public Company and adjusted to the conditions of the Public Company which includes the characteristics, capacity, and size of the Public Company and how effective decision-making of the directors is achieved.

2.4 The Proportion of Independent Commissioners

The proportion of independent commissioners as members of the board of commissioners who are not affiliated with management, other members of the board of commissioners, and controlling shareholders, and are free from business relationships or other relationships that may affect their ability to act independently or act solely for the benefit of the company [26]. The number of independent commissioners has been regulated in the Financial Services Authority Regulation Number 33/POJK.04/2014 concerning Directors and Board of Commissioners of Issuers or Public Companies, that the number of independent commissioners must be at least 30% (thirty percent) of the total number of members of the board of commissioners. The existence of an independent commissioner is expected to be able to reduce the impact caused by conflicts of various interests which result in the interests of public shareholders.

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2.5 The Effect of the Size of the Board of Directors on Financial Distress

The more boards in a company will provide a better form of oversight of company performance [4]. The board of directors is a very important mechanism in corporate governance, where its existence determines the company's performance [25]. Some of the results of previous studies indicate that the size of the board of commissioners has a negative effect on financial distress [15]; the size of the board of directors has a positive effect on financial distress [23]; the size of the board of directors has no effect on financial distress [17]. Based on the description above, the hypothesis proposed is

H₁: The size of the board of directors affects financial distress.

2.6 The Effect of the Proportion of Independent Commissioners on Financial Distress

Independent commissioners are considered stronger than the board of commissioners because they are able to provide more independent oversight so that company management cannot commit fraud that can harm the company [21]. The greater the number of independent commissioners in the company, the more the company will avoid the threat of financial distress because supervision over the implementation of company management is more supervised by independent parties. Several previous research results show that the proportion of independent commissioners has a negative effect on financial distress [17]; the proportion of independent commissioners has a positive effect on financial distress [9]; the proportion of independent commissioners has no effect on financial distress [21]. Based on the description above, the hypothesis proposed is

H₂: The proportion of independent commissioners affects financial distress.

III. METHOD

3.1 Population and Sampling

The population in this study are retail sector companies listed on the Indonesia Stock Exchange from 2018 to 2021. In this study, purposive sampling, namely determining samples from the existing population based on certain criteria. These criteria consist of retail companies that were not delisted during the 2018-2021 period and retail companies whose financial reports were available consecutively from 2018-2021. The total samples obtained were 84 companies.

3.2 Data Sources and Data Collection Techniques

The data source used in this study is secondary data, namely data on the financial statements of retail sector companies for 2018-2021. The data was obtained by accessing the official website of the Indonesia Stock Exchange, namely www.idx.co.id. The data to be used in this research is an annual report for the 2018-2021 period. The data collection technique in this study was carried out using the archival method, namely by searching for data from archival records, in this case in the form of annual reports of retail sector companies for the 2018-2021 period which are available on website the Indonesia Stock Exchange

3.3 Operational Definition of Variables

The variables in this study consist of one dependent variable and two independent variables. The dependent variable of this study is a Financial Distress. Then, the independent variable of this study is size of the board of directors, and proportion of independent commissioners as a moderating variable.

Financial distress is a stage of decline in the company's financial condition before bankruptcy or liquidation [18]. Financial distress is reflected in the unavailability of funds or the company's inability to pay obligations that are due. Companies that experience negative operating profit for two consecutive years can be categorized as experiencing financial distress [1]. Measurement of financial distress in this study uses the Altman Z-Score model which has been modified and can be used for all types of companies. The Altman Z-Score model modified by Altman in 1995 can be seen below [8]:

$$Z = X1 + X2 + X3 + X4$$

Information:

X1 = Net Working Capital to Total Assets (WCTA)

$$WC \text{ to } TA = \frac{\text{Current Asset} - \text{Current Liabilities}}{\text{Total Asset}}$$

X2 = Retained Earnings to Total Assets (RE/TA)

$$RE \text{ to } TA = \frac{\text{Retained Earning}}{\text{Total Asset}}$$

X3 = Earnings Before Interest and Taxes to Total Assets (EBIT/TA)

$$EBIT \text{ to } TA = \frac{\text{Earning Before Interest and Tax}}{\text{Total Asset}}$$

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$X4 = \text{Book Value of Equity to Book Value of Total Debt (BE/BVTD)}$

$BVE \text{ to } BVTD = \frac{\text{Book Value of Equity}}{\text{Book Value of Total Debt}}$

Book Value of Total Debt

Based on calculation of Model if the value of $Z > 2.60$, then the company is in a healthy financial condition. If the value is $1.10 < Z < 2.60$ then the company is included in the gray area category or is likely to experience financial difficulties. If the Z value < 1.10 indicates that the company is experiencing financial difficulties and is at high risk.

The size of the board of directors is the number of directors in the company, if there are more boards in the company it will provide a form of oversight of the company's performance which is getting more and more [4]. The board of directors is a very important mechanism because its existence determines the company's performance [25]. The variable size of the board of directors is formulated as follows [20]:

BOD = Number of the board of directors in the company

Independent commissioners are members of the board of commissioners who do not have any relationship with the company's management. Independent commissioners are measured using the percentage of members to the total company commissioners [2]. The proportion of independent commissioners is formulated according to [19]:

IC = Total of independent commissioners / Total board of commissioners

3.4 Data Analysis Methods

Descriptive statistical analysis is statistics used to analyze data by describing or depicting data that has been collected as it is without intending to make conclusions general or generalization [22]. Descriptive statistical analysis is used to explain the data description of all variables in the study as seen from the minimum value, maximum value, average, and standard deviation. Tests on classical assumptions are used to find out whether a regression model is good or not when used to make estimates [12]. A model is said to be good if it is BLUE (Best Linear Unbiased Estimator), which fulfills the classical assumptions or avoids multicollinearity, heteroscedasticity, and linearity tests. The classic assumption test includes the normality test, multicollinearity test, and heteroscedasticity test. The purpose of the classical assumption test is to obtain reliable and unbiased results or to test whether the research regression model is feasible or not feasible to be tested.

The autocorrelation test aims to test whether in the moderate regression analysis there is a correlation between the confounding errors in period t and the confounding errors in the $t-1$ (previous) period. If there is a correlation, then there is called an autocorrelation problem [6]. To detect the presence or absence of autocorrelation by performing the Durbin-Watson test.

Hypothesis testing in this study used the moderate regression analysis. If the significance value is < 0.05 , the independent variable partially has a significant effect on the dependent variable, and conversely, if the significance value is > 0.05 , the independent variable partially has no significant effect on the dependent variable. Multiple regression analysis in this study used to test the effect of the independent variable, namely the size of the board of commissioners on the dependent variable, namely financial distress, and test the influence of the independent variable moderation, namely the proportion of independent commissioners on the dependent variable, namely financial distress.

IV. RESEARCH RESULT

4.1 Descriptive Statistical Analysis

This analysis describes data with a minimum value, maximum value, mean value, and standard deviation. The results of the descriptive analysis can be seen in the following table:

Table 2. Summary of Descriptive Statistical Test Results

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
FIND	84	-653.08	15.97	-37.0774	128.54081
BOD	84	2.00	8.00	4.9286	1.54285
IC	84	.20	.75	.4121	.08803
Valid N (listwise)	84				

Based on table 2. shows the results of the descriptive statistical values of each variable in this study. The financial distress variable has the lowest value of -653.08, the highest value is 15.97, the mean value is -37.0774, and a standard deviation value is 128.54081. The mean financial distress value of -37.0774 indicates that the average sample company has a Z-Score < 2.60 . This

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means that the average sample company is in an unhealthy financial condition. The standard deviation is bigger than the mean value of $128.54081 > -37.0774$, indicating that the variation in financial distress in the sample companies has a large data distribution.

The board of director variable size has a minimum value of 2.00, a maximum value of 8.00, a mean value of 4.9286, and a standard deviation value of 1.54285. The standard deviation is smaller than the mean value of $1.54285 < 4.9286$, this means that variations in the size of the board of directors in the sample companies have a small distribution of data. The proportion of independent variable commissioners has a minimum value of 0.20, a maximum value of 0.75, a mean value of 0.4121, and a standard deviation value of 0.08803. The standard deviation is smaller than the mean value of $0.08803 < 0.4121$, this means that variations in the proportion of independent commissioners in the sample companies have a small distribution of data.

4.2 Classical Assumption Test

Classical assumption test includes the normality test, multicollinearity test, and heteroscedasticity test. The purpose of the classical assumption test is to obtain reliable and unbiased results or to test whether the research regression model is feasible or not feasible to be tested. The following is a normality test using the One-Sample Kolmogorov-Smirnov Test:

Table 3. Summary of The Results of Normalitas Testing

One-Sample Kolmogorov-Smirnov Test			
		Unstandardized Residual Model 2	Unstandardized Residual Model 1
N		84	84
Normal Parameters ^{a,b}	Mean	0E-7	0E-7
	Std. Deviation	.98210669	.98172235
Most Extreme Differences	Absolute	.107	.100
	Positive	.072	.070
	Negative	-.107	-.100
Kolmogorov-Smirnov Z		.839	.754
Asymp. Sig. (2-tailed)		.482	.571

a. Test distribution is Normal.
b. Calculated from data.

The results of the multicollinearity test can be seen in the table below:

Table 4. Summary of The Results of the Multicollinearity Test

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	BOD	1.000	1.000
2	(Constant)		
	BOD	.325	3.073
	MOD1	.325	3.073

The results of the heteroscedasticity test can be seen in the table below:

Table 5. Summary of The Results of the Heteroscedasticity Test

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.000	.338		2.963	.004
	BOD	-.121	.206	-.076	-.589	.558

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2	(Constant)	1.025	.356		2.878	.006
	BOD	-.192	.369	-.121	-.521	.605
	MOD1	.042	.181	.054	.232	.817

The results of the autocorrelation test using the run test can be seen in the table below:

Table 6. Summary of The Results of the Autocorrelation Test

	Unstandardized Residual Model 1	Unstandardized Residual Model 2
Test Value ^a	.18144	.15683
Cases < Test Value	40	40
Cases >= Test Value	44	44
Total Cases	84	84
Z	1.939	1.939
Asymp. Sig. (2-tailed)	.052	.052
a. Median		

This study has carried out classic assumption tests, namely the normality test, multicollinearity test, heteroscedasticity test, and run test where the calculation results meet the specified criteria so that a moderate regression analysis test can be carried out as shown in the table below:

Table 7. Summary of The Results of Hypothesis Testing

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-166.026	45.087		-3.682	.000
	BOD	26.163	8.735	.314	2.995	.004
2	(Constant)	-161.469	44.638		-3.617	.001
	BOD	47.530	15.132	.570	3.141	.002
	MOD1	-54.368	31.624	-.312	-1.719	.089

The first hypothesis in this study is the significant negative effect of board size on financial distress in retail companies listed on the IDX for the 2018-2021 period. Based on the results of the table hypothesis test above, the significance value is 0.04 < 0.05 and the T value is 2.995, it can be concluded that the size of the board of directors has a positive effect on financial distress. The second hypothesis in this study is that the proportion of independent commissioners is able to moderate the relationship between board size and financial distress in retail listed on IDX for the 2018-2021 period. Based on the results of the Moderated Regression Analysis test, shows that the significance value of the moderating variable is 0.089 > 0.05 so H2 is not supported. So, the size of the proportion of independent commissioners is not able to strengthen or weaken the relationship between the size of the board of directors and financial distress.

V. DISCUSSION

The results of the research that has been done show that the variable size of the board of directors has a positive influence on financial distress. This means that the smaller the number of directors, the lower the possibility of financial distress in the company. Conversely, the greater the number of directors, the higher the possibility of financial distress [13]. The board of directors in a company will determine the policies to be taken or the company's strategy in the short term and long term where its existence determines the company's performance. The size of a large board of directors can reduce the possibility of financial distress because more boards of directors can monitor the financial reporting process more effectively than a small board of

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directors because a large number of boards of directors provides benefits to the company because it creates a network with outsiders in guaranteeing the availability of resources.

In this study, PT Supra Boga Lestari Tbk and PT Kokoh Inti Arebama Tbk in 2021 have a high number of boards of directors, but their financial distress is also high. Meanwhile, PT Kioson Komersial Indonesia Tbk, and PT Mitra Komunikasi Nusantara Tbk have a low number of boards of directors and are not experiencing financial distress. In this case, it can be concluded that if the board of directors does not carry out its obligations optimally in managing assets, then the company will still have the potential to experience financial distress because the board of directors cannot balance company management between management control and coordination problems [10].

The results of this study also indicate that the variable proportion of independent commissioners as a moderating variable has no effect on financial distress. This can happen because companies in Indonesia have independent commissioners only to fulfill the requirements to comply with existing regulations without considering the performance provided by independent commissioners. The performance of independent commissioners that is less than optimal in the company will lead to weak monitoring of the board of directors' performance. The less-than-optimal performance of independent commissioners can also be influenced by the lack of independence of its members in carrying out their duties [26].

Based on the research that has been described, it can be concluded that board size has a positive effect on financial distress and the proportion of independent commissioners cannot strengthen or weaken the relationship between board size and financial distress in retail companies listed on the Indonesia Stock Exchange during the 2018-2021 period. The results of the adjusted R square value for data analysis show a value of 0.130 and 0.099, this means that financial distress can be influenced by the size of the board of directors of 13% and by the proportion of the board of commissioners of 9%. While the remaining is explained by other factors not present in this study, such as audit committee, managerial ownership, institutional ownership, and others.

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