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Corporate Governance and Financial Distress: Indonesian Perspective

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ABSTRACT

This research aims to analyze the influence of corporate governance mechanisms on financial distress in companies listed on the LQ45 Index of the Indonesia Stock Exchange during the 2020–2023 period. The corporate governance variables examined include institutional ownership, managerial ownership, independent commissioners, and profitability. The study uses a quantitative approach with secondary data obtained from company financial statements and annual reports. The sample consists of 17 companies continuously listed in LQ45 over four years, selected through purposive sampling. Financial distress is measured using the Altman Z-Score model, while the analytical method employed is multiple linear regression using SPSS 27. The results show that institutional ownership and profitability have a significant effect in mitigating financial distress. Meanwhile, managerial ownership and independent commissioners do not have a significant effect on financial distress. These findings contribute to the development of agency theory and signal theory by emphasizing the role of corporate governance in predicting and preventing financial crises in companies.
Keywords: Corporate governance, institutional ownership, managerial ownership, independent commissioner, profitability, financial distress, altman z-score**.**

INTRODUCTION

The development of the business sector in Indonesia is currently growing rapidly, resulting in increasingly intense competition among companies. Generally, each company has the same primary goal, namely to generate the highest possible profit. Profit serves as a key indicator in measuring the overall operational performance of a company. Moreover, profit also reflects business sustainability, indicating the company's ability to survive in a competitive business environment (Handriani et al., 2021). However, in running their business operations, companies inevitably face various internal and external challenges. One of the main issues frequently encountered is financial problems. These issues may arise due to continuous losses, failure to meet sales targets, imbalanced capital structures, or weak corporate governance systems. Such conditions can lead to a financial distress, which refers to the stage of declining financial conditions occurring prior to bankruptcy or liquidation (Platt & Platt, 2002; Nasiroh & Priyadi, 2018). This condition does not only affect the company itself but also harms all stakeholders such as investors, employees, and creditors.

The phenomenon of financial distress is not only a remnant of past financial crises but continues to emerge in modern corporate practices. A recent example can be seen in the case of eFishery, a prominent Indonesian start-up that reportedly inflated its revenue by up to US$600 million**,** triggering public scrutiny and investor backlash. This case highlights the growing concern over weak corporate governance structures, particularly in technology-based companies that often lack strong internal controls and transparent financial reporting systems. Many Indonesian start-ups, despite being highly valued and well-funded, operate with minimal oversight, limited board independence, and insufficient audit assurance. The eFishery scandal underscores how the absence of robust governance mechanisms can lead to misleading financial practices and expose companies to a high risk of financial distress (The Jakarta Post, 2025). This reinforces the need for strengthening governance frameworks, even in high-growth sectors, to ensure long-term financial sustainability and investor trust.

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Reflecting on these phenomena, the implementation of Good Corporate Governance (GCG) becomes crucial to minimize the risk of financial failure. GCG is a set of rules that governs the relationships between shareholders, management, creditors, government, employees, and other parties within the company's control system (KNKG, 2006). In Indonesia, awareness of the importance of GCG began to grow after the 1997–1998 economic crisis, which revealed the poor oversight of many companies at that time. In response, the Indonesian government formed the National Committee on Governance Policy, which issued GCG guidelines in 2001 as part of corporate governance reform.

This study focuses on four key mechanisms of corporate governance such as institutional ownership, managerial ownership, independent commissioners, and profitability. Several prior studies have shown varying results. Usman et al. (2022) found that institutional ownership has a significant influence on financial distress through its effective monitoring function. Meanwhile, managerial ownership is believed to align the interests of management and shareholders, thereby reducing opportunistic behavior. However, findings related to the role of independent commissioners in preventing financial distress remain inconsistent. Studies such as Ibrahim (2019) showed that the presence of independent commissioners has no significant effect. Additionally, profitability, which is generally seen as a signal of good financial health, has also shown mixed results in explaining financial distress. For instance, Azizah & Chasanah, (2025) found that profitability does not have a significant effect on financial distress, which highlights the need for further research on this matter.

Based on this background, the objective of this research is to analyze the influence of corporate governance mechanisms, including institutional ownership, managerial ownership, independent commissioners, and profitability on financial distress in companies listed in the LQ45 index on the Indonesia Stock Exchange for the 2020–2023 period. This research is important both theoretically and practically. Theoretically, it contributes to agency theory and signaling theory by examining the extent to which ownership structure and performance indicators influence financial risk. Practically, the findings are expected to provide useful insights for investors in making investment decisions, for company management in improving internal controls, and for regulators in strengthening corporate governance policies, particularly in facing post-pandemic economic uncertainty.

Research Objectives

1. To find out the effect of institutional ownership on financial distress.
2. To find out the effect of managerial ownership on financial distress.
3. To find out the effect of proportion independent commissioners on financial distress.
4. To find out the effect of profitability on financial distress.

LITERATURE REVIEW

Agency Theory

According to Fakhriyyah & Cholid Mawardi (2020) agency conflict is caused by the separation of ownership and management. According to this theory, there is a gap between owners and managers arising from a decrease in share ownership. This condition causes managers to pursue their own interests, not maximize company value. The main principle of this theory states that, in a cooperation contract, there is a working relationship between the party who authorizes (principal), the investor, and the party who receives the authority (agent), the manager.

Signaling Theory

Signaling theory, introduced by Damayanti & Kusumaningtias (2020), suggests that company management can provide signals to external parties through published financial information. These signals help investors assess the company's performance and prospects. One of the most commonly used signals is profitability, which reflects the company's ability to generate income. A company with high profitability sends a positive signal that it is in good financial condition and less likely to experience financial distress. In this research, signaling theory is applied to explain how profitability can serve as an indicator of the company's financial health and risk.

Financial Distress

According to Nasiroh & Priyadi (2018) Financial distress is a condition where the company is facing financial difficulties. Financial distress conditions are reflected in the company's inability or unavailability of funds to pay its maturing obligations. Financial distress occurs before bankruptcy, which is defined as a condition in which the company fails or is no longer able to fulfill debtor obligations because the company experiences a lack and insufficiency of funds to run its business.

Corporate Governance

The Institute of Internal Auditors (IIA) explains that governance is a combination of processes and structures implemented by the board to inform, direct, manage, and monitor organizational activities in achieving its goals (Institute of Internal Auditors, 2016).

Institutional Ownership

Institutional ownership refers to the proportion of company shares held by institutional investors such as banks, mutual funds, insurance companies, or other investment institutions. This type of ownership is considered to enhance monitoring of managerial actions due to institutional investors' expertise and long-term interests. The greater the institutional ownership, the stronger the external supervision, thereby reducing the potential for earnings manipulation or poor decision-making. Usman et al. (2022) found that institutional ownership has a significant negative influence on financial distress, indicating that companies with high institutional ownership are less likely to face financial difficulties.

Managerial Ownership

Managerial ownership is the percentage of shares owned by the company's internal management, including directors and commissioners. According to agency theory, this form of ownership aligns the interests of managers with those of shareholders. Managers who hold shares are more likely to act in the best interest of the company because their personal wealth is tied to the company's performance. Azzahra & Yuyetta (2022) found that managerial ownership negatively affects financial distress, meaning that higher managerial ownership can reduce the risk of financial problems due to more responsible decision-making.

Independent Commissioners

Independent commissioners are members of the board of commissioners who do not have any financial, management, or family relationship with major shareholders or the company. They are expected to act objectively and supervise managerial activities to ensure transparency and fairness. However, studies have shown mixed results regarding their effectiveness. (Ibrahim, 2019) found that the presence of independent commissioners does not have a significant effect on financial distress, possibly due to their limited authority or the ineffectiveness of their oversight in practice.

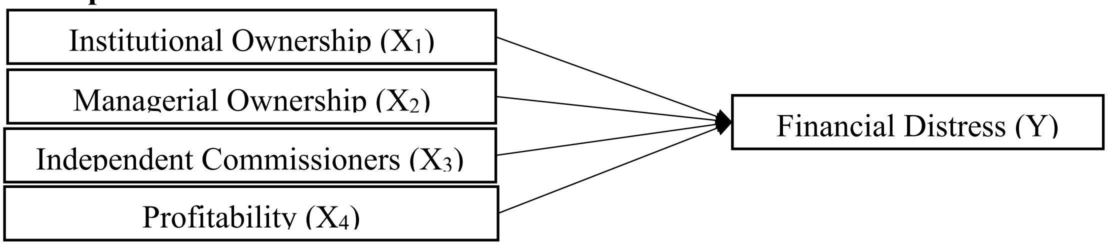
Profitability

Profitability reflects a company's ability to generate profits from its operations. It is often used as a key indicator of financial health. In signaling theory, profitability is viewed as a positive signal for external parties such as investors, suggesting that the company is financially sound and less likely to experience distress. (Handriani et al., 2021) explain that strong profitability can reduce the likelihood of financial distress. However, other studies such as Azizah & Chasanah (2025) found that profitability does not significantly influence financial distress, indicating that other factors may play a more dominant role in affecting financial risk.

Z-Score Altman

The Altman Z-Score is a financial analysis model developed by Edward I. Altman to predict the likelihood of a company experiencing financial distress or potential bankruptcy. This model combines several key financial ratios that reflect a company's liquidity, profitability, efficiency, and solvency. In this study, the Z-Score is used as a tool to assess the financial health of companies based on their published financial statements. Companies with Z-Scores below a certain threshold are classified as financially distressed, while those with higher scores are considered financially stable. The Z-Score is considered a relevant and reliable indicator because it provides an early warning signal of potential financial failure based on historical financial performance.

Conceptual Framework



Research Hypothesis

H1 : Institutional ownership affects financial distress.
H2 : Managerial ownership affects financial distress.
H3 : Independent commissioners affect financial distress.
H4 : Profitability affects financial distress.

RESEARCH METHOD

Type Research and Data Source

The type of research used in this study is quantitative research, which involves the collection and processing of data in numerical form. According to Sugiyono, (2022), quantitative research is a research method based on the philosophy of positivism. The data used in this study are secondary data obtained from the website www.idx.co.id.

Population

The population in this study includes all companies listed on the Indonesia Stock Exchange (IDX) that are included in the LQ45 index.

Sample

The sample in this study was determined using a purposive sampling method, which is a sampling technique based on specific considerations or criteria that align with the objectives of the research. The sample criteria in this study are as follows:

a) Companies listed on the Indonesian Stock Exchange (IDX) and continuously report their financial statements during the observation period.
b) Companies that are consecutively included in the LQ45 index during 2020-2023.
c) Companies that use Rupiah currency.

RESEARCH RESULTS AND DISCUSSION

Research Result

The list of companies based on the criteria for sample selection in this study is listed in table below:

Table: List of Companies Based on Research Criteria

No.	Code	Company Name
1	ANTM	PT. Aneka Tambang Tbk.
2	ASII	PT. Astra Internasional Tbk.

No.	Code	Company Name
3	BBCA	PT. Bank Central Asia Tbk.
4	BBNI	PT. Bank Negara Indonesia Persero Tbk.
5	BBRI	PT. Bank Rakyat Indonesia (Persero) Tbk.
6	BBTN	PT. Bank Tabungan Negara (Persero) Tbk.
7	CPIN	PT. Charoen Pokphand Indonesia Tbk.
8	ICBP	PT. Indofood CBP Sukses Makmur Tbk.
9	INDF	PT. Indofood Sukses Makmur Tbk.
10	INTP	PT. Indocement Tunggal Prakarsa Tbk.
11	KLBF	PT. Kalbe Farma Tbk.
12	PTBA	PT.Tambang Batu Bara Bukit Asam (Persero) Tbk
13	SMGR	PT. Semen Indonesia (Persero) Tbk.
14	TBIG	PT. Tower Bersama Infrastructure Tbk.
15	TOWR	PT. Sarana Menara Nusantara Tbk.
16	UNTR	PT. United Tractors Tbk.
17	UNVR	PT. Unilever Indonesia Tbk.

Source: Data was obtained from www.idx.co.id, 2025

Descriptive Analysis

Table 1 Descriptive Statistic

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Institutional Ownership	68	0.15	0.96	0.5999	0.16266
Managerial Ownership	68	0.00	0.44	0.0973	0.16371
Independent Commissioners	68	0.25	5.00	1.4732	1.15956
Profitability	68	0.00	0.63	0.1062	0.13711
Financial Distress	68	1.29	1598.66	115.8606	337.64215
Valid N (listwise)	68				

Source: Data processed by SPSS 27, 2025

Based on the descriptive statistical analysis in the table above, the following conclusions can be drawn:

a. The **Institutional Ownership** variable has a minimum value of 0.15 and a maximum value of 0.96, with a mean value of 0.59 based on company data.
b. The **Managerial Ownership** variable has a minimum value of 0.00 and a maximum value of 0.44, with a mean value of 0.09 based on company data.
c. The **Independent Commissioners** variable has a minimum value of 0.25 and a maximum value of 5.00, with a mean value of 1.47 based on company data.
d. The **Profitability** variable has a minimum value of 0.00 and a maximum value of 0.63, with a mean value of 0.10 based on company data.
e. The **Financial Distress** variable has a minimum value of -1.29 and a maximum value of 1598.66, with a mean value of 115.86 based on company data.

Discussion

Normality Test Result

Table 2 Normality Test Result

Tests of Normality						
	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	df	Sig.
Institutional Ownership	0.136	40	0.061	0.924	40	0.010
Managerial Ownership	0.120	40	0.148	0.889	40	0.001
Independent Commissioners	0.067	40	0.200	0.981	40	0.718
Profitability	0.128	40	0.096	0.959	40	0.051
Financial Distress	0.132	40	0.076	0.872	40	0.001
*. This is a lower bound of the true significance.						
a. Lilliefors Significance Correction						

Source: Data processed by SPSS 27, 2025

Based on the Kolmogorov-Smirnov normality test results, all variables in this study are normally distributed. The institutional ownership variable has a significance value of 0.061, managerial ownership 0.148, independent commissioners 0.200, and profitability 0.096; all of which are greater than 0.05. This indicates that the data meet the assumption of normality and are suitable for further analysis.

Classical Assumption Result

Multicollinearity Test

Table 3 Multicollinearity Test

Coefficients[a]			
Model		Collinearity Statistics	
		Tolerance	VIF
1	Institutional Ownership	0.913	1.095
	Managerial Ownership	0.920	1.087
	Independent Commissioners	0.991	1.009
	Profitability	0.926	1.080
a. Dependent Variable: Financial Distress			

Source: Data processed by SPSS 27, 2025

Based on the results that have been described, it can be concluded that there is no multicollinearity problem that occurs in all independent variables, because the tolerance value of each variable is greater than 0.10 and the VIF value is less than 10.00.

Heteroscedasticity Test

Table 4 Heteroscedasticity Test

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.710	1.493		1.816	0.078
	Institutional Ownership	0.135	1.253	0.018	0.107	0.915
	Managerial Ownership	0.026	0.099	0.045	0.265	0.792
	Independent Commissioners	-0.825	1.051	-0.129	-0.786	0.348
	Profitability	-1.969	1.325	-0.252	-1.487	0.341
a. Dependent Variable: ABS_RES1						

Source: Data processed by SPSS 27, 2025

It can be concluded that the independent variables do not experience heteroscedasticity, because the significance value of all these variables is greater than 0.05.

Autocorrelation Test

Table 5 Autocorrelation Test

Model Summary[b]					
Model	F Change	df1	df2	Sig. F Change	Durbin-Watson
1	9.066	4	35	0.001	1.232
b. Dependent Variable: Financial Distress					

Source: Data processed by SPSS 27, 2025

Based on the output above, the Durbin - Watson test results obtained a value of 1.232. So it can be concluded that the autocorrelation test passes because the Durbin - Watson value is between the values of -2 to +2.

Multiple Linear Regression Analysis

Table 6 Multiple Linear Regression Analysis

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	T	Sig.	Tolerance	VIF
1	(Constant)	277.519	102.908		2.697	.011		
	Institutional Ownership	-360.845	135.458	-.330	-2.664	.012	.913	1.095
	Managerial Ownership	-55.296	10.531	-.648	-5.251	.000	.920	1.087
	Independent Commissioners	32.757	31.153	.125	1.051	.300	.991	1.009
	Profitability	-80.556	110.588	-.090	-.728	.471	.926	1.080
a. Dependent Variable: Financial Distress								

Source: Data Processed by SPSS 27, 2025

Based on table 6, the results of the multiple regression test constant has a Beta value of 277.519, institutional ownership obtained a Beta value of -360.845, managerial ownership obtained a Beta value of -55.296, independent commissioners obtained a Beta value of 32.757, and profitability obtained a Beta value of -80.556. Based on this data, the regression equation can be made as follows:

$$\boldsymbol{Y = 277.519 - 360.845X_1 - 55.296X_2 - 32.757X_3 - 80.556X_4 + \epsilon}$$
$$\boldsymbol{(-0.330) \quad (0.648) \quad (-0.125) \quad (0.090)}$$

Hypothesis Test

Simultaneous Test (F Test)

Table 7 Simultaneous Test (F Test)

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	84376.891	4	21094.233	9.066	0.001[b]
	Residual	81434.710	35	2326.706		
	Total	165811.601	39			
a. Dependent Variable: Financial Distress						
b. Predictors: (Constant), Profitability, Independent Commissioners, Managerial Ownership, Institutional Ownership						

Source: Data processed by SPSS 27, 2025

The results in Table 7 show that institutional ownership, managerial ownership, independent commissioners, and profitability simultaneously have a significant effect on financial distress. This is indicated by the F-value of 9.066 with a significance level of 0.001 < 0.05, so H0 is rejected.

Test Coefficient of Determination (R^2)

Table 8 Test Coefficient of Determination (R^2)

Model Summary[b]				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.713[a]	0.509	0.453	48.23594
a. Predictors: (Constant), Profitability, Independent Commissioners, Managerial Ownership, Institutional Ownership				
b. Dependent Variable: Financial Distress				

Source: Data Processed by SPSS 27, 2025

Based on table 8 above, it shows that the results of the determination test can be explained based on the r-square value of 0.509 which means that the independent variable can describe the relationship with the dependent variable by 50.9% and the remaining 49.1% is influenced by other variables that are outside the regression model.

Partial Test (t)

Table 9 Partial Test (t)

Coefficients[a]						
Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	277.519	102.908		2.697	0.011
	Institutional Ownership	-360.845	135.458	-0.330	-2.664	0.012
	Managerial Ownership	-55.296	10.531	-0.648	-5.251	0.001
	Independent Commissioners	32.757	31.153	0.125	1.051	0.300
	Profitability	-80.556	110.588	-0.090	-0.728	0.471
a. Dependent Variable: Financial Distress						

Source: Data Processed by SPSS 27, 2025

H1: Institutional ownership affects financial distress.

The institutional ownership variable obtained a t value of -2.664 with a significance value of 0.012. The significant value obtained is less than 0.05 so it can be concluded that H_0 is rejected and H_1 is accepted, this shows that the institutional ownership variable has a significant negative effect on financial distress. This means that the greater the institutional ownership, the lower the potential for the company to experience financial distress. Thus, this finding supports Agency Theory (Jensen and Meckling, 1976) which states that institutional investors have an interest and capacity in conducting managerial supervision, so as to reduce the risk of financial distress. Therefore, institutional ownership can be used as additional information to predict whether or not there is a potential for financial distress in LQ45 companies listed on the Indonesia Stock Exchange (IDX) in 2020 - 2023. This is in line with previous research conducted by Damayanti & Kusumaningtias (2020) stating that this study shows that institutional ownership variables and audit committees have an influence on financial distress.

H2: Managerial ownership affects financial distress.

The managerial ownership variable obtained a t value of -5.251 with a significance value of 0.001. The significant value obtained is less than 0.05 so it can be concluded that H_0 is rejected and H_2 is accepted, this indicates that the managerial ownership variable has a significant negative effect on the occurrence of financial distress. This means that the greater the managerial share ownership, the risk of financial distress tends to decrease. This supports agency theory (Jensen and Meckling, 1976) which explains that managers who own shares are encouraged to act more carefully and efficiently because they have a direct interest in the continuity of the company. Share ownership creates an alignment of interests between managers and other shareholders. Therefore, managerial ownership can be used as additional information to predict whether or not there is a potential for financial distress in LQ45 companies listed on the Indonesia Stock Exchange (IDX) in 2020 - 2023. This is in line with previous research conducted by Azzahra & Yuyetta (2022), stating that managerial ownership, institutional ownership, independent commissioners, and audit committee expertise have a significant negative effect on financial distress.

H3: Independent commissioners affect financial distress.

The independent commissioners variable obtained a t value of 1.051 with a significance value of 0.300. The significant value obtained is more than 0.05 so it can be concluded that H_0 is accepted and H3 is rejected, this indicates that the independent commissioners variable has no significant effect on financial distress. According to the agency theory proposed by Jensen and Meckling (1976), the existence of independent commissioners should strengthen the supervisory function of management to act in the interests of shareholders. However, these results indicate that in the context of the companies studied, the role of independent commissioners is not optimal in preventing financial distress. This can be caused by a lack of practical independence, lack of authority, or ineffective supervisory functions in making strategic company decisions. Therefore, independent commissioners cannot be used as additional information to predict whether or not there is a potential for financial distress in LQ45 companies listed on the Indonesia Stock Exchange (IDX) in 2020 - 2023. This is in line with previous research conducted by Ibrahim (2019), states that corporate governance as measured by institutional ownership, board size, and board size has a significant negative effect on financial distress, while managerial ownership and independent commissioners have no significant effect on financial distress.

H4: Profitability affects financial distress.

The profitability variable obtained a t value of -0.728 with a significance value of 0.471. The significant value obtained is more than 0.05 so it can be concluded that H_0 is accepted and H4 is rejected, this indicates that the profitability variable has no significant effect on financial distress. Based on signal theory as explained by Damayanti (2020), financial information such as profitability is used as a signal by management to show company performance to outsiders, including investors. High profitability should be a positive signal that indicates the company's financial health and reduces the risk of financial distress. However, in this study, the signal is not strong enough or not effectively accepted by the market so that it does not have a significant impact on the company's financial distress condition. This can be influenced by other external factors such as company policy or investor confidence. Therefore, profitability cannot be used as additional information to predict whether or not there is a potential for financial distress in LQ45 companies listed on the Indonesia Stock Exchange (IDX) in 2020 - 2023. This is in line with previous research conducted by Azizah & Chasanah (2025), stating that profitability and solvency have no significant effect.

Conclusion, Research Limitations, and Suggestions

This study concludes that institutional ownership and managerial ownership significantly and negatively affect financial distress, meaning that higher levels of ownership by institutions and management can reduce the likelihood of companies experiencing financial difficulty. In contrast, independent commissioners and profitability do not have a significant influence, indicating that these variables alone are not strong predictors of financial distress. This research, however, has certain limitations. The sample is limited to companies listed in the LQ45 index during the 2020–2023 period, which may not represent all industry conditions or company sizes. Additionally, the study only focuses on four independent variables, without considering other financial or macroeconomic factors that might also contribute to financial distress. Based on these limitations, future researchers are encouraged to include broader samples and additional variables such as leverage, liquidity, or firm size, or to apply qualitative methods to gain deeper insights into company financial health and governance practices.

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