



The Effect of Corporate Governance Mechanism and Company Size on Financial Distress

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Abstract

This study aims to examine the effect of corporate governance mechanisms and company size on the condition of a company experiencing financial distress. The indicators used to measure the corporate governance mechanism in the sample companies are the board of directors, the proportion of independent commissioners, managerial ownership, institutional ownership, and the audit committee. Meanwhile, financial distress is measured using a Springate model. This study uses secondary data from the entire population of mining companies listed on the IDX in 2016-2019. The sampling technique used purposive sampling. The analytical method used is ordinal logistic regression. The results of hypothesis testing show that the board of directors, the proportion of independent commissioners, the audit committee, and company size do not significantly affect the condition of the company experiencing financial distress. Meanwhile, managerial ownership and institutional ownership have a significant effect on companies experiencing financial distress.

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1. INTRODUCTION

The global economic crisis that has occurred since 2008 began with the financial crisis in the United States, which then spread to all parts of the world. Not only in the real sector but to all non-financial sectors as well across the globe. Indonesia is one of the countries that has felt the impact of this crisis and caused the rupiah exchange rate to decline and made many companies unable to survive and foreign companies experiencing financial difficulties.

Financial distress occurs before the company goes bankrupt and starts from the company's inability to fulfill its obligations, especially short-term liabilities, including liquidity obligations, including those in the solvency category (Helena and Saifi, 2018). A company must continue to improve and maintain its performance to become a healthy company and avoid financial problems (financial distress) or even bankruptcy. But in reality, many large companies in Indonesia have gone bankrupt or bankrupt. For example, PT. Nyonya Mener, established in 1919, On August 3, 2017, the Semarang District Court was declared bankrupt because it has debts of up to Rp7.4 billion. Then PT. Royal Standard (RS) The group that houses Envelope Jaya is declared bankrupt by the Commercial Court Central Jakarta on March 6, 2017, for having debts worth three hundred thirty-three billion rupiahs, which from 18 creditors out of a total of Rp1,258 trillion of the RS Group's billing expenses from a total of 23 creditors. The companies that went bankrupt or bankrupt can be said to be experiencing financial distress can lead to delisting from the Indonesia Stock Exchange (IDX), which results in the company being unable to fulfill its obligations.

Research on financial distress is critical and interesting because previous studies still provide different research results, causing inconsistencies in research results. Therefore, the authors are interested in examining the direct effect by adding several criteria included in corporate governance and firm size on financial distress to obtain consistent research results regarding the factors that affect financial distress. Agency theory states that principals and agents maximize their welfare for personal gain, so there is good reason for investors to believe that agents will not always act in the principal's best interests, which can lead to a conflict of interest (Jensen and Meckling, 1976). Plat (2002) defines financial distress as a stage of difficulty that occurs before bankruptcy or liquidation or a decline in a company's financial status. If symptoms of financial distress occur and are not immediately resolved, they will be bad for the company. Therefore, company management must immediately take action to deal with it before bankruptcy occurs.

One of the mechanisms for overcoming the symptoms of financial distress is by implementing Corporate Governance. According to the Forum for Corporate Governance in Indonesia (FCGI), corporate governance is a system and rules designed to regulate the relationship between shareholders, company management, creditors, government, employees, and other internal and external stakeholders related to their rights and obligations. Therefore, the elements in good corporate governance require several components, including fairness, transparency, accountability, responsibility. Meanwhile, the corporate governance mechanism is the relationship between decision-makers and decision-makers who control or supervise (Fitdini and Yuyetta, 2009). This study's corporate governance mechanisms are the board of directors, the proportion of independent commissioners, managerial ownership, institutional ownership, and the audit committee.

The size of the company describes how many total assets the company has. The greater the total assets owned by the company, it is expected that the company will be more able to pay off future liabilities so that the company can avoid financial problems. According to Loman and Male (2015), company size can describe how many assets a company has.

Hypothesis Development

The Effect of the Board of Directors on Financial Distress

According to the Indonesian General Guidelines for Good Corporate Governance, the board of directors is a professional selected by the company's owner to lead and manage the company. According to Neldawati (2018), the board of directors' size has no significant effect on financial distress. Meanwhile, the board of directors' size has a significant effect on financial distress (Helena and Saifi, 2018).

H1: The size of the Board of Directors affects Financial Distress

The Effect of Proportion of Independent Commissioners on Financial Distress

Companies with a higher proportion of independent commissioners will have better corporate governance. The greater the number of independent commissioners in the company, the less likely it is that financial distress will occur because its supervision is more subject to an independent charge (Hanifa and Purwanto, 2013). Ariesta and Chariri (2012) show that the proportion of independent commissioners has a significant effect on financial distress.

H2: The proportion of Independent Commissioners affects Financial Distress.

The Effect of Managerial Ownership on Financial Distress

Managerial ownership is the ratio of managerial share ownership to the number of shares outstanding in the stock market. Cinanttya and Merkusiswati (2015) show that management ownership does not affect financial distress. Meanwhile, Setiawan et al (2016) show that management ownership influences the company's financial distress it conclude that managerial ownership affects financial distress.

H3: Managerial ownership affects financial distress

The Effect of Institutional Ownership on Financial Distress

Institutional ownership is an excellent corporate governance mechanism that can reduce agency theory problems between companies and managers. Parulian (2012) revealed in his research that institutional share ownership will be able to oversee management in business activities better to be more immune to financial distress. According to Fathonah (2017), managerial ownership affects financial distress.

H4: Institutional ownership affects Financial Distress

The Effect of the Audit Committee on Financial Distress

The audit committee was formed to assist the supervisory board in ensuring that financial reports are presented fairly according to generally accepted accounting principles. The company's internal control structure has been appropriately implemented, and the internal control structure has been properly implemented. According to (Fathonah, (2017, the Audit Committee has a positive influence on financial distress. Helena and Saifi, (2018) stated in their research that the audit committee had an insignificant effect on financial distress.

H5: The Audit Committee affects Financial Distress

The Effect of Firm Size on Financial Distress

The greater the total assets owned by the company, it is expected that the company will be more able to pay off future liabilities so that the company can avoid financial problems. The greater the company's total assets, the more expected the company would be able to pay off its debts in the future to avoid financial difficulties (Putri and Merkusiswati, 2014). Ariesta and Chairiri (2012) indicated that company size does not affect financial distress, meaning that any reduction or increase in company size will not affect the possibility of the company experiencing financial distress. According to Susilawati et al (2017), it shows that company size affects financial distress.

H6: Firm Size affects Financial Distress

2. METHOD

This type of research uses a quantitative approach and aims to examine a specific population or sample. The annual reports of mining companies listed on the Indonesia Stock Exchange (IDX) during 2016-2019 were used as a population sample. The technique used in sampling is the purposive sampling technique with the following criteria:

- a. Mining companies listed on the Indonesia Stock Exchange (IDX) for 2016-2019.
- b. Mining companies that publish annual reports for 2016 - 2019, respectively.
- c. Mining companies listed on the Indonesia Stock Exchange (IDX) have received negative profits at least once during the period 2016 to 2019.
- d. Mining companies that prepare financial reports for 2016 - 2019 in Rupiah (Rp).
- e. Mining companies must have financial reports for the 2016-2019 period, which can be accessed through the IDX website www.IDX.co.id.

Dependent Variable

The dependent variable in this study is financial distress. The measurement of financial distress in this study uses Springate.

Independent Variable

This study's independent variables are the board of directors, the proportion of independent commissioners, managerial ownership, institutional ownership, audit committee, and company size.

Table 1. Variables Measurement

Variable Name	Measurement
Board of Directors	The number of the Board of Directors in the company in period t
The proportion of Independent Commissioners	Number of members of the board of independent commissioners / Total number of members of the board
Managerial Ownership	(Management share/ total shares outstanding) x100%
Institutional Ownership	(Institutional share/ total shares outstanding) x100%
Audit committee	number of members of the audit committee
Company Size	Ln Total in Aset

source: processed data

The method of analysis used in this study is logistic regression analysis. Assessing the regression model's feasibility using Hosmer and Lemeshow's Goodness of Fit Test by assessing the overall model (overall model fit) based on the likelihood function L. Meanwhile, to calculate the coefficient of determination using Negelkerke R². The research logistic regression model, namely:

$$\ln \frac{p}{1-p} = \alpha + DD + PKI + KM + KI + KA + UP + e$$

Information:

The company experiences the possibility of financial distress. One value for financial distress and zero for non-financial distress.

A = Constant

DD = Size of the Board of Directors

PKI = Proportion of Independent Commissioners

KM = Managerial Ownership

KI = Institutional Ownership

KA = Audit Committee

UP = Company Size

e = error

$\beta_1 \beta_2 \beta_3 \beta_4 \beta_5 \beta_6$ = Coefficient

3. RESULT AND DISCUSSION

RESEARCH RESULT

The sample used in mining companies listed on the Indonesia Stock Exchange (IDX) and publishing complete and consecutive annual reports during the 2016-2019 period. The companies' sample is selected using the purposive sampling method, which produces 65 companies each year to meet the sample criteria. The number of samples in this study was 260 (65x4) companies.

Table 2. Research Sampling Criteria

Explanation	Total
Mining companies and those listed on the Indonesia Stock Exchange (IDX) for 2016-2019.	179
Companies that do not publish consecutive annual	(65)
Companies that do not use rupiah currency.	(23)
Companies that have positive profits	(26)
Research sample	65
total	260
Outlier	(5)
The number of samples that can be processed	255

source: processed data

Based on the descriptive analysis table above, the financial distress variable has a minimum value of 0.0000 and a maximum of 1,000,000. While the standard deviation of 0.488. The mean (average) value of financial distress is 0.39; this shows that $S < 0.862$, the company used as the research sample, can go bankrupt.

Table 3. Descriptive Statistic

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Financial distress	255	0,0000	1,0000	0,390000	0,4880000
Board of directors	255	2,0000	16,0000	5,480000	2,4680000
Independent commissioners	255	0,1250	0,75000	0,363564	0,1481039
Managerial ownership	255	0,0000	0,81000	0,052280	0,1399729
Institutional ownership	255	0,0000	0,94010	0,667040	0,2192998
Audit committee	255	2,0000	5,00000	3,110000	0,3850000
Company Size	255	20,425	34,1860	28,78190	1,6752630

source: processed data

The overall model fit test shows a decrease in the value of the -2 log-likelihood block number by 312,669, which illustrates that the better regression model or the hypothesized model is in a fit condition with the data. The test results of the coefficient of determination (Nagelkerke R Square) show that it is 0.141. This means that this study's independent variables can explain the dependent variable by 14.1%, while other variables explain 85.9% outside of this study. The regression model's feasibility test results with the Hosmer and Lemeshow goodness of fit test shows a significance value of 0.209 which illustrates that the model can predict the value of its observations or the model is acceptable because it is by the observations.

Hypothesis Test

Table 4. Hypothesis Testing

Variable	B	S.E.	Wald	df	Sig.	Exp (B)
Board of directors	-,097	1,519	1,519	1	,218	,908
Independent Commissioners	,113	,012	,012	1	,911	1,119
Managerial Ownership	-5,569	1,575	12,497	1	,000	,004
Institutional ownership	-3,912	,910	18,475	1	,000	,020
Audit committee	-,015	,365	,002	1	,967	,985
Company Size	,057	,101	,325	1	,569	1,059
Constant	1,272	2,964	,184	1	,668	3,570

source: processed data

The model resulting from testing the regression model is as follows:

$$= 1.272 - 0.097 DD + 0.097 PKI - 5,569 KM - 3,912 KI - 0.015 KA + 0.057 UP + e$$

DISCUSSION

Board of directors

The board of directors variable (DD) shows a significance value of $0.218 > \alpha = 0.05$ or H1 is rejected. So the results show that the board of directors does not affect financial distress. This study's results are consistent with previous studies conducted by Dewi et al (2020), Yudha and Fuad (2012). However, it is different from Helena and Saifi, 2018t, which states that the board of directors significantly affects financial distress. This indicates that the number or number of the board of directors does not influence the company's success in managing financial distress. It is hoped that the company will consider the board of directors' competency to minimize financial distress.

The proportion of Independent Commissioners

The variable proportion of independent commissioners (PKI) shows a significance value of $0.911 > \alpha = 0.05$ or H2 is rejected. The results of this study's analysis imply that the proportion of independent commissioners does not affect financial distress. This is supported by the results of research by Dewi et al (2020). However, it is different from the research results of (17), which states that the proportion of independent commissioners significantly affects financial distress. The smaller proportion of independent commissioners will make it difficult for the board of commissioners to monitor management performance effectively.

Managerial Ownership

The managerial ownership variable (KM) shows a significance value of $0.000 < \alpha = 0.05$ or H3 is accepted. The result of the research analysis found that managerial ownership affects financial distress. These results support the study of Yudha and Fuad (2012). But it is not in line with Dewi et al (2020). Thus, this study's results indicate that companies whose share ownership ratio is partly owned by management can reduce the possibility of financial distress. A company experiencing financial distress indicates that the company's manager is implementing an appropriate incentive policy to protect against the possibility of financial distress.

Institutional Ownership

The institutional ownership variable (KI) shows a significance value of $0.000 < \alpha = 0.05$ or H4 is accepted. The results of this study found that institutional ownership affects financial distress. This study supports DP Enur (2007). But not supported by Yudha and Fuad (2012), Christella and Osesoga (2019). Theoretically, the company's financial condition is strongly influenced by institutional ownership because important decisions made by management must involve institutions as shareholders. This means that the

increase in institutional ownership in the company encourages less potential financial distress.

Audit Committee

The audit committee variable (KA) shows a significance value of $0.967 > \alpha = 0.05$ or H5 is rejected. This study found that the audit committee does not affect financial distress. This study supports Dewi et al (2020) and Ulfa et al (20). The report on the decision of the head of Bapepam Number: KEP-29 / PM / 2004 explains that the Audit Committee is a committee formed by the Board of Commissioners to help carry out its duties and functions to assist and process to reduce financial distress.

This finding therapy does not support Harahap (2017), which states that the audit committee affects financial distress. According to the Decree of Kep-315 / BEI / 06200, listed companies must have an audit committee to implement good corporate governance. The presence of audit committee members in companies in Indonesia. Findings that do not support this theory indicate that an audit committee's existence is merely fulfilling regulatory requirements and avoiding existing sanctions so that it has not been effective in carrying out its functions.

Company Size

The firm size variable (UP) shows a significance value of $0.569 > \alpha = 0.05$ or H6 is rejected. Thus company size does not affect financial distress, meaning that any reduction or increase in company size will not affect the company experiencing financial distress. This study supports Christella and Osesoga (2019). But contrary to Dewi et al (2020), company size affects financial distress. The greater the company's size, the higher the company's ability to generate profits, thereby reducing the company's dependence on financing its company's operations on loans, which can reduce financial distress.

4. CONCLUSION

This study aims to obtain empirical evidence regarding the influence of corporate governance mechanisms consisting of the board of directors, the proportion of independent commissioners, managerial ownership, institutional ownership, audit committee, and company size on financial distress. The sample in this study used a purposive sampling method and obtained data from as many as 65 companies, then multiplied by four periods, namely 2016 to 2019, so that 260 data were obtained.

Based on the results of data testing and discussion of the hypotheses that have been carried out, it can be concluded that the board of directors, the audit committee the proportion of independent commissioners, and company size do not have a significant influence on financial distress conditions. Meanwhile, managerial ownership and Institutional ownership have a significant negative effect on financial distress conditions. Based on this study's findings, further research is suggested to increase the sample of companies by expanding the sample sectors and adding independent variables that have not been used and are relevant to financial distress problems.

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