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## THE IMPACT OF PROFITABILITY, LIQUIDITY, AND GOOD CORPORATE GOVERNANCE ON FINANCIAL DISTRESS WITH CAPITAL STRUCTURE AS A MODERATION VARIABLE

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### ABSTRACT

Financial distress is a situation when a company's operating cash flows are insufficient to meet its obligations and the company is required to take corrective action. The aim of this study is to know the impact of profitability, liquidity, GCG on financial distress with capital structure as a variable of moderation. The population in this study amounted to 82 companies in the property and real estate sector listed in the EIB period 2017-2021. The sampling technique used is purposive sampler and produces as many as 25 companies. The results of the research showed that profitability has a significant positive impact on financial distress, liquidity has a significant positive effect on financial disaster, GCG has a substantial negative impact on finance distress. Capital structure as a variable of moderation can't strengthen the relationship of profitability to financial distress, capital structure can weaken the relationship between liquidity to financial crisis, and capital structure cannot strengthen relationship between GCG and financial crisis.

**Keywords:** Financial Distress, Profitability, Liquidity, GCG

### INTRODUCTION

In the current era of globalization, competition is becoming more and more stringent for all companies in all fields, both from different countries and from Indonesia. With this tough competition, companies are required to adapt to technology and innovate more creatively in order to compete in the performance and existence of their companies. If the company is unable to adapt well, then it can be assured that the company's economic growth will experience a decline that will make the company in financial difficulties. Failure in a business is often characterized by financial difficulties in the company. Financial distress is a situation where the company's performance income is insufficient in meeting its obligations and the company must take corrective action (Sudana, 2015).

As the development of real estate in Indonesia is currently on the rise across Indonesia, both in cities and in rural areas, the growing development of Indonesian society requires a lot of housing, apartments, hotels and shopping centers. The property and real estate sector is one of the services companies that are listed as public companies on the Indonesian Stock Exchange (BEI). However, in the past five years, the movement of real estate and real estate companies has weakened. This can be seen from the drop in average sales revenue. The weakening of the property and real estate sector could be due to the decline in the purchasing power of the community accompanied by the increasing price of real estate, as well as due to COVID-19 that occurred in 2019-2021.

### LITERATURE REVIEW

#### Financial distress

According to Sudana (2015), financial difficulties (financial distress) is a condition in which the operating cash flow in the company is insufficient in paying debts smoothly and the company must take corrective action, this expands its relationship with insolvency. Insolvency can be interpreted as inability to pay a debt or lack of instruments in the payment of debt. This study uses the Altman Modification model.

**Profitability**

Profitability ratio according to Hanafi (2016) is a ratio used to measure a company's ability to generate profit (profitability) at a certain level of sales, assets, and equity capital. In addition, profitability is used to measure a company's ability to generate profit by using resources owned by the company such as assets, capital or sales of the company (Sudana, 2015). In this study, profitability is projected with return on asset. (ROA). According to Sudana (2015) ROA shows the ability of a company to use all of its company's assets in generating profit after taxation.

**Liquidity**

According to Mamduh Hanafi (2016) it is stated that liquidity refers to the company's ability to meet its short-term obligations. Liquidity is the ability to convert assets into cash or the ability in obtaining cash. The liquidity ratio in this study is proxied with the current ratio, according to the Sudana (2015) actual ratio is used in measuring the ability of a company to pay off debt smoothly by using the properly owned assets. The greater this ratio, the more liquid the company will be.

**Good corporate governance**

Good corporate governance is a corporate management system designed to improve the company's performance, protect the interests of stakeholders and improve compliance with legal regulations and ethical values in general (Kusmayadi, D., Rudiana, D., Badruzaman, 2015). Corporate governance is a concept proposed in order to improve the performance of the company through supervision or monitoring of management performance and ensuring management accountability to stakeholders based on a regulatory framework. The implementation of good corporate governance also makes the management of the company more focused and clear in its division of tasks, responsibilities, and supervision. In this study, GCG is proxied with Managerial Ownership (KM). According to Dirman, (2020), managerial ownership is the proportion of shares owned by the management of the company. The higher the level of management participation, the greater the responsibility of management in managing the company.

**Modal Structure**

According to Fahmi (2014), the capital structure is the composition of ordinary stocks, preferential stocks and various such classes, held profits, and long-term debt held by the enterprise in funding assets. And according to Utari, et al., (2014) capital structure is the arrangement and interrelationship between long-term debt with own capital aimed at finding profit. If it changes, it will affect the shape.

**METHODS**

This research uses quantitative methods, which is the study of numbers or numbers that are already certain so that they can be calculated and also facilitate reading, as well as facilitate the researcher to make a understanding. The location in this study was carried out in the property and real estate sector companies listed on the Indonesian Stock Exchange (BEI), using data in the form of the annual financial reports of real estate and property companies in 2017-2021 accessed through the Sharia Investment Gallery (GIS) UIN Maulana Malik Ibrahim Malang. The collection of data used in this research is with documentary techniques, which is to look for data about variables such as notes, copies, books, newspapers, magazines, writings, minutes of meetings, calendar, agenda, and so on (Sandu Siyoto and Sodik 2015). The population used in this study is the property and real estate sector companies that have been listed on the Indonesian Stock Exchange (BEI) in 2017-2021. The total number of companies is 82. A sample of 25 companies.

**The impact of profitability on financial distress**

The results showed that the ROA value showed a positive value of 0,150 seen from the regression coefficient, then t counted a value of 3,270 with a significance level of 0,001 or a value less than the expected significance value ( $0,001 < 0,05$ ). It can then be concluded

that profitability with indicators of return on assets has a significant and positive impact on the occurrence of financial distress. Based on this test, H1 is accepted.

#### Effects of Liquidity on Financial Distress

The results showed that the CR value had a positive value of 0,235 seen from the regression coefficient, then t counted as 2,050 with the significance level of 0.043 or the value is less than the expected significance value ( $0,043 < 0,05$ ). It can then be concluded that liquidity with the current ratio indicator has a significant and positive impact on the occurrence of financial distress. Based on this test, H2 was rejected.

## RESULTS

#### The impact of GCG on financial distress

The results showed that KM had a value -1,283 (negative) seen from the regression coefficient, then t counted a value of -2,153 with a significance level of 0.033 or a value less than the expected significance value ( $0,033 < 0,05$ ). It can then be concluded that good corporate governance with managerial ownership indicators has a significant and negative impact on the occurrence of financial distress. Based on this test, H3 is acceptable.

**Table 1.** Results of MRA

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2,120	,349		6,082	,000
	ROA	,129	,067	,236	1,913	,058
	CR	-,235	,164	-,171	-1,434	,154
	KM	-,878	,656	-,122	-1,338	,183
	DER	-1,418	,407	-,718	-3,488	,001
	MODERASI 1	,022	,075	,037	,299	,766
	MODERASI 2	,698	,191	,711	3,655	,000
	MODERASI 3	,162	,487	,042	,332	,740

a. Dependent Variable: *Financial distress*

Source: Processed data, 2023

#### The Effect of Profitability on Financial Distress Moderated Capital Structure

From the moderation test, it can be seen that the influence of the debt to equity ratio (DER) value of significance is  $0,001 < 0,005$ ; whereas the variable of moderation of the Debt to Equity ratio with the interaction of return on assets is not significant with the value of  $0,766 > 0,05$ . The results of the study are then included in the category of predictor moderation which means that the variable DER acts as a predictor variable in the model of relational relationships resulting. This suggests that the capital structure (DER) is more suitable for use as an independent variable (X), so H4 is rejected.

#### The Effect of Liquidity on Financial Distress Moderates Capital Structure

From the moderation test, it can be seen that the influence of the debt to equity ratio (DER) value of significance is  $0,001 < 0,005$ ; whereas the variable of moderation of the Debt to Equity ratio with the interaction of the current ratio is significant with the value of  $0,000 < 0,05$ . The results of the study are included in the category of pure moderation, which means that the DER variable that moderates the relationship between the independent variable and the dependent variable is a purely moderated variable which interacts with the independent Variable without becoming an independent. H5 is accepted

#### GCG's Effect on Financial Distress Moderates Capital Structure

From the moderation test, it can be seen that the influence of the debt to equity ratio (DER) value of significance is  $0,001 < 0,005$ ; while the variable of moderation of the Debt to Equity ratio with the interaction of managerial ownership is not significant with the value of  $0,740 > 0,05$ . The results of the study are then included in the category of predictor moderation which means that the DER variable only acts as a predicting variable in the resulting

relationship model. This suggests that the capital structure (DER) is more suitable for use as an independent variable (X), so H6 is rejected.

## DISCUSSION

Based on the results of the data analysis carried out, the result is that the profitability projected with Return On Asset (ROA) has a positive and significant impact on financial distress in the property and real estate sector companies listed in the EIB period 2017-2021. This is because the profits of companies in the property and real estate sector tend to decline but the obligations and other costs can still be met by the company using internal and external data of the company. This means that the company is still able to use its assets and equity properly. Based on the results of this research, it is supported by Hanafi & Halim (2016) theory that low profitability (ROA) indicates that the company is at an unstable performance where the company cannot optimize its assets in generating profits and vice versa. The higher the profitability rate, the less likely the financial distress is (Kazemian et al. 2017).

Based on the results of the data analysis carried out, the result is that liquidity with the current ratio indicator (CR) has a positive and significant impact on financial distress in the property and real estate sector companies listed in the EIB period 2017-2021. This can be interpreted when the liquidity of the property and real estate sector companies is increased, then will be followed by an increase in the value of Altman Z-Score and financial distress can have a smaller impact. The decrease in the value of the current ratio can be caused by external factors such as the weakening of economic conditions due to the presence of covid in 2020 that has an impact on the economy in Indonesia. With the presence of the Covid 19 pandemic caused a decrease in the purchasing power of the community so that there was an accumulation of supplies and also cash. The weak purchasing power of the population is due to high inflation, which is above 3%. And with the presence of this phenomenon, a lot of debt is not deducted and on the smooth part of the debt has experienced a decrease especially in the purchase money. As a result, the risk of financial difficulties cannot be avoided, so the company must increase the liquidity of the company. The results of this study rejected the second hypothesis that liquidity had a significant negative impact on financial distress. The results of this study are in line with the research conducted by Reschiwati et al., (2021) and Oktasari (2020), which stated that increasing the value of liquidity with the current ratio indicator will be followed by an increase in the occurrence of financial distress and vice versa when the liquidity value decreases then the financial stress will also decrease.

Based on the results of the analysis of the data carried out, the results were obtained that good corporate governance provoked by managerial ownership (KM) had a negative and significant impact on financial distress in the property and real estate sector companies listed in the BEI period 2017-2021. It points out that ownership is able to reduce agency conflict and managerial ownership has proven to be one of the alternatives in avoiding financial distress. With increased management ownership, the manager will be motivated to improve its performance, so that this will have a good impact on the company and can meet the wishes of shareholders. However, too high level of management ownership also has a negative impact on the company (Fina Rifiana, Aziz Fathoni 2018). Based on the results of this research, in accordance with the agency theory, agents have the authority and responsibility to maximize profits by optimizing the use of the company's resources. Jensen and Meckling (1976) stated that managers have a tendency to gain additional profits from company resources used for their own consumption (Khafid, Tusyanah, and Suryanto 2019). This study is in line with the Pramudena (2017) study that stated that managerial ownership has a negative impact on financial distress. Based on the results of the moderation test variables with the debt to equity ratio indicator has not been able to strengthen the impact of profitability on financial distress on real estate and real estate companies. The inability of capital structures to strengthen the relationship of profitability to financial distress is due to the effective management of internal funds so that the company's guarantees can be met well. The net margin value (EBIT) used in the calculation

of the “high Altman Z-Score” will increase the value of the Altman Score” so that the potential for financial distress is also low. This is in line with research conducted by Fahlevi (2018) and Oktasari (2020) that says that capital structures have no impact on financial distress.

Based on the results of the moderation test, the results were obtained that the capital structure projected with the debt to equity ratio was able to weaken the liquidity relationship to financial distress in the property and real estate sector companies listed in the Indonesian Stock Exchange period 2017-2021. This means that the value of the capital structure (DER) can increase the funding of the company where it will reduce the likelihood of financial distress. Companies that are able to pay their short-term debt accurately at the time of due, have sufficient internal funds in the company’s financing. The company will tend to use both internal and external funds when the internal funds are assessed to be sufficient to pay off its short-term obligations so that the potential for financial distress is also small. This is in line with a study conducted by Ikpesu & Eboiyehi (2018) that stated that capital structures influence financial distress.

The results of the moderation test showed that the capital structure projected with the debt to equity ratio was not able to strengthen the relationship of good corporate governance with the managerial ownership indicator against financial distress in the property and real estate sector companies listed on the Indonesian Stock Exchange period 2017-2021. The underlying reason for the results of this research is that the real estate company is an open company whose decision-making is through RUPS. Within RUPS, majority shareholders (blockholders) still hold an important role in the company (Masnoon dan Rauf, 2013). While based on its average value (mean), managerial ownership in property and real estate companies was only 14.5%, which means that it does not include majority shareholders. This leads management ownership to have no role in decision-making related to the company’s debt policy. (DER). Thus it is possible that DER is not able to be a moderation in the management ownership relationship against the occurrence of financial distress. The results of this study are in line with the research conducted by Taufiq & Paulus (2017), Nanda & Retnani (2017) and Hayat et al., (2018).

## **CONCLUSION**

Profitability with ROA indicators has a positive and significant impact on financial distress. This shows the conditions the company is able to use the assets effectively so as to get the maximum profit. In addition, the company’s managerial performance can be said to be good when the value of profitability generated by the company is increasing. Liquidity with the CR indicator has a positive and significant impact on financial distress with the Altman Z-Score indicator. This shows that the larger the value of liabilities means the greater the likelihood of the company in paying its obligations smoothly, and there is a reserve fund of profits that can be used to mitigate any financial distress. GCG with the management ownership indicator has a negative and significant impact on financial distress with the Altman Z-Score indicator. It points out that ownership is able to reduce agency conflict and managerial ownership has proven to be one of the alternatives in avoiding financial distress. Capital structures with the debt to equity ratio (DER) indicator as a moderation variable cannot strengthen the impact of profitability with the return on assets indicator on financial distress. This is due to the effective management of internal funds so that the security that the company has can be met well. The net margin value (EBIT) used in the calculation of the “high Altman Z-Score” will increase the value of the Altman Score” so that the potential for financial distress is also low. Capital structures with the debt to equity ratio (DER) indicator as a moderation variable can weaken the impact of liquidity with the current ratio indicator on financial distress. This means that the value of the capital structure can increase the funding of the company, which will reduce the likelihood of financial distress. Companies that are able to pay their short-term debt accurately at the time of due, have sufficient internal funds in the company’s financing. The company will tend to use both internal and external funds when the internal funds are assessed to be sufficient to pay off its short-term obligations so that the potential for financial distress is also small. Capital

structures with the debt to equity ratio (DER) indicator as a moderation variable cannot strengthen the influence of good corporate governance with the managerial ownership indicator on financial distress because it is possible that the value of management ownership is too small to participate in debt-related decision-making, so that the capital structure can not be able to reinforce the relationship of good Corporate Governance to financial distresses.

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