KnE Social Sciences

IRCEB
International Research Conference on Economics and Business
Volume 2021

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Conference Paper

The Influence of Corporate Governance Structures on Financial Distress: A Study of Coal Mining Companies

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Abstract

The purpose of this research was to analyze the effect of corporate governance mechanisms on financial distress, through the measurement of board of directors, board of commissioners, independent ownership structures and managerial ownership structures. The sample consisted of coal mining companies listed on the Indonesian Stock Exchange from 2013 to 2017 and a purposive sampling method was used. Data were analyzed using descriptive analysis and multiple linear regression. The results confirmed that the size of the board of commissioners and institutional ownership had no effect on conditions of financial distress. This was possible because the board of commissioners functions as supervisor in the company, but sometimes it did not carry out its role to its full potential. Meanwhile, institutional ownership was expected to encourage more optimal supervision of management performance so that agency costs could be minimized, but this could not be proven. The size of the board of directors had a significantly positive effect on finances distress. The size of the board of directors could indicate collusion in the company and thus the possibility of experiencing financial distress was greater. Managerial ownership had a significantly negative effect on conditions of financial distress. With an increase in ownership by managers, managers could immediately feel the benefits and losses of the decisions taken.

Keywords: board size, the company's health condition, corporate governance, financial distress, the Altman Z-Score, the number of boards.

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Published: 14 July 2021

Publishing services provided by Knowledge E

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Selection and Peer-review under the responsibility of the IRCEB Conference Committee.

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1. Introduction

Coal production in 2019 was predicted to be lower than in 2018. This is possible due to a number of challenges faced by the coal industry, ranging from fluctuations in price to the obligation to supply domestic needs or Domestic Market Obligation (DMO) which is still a problem for some companies. According to the above issues, the level of competition is getting tighter as well. Companies are always competing to survive in similar industries. Every company with the same industry is required

How to cite this article: Yuli Agustina and Choisi Elgamalia Anwar, (2021), "The Influence of Corporate Governance Structures on Financial Distress: A Study of Coal Mining Companies" in *International Research Conference on Economics and Business*, KnE Social Sciences, pages 313–321. DOI 10.18502/kss.v5i8.9383

to continue to improve the effectiveness and efficiency of company management by evaluating company strategy and policies. The evaluation in this context is to assess the performance and health of the company in winning the competition, economic growth, increase profits, return on investment, cost efficiency, and create corporate economic value.

This study develops from previous research, namely from Deviacita & Achmad (2013) due to a research gap in the results of research regarding share ownership by the board of directors and share ownership by institutions. Therefore, the researchers are interested in re-examining the issues by including the size of the board of directors and the size of the board of commissioners. Thus, this study aims to determine the effect of board size, board of commissioners size, managerial ownership, institutional ownership on financial distress.

According to Bodroastuti (2009) the number of boards of directors and number of boards of commissioners have a significant positive effect on financial distress. This situation means that the number of boards of directors and the number of boards of commissioners that is large actually increases the possibility of the company being in a financial distress; this is possible because with a larger number of boards of directors and boards of commissioners it becomes ineffective in carrying out its monitoring function thus the performance of the directors is actually ineffective and decreases the performance which results in an increase in the possibility of the company experiencing financial distress. Good and poor company values will be related to how the corporate governance system (Good Corporate Governance). According to Sutedi (2011), corporate governance is a process and structure used by companies (shareholders/capital owners, commissioners/supervisors and directors) to increase business success and company accountability to create long-term shareholder value. keep paying attention to stakeholders other, which is based on laws and regulations and ethical values.

Good corporate governance can be seen from the independent board of commissioners and managerial ownership. The independent board of commissioners is a member of the board of commissioners who is not affiliated with management and controlling shareholder. The existence of an independent board of commissioners can increase the effectiveness of supervision and improve the quality of financial reporting (Dechow et al., 1996). Independent commissioners can be measured by dividing the number of independent commissioners divided by the number of commissioners. Meanwhile, managerial ownership in company is a party which acts as manager and shareholder. The existence of managerial ownership can cause agency problems that occur between the manager (agent) and the principal. This is because there are differences in interests

between managers and company owners. Therefore, it is necessary to have a control mechanism that can align the differences in interests between managers and company owners in order to increase firm value.

2. Method

The method used in this research was a quantitative research design in the form of associative, which aimed at knowing the relationship between two or more variables. The independent variables in this study were the independent board of commissioners (X1), the board of directors (X2), institutional ownership (X3) and managerial ownership (X4). The population in this study were 22 mining companies in the coal mining sub-sector. The sampling used purposive sampling technique with certain criteria. Based on predetermined criteria, there were 16 companies that were used as research samples.

Table 1: Sampling Criteria

No	Criteria	Number
1	Coal mining sub-sector mining companies listed on the Indonesia Stock Exchange (IDX) during 2013 - 2017	22
2	Coal mining sub-sector mining companies that consistently report financial reports on the Indonesia Stock Exchange (IDX) during years 2013 - 2017	16
	Number of companies served as the object of research	16

There were two types of variables in this study, namely independent or free variables (which affect) and dependent variables (which are affected). The independent variable used in this study was Good Corporate Governance, while the dependent variable was Financial Distress. The research design is be described as follows.

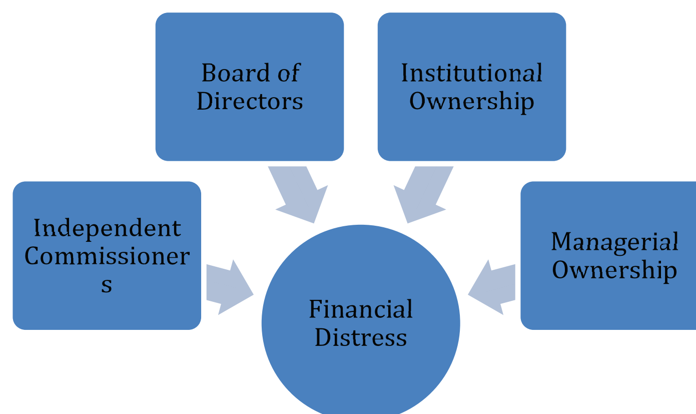

Figure 1: Research Design

While the multiple linear regression analysis method used is as follows:

$$Y = \alpha + b1X1 + b2X2 + b3X3 + b4X4 + \epsilon$$

3. Results & Discussion

3.1. Results

Based on the research that has been carried out, the following research results are obtained:

TABLE 2: Multiple Regression Test Results

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-, 481	1,554		-,	310,758
	Independent Board of Comissioners	-,	025,018	-, 152		- 1.412,162,
	Board of Directors		615,161,	541	3,814,	000
	Institutional Ownership,		019,010,	228	1,890,	063
	Managerial Ownership	-, 056	, 012	-,	554-4,726	, 000

Source: Data processed by the researchers

The average independent board of commissioners during 2013-2017 was 43% means that out of 100% of the board of commissioners, as much as 43% were independent commissioners. This percentage is in accordance with regulations from the Financial Services Authority Number 57 of 2017, which requires companies to have an independent board of commissioners of at least 30% of the board of commissioners. Based on the data obtained, it can be seen if the sample of coal mining companies listed on the IDX is classified as good. This is because the number of independent commissioners has exceeded the minimum requirement of 30%. Based on the results of the Independent Commissioner's statistical test, the Sig. t = 0.162> 0.05. Thus, the hypothesis which states that Independent Commissioners have an effect on Financial Distress was rejected. While the beta coefficient value was -0.025, but because it was not significant, the changes in the Independent Commissioner did not affect the company's financial distress.

The average board of directors during 2013-2017 was only 26%. Based on the data obtained, it can be seen that the sample of coal mining companies listed on the IDX is classified as poor. Jensen & Meckling (1976) states that from the average size of the board of directors for companies that remain healthy, it is indeed larger than the size of the board of directors of companies experiencing financial distress. This means

that monitoring company performance for companies that remain healthy is better than companies that are experienced financially distress. Based on the statistical test results of the Board of Directors, it obtained Sig. t = 0.000 <0.05. Thus, the hypothesis which states that the Board of Directors has an effect on Financial Distress is accepted. While the beta coefficient value was 0.615 and the value was positive, which means that the Board of Directors has a positive effect on Financial Distress. This means that if the Board of Directors increases by 1%, then Financial Distress also increase by 0.615%. This also applies when the Board of Directors decreases, the Financial Distress also decrease.

From the research sample, it can be seen that the proportion of institutional ownership is moderately high. The average institutional ownership during 2013-2017 wass 62%. The greater the institutional ownership, the more efficient the utilization of company assets, thus the potential for financial difficulties can be minimized since the companies with larger institutional ownership (more than 50%) are indicated able to carry monitor the management process. Based on the results of the statistical test of institutional ownership, it obtained the Sig. t = 0.063> 0.05. Thus, the hypothesis which states that Institutional Ownership has an effect on Financial Distress was rejected. While the beta coefficient value was 0.019, but because it was not significant, the changes in Institutional Ownership did not affect the company's financial distress.

Of the 16 research samples, there are several companies that do not have a share proportion by their managerial ranks. In the mining sector companies, which were a sample of 16 companies, only six companies provided incentive policies in the form of managerial ownership with a percentage ranging from 3% to 58%. Supposedly with managerial ownership, managers tend to act in the interests of shareholders and protect the company from the possibility of financial distress. Increasing managerial ownership is able to decrease the potential for financial distress. Based on the results of the managerial ownership statistical test, the Sig value was obtained. t = 0.000 <0.05. Thus, the hypothesis which states that Managerial Ownership has an effect on Financial Distress was accepted. While the beta coefficient value was -0.056 and the value was negative, which means Managerial Ownership has a negative effect on Financial Distress. This means that if Managerial Ownership has increased by 1%, then Financial Distress decrease by 0.056%. This also applies when the Board of Directors decreases, the Financial Distress increase.

3.2. Discussion

From Calculation Analysis Altman Z-Score, this research shows that in 2013 to 2017, 16 samples of Coal Mining companies taken, the average results showed that as much as 44% of coal mining companies were in unhealthy condition, as much as 31% in healthy condition, and as much as 25% in prone condition. Companies that are included in 44% (unhealthy condition) consist of seven companies from a total sample of 16 companies. The existence of a board of commissioners has no effect on financial distress, because the companies only make an independent board of commissioners a formality that must be fulfilled as a securities company. This causes the independent board of commissioners to be unable to carry out its supervisory function and provide advice to the board of directors. According to Darwis (2009) there is a possibility that the placement or addition of members of the independent board of commissioners is only to meet regulatory requirements. Research conducted by Darwis (2009) supports the results of this study which states that independent board of commissioners has no effect on firm value. This is because the role of the independent board of commissioners has not yet been felt even though there are regulations governing it. However, the results of this study are not in line with research conducted by Abbasi et al (2012), Dewi & Nugrahanti (2014) and Siallagan & Machfoedz (2006) which state that independent boards of commissioners have an effect on firm value.

The Board of Directors has a positive effect on Financial Distress. The large number of boards can affect the financial condition because every decision that the company carries out comes from the decision of the board. The number of boards of directors in the company can indicate collusion in the company. This shows that its a having a large number of directors, the possibility of experiencing financial distress is greater. These findings are inconsistent with the results of research by Wardhani (2007) which states that with the presence of directors who leave, the company will lose the directors' expertise and networking that the directors have, so that the company's performance will actually decrease and the company may be in condition. The insignificance of the number of directors leaving for financial distress is due to the fact that the health condition of a company is not caused by the number of directors leaving, but rather due to other aspects, such as professionalism, adequate experience, and the ability to exercise the power of the directors in managing company, as stated by Tjager (2003).

Institutional ownership has an effect on Financial Distress rejected. Research from Widyasaputri (2012) also explains that there is no influence of Institutional Ownership onConditions Financial Distress. It shows that no matter how big the percentage of

institutional ownership can prove the possibility of conditions financial distress. The greater the institutional ownership then the financial condition of the company is getting worse, because the company institutions lack the ability to control the performance of managers. The results of this study are inconsistent with the results of research by Crutchley et al (1999) and Nur DP (2007) and the theories put forward. As is well known, the higher the institutional ownership, the stronger the internal control over the company is expected thus it will reduce agency costs. The existence of this control make managers employ debt at a low level to anticipate the possibility of financial distress and company bankruptcy (Crutchley et al., 1999). Thus, institutional ownership, which is expected to encourage an increase in more optimal supervision of management performance accordingly agency costs can be minimized, cannot be proven in this study.

Managerial ownership in the company is expected to make managers make decisions more carefully because they will also bear the risks if the company experiences a setback or a loss. Therefore, in relation to company performance, the higher the managerial ownership increase the management's efforts to bring the company to a better direction that is more profitable for the owner where the management includes the owner of the company concerned. Managerial ownership has an effect on Financial Distress accepted. The results of this study support agency theory which states that managerial ownership is able to reduce agency problems that arise in a company which if they occur continuously can cause financial distress to the company (Hanifah & Purwanto, 2013). The results of this study support research conducted by Deviacita & Achmad (2013) which states that the level of managerial ownership can prevent companies from experiencing financial difficulties.

4. Conclusion

The number of companies that are in an unhealthy condition has the largest number due to low sales and high operational costs. The size of the Board of Commissioners has no effect on Conditions Financial Distress. This is possible because the board of commissioners functions as supervisor in the company, but sometimes it has not carried out its role to its full potential. The size of the board of directors has a significant positive effect on finances distress. The number of boards of directors in the company indicate collusion in the company thus the possibility of experiencing financial distress is greater. Institutional ownership does not have a significant effect on financial distress. Institutional ownership, which is expected to encourage an increase in more optimal

supervision of management performance thus agency costs can be minimized, cannot be proven. Managerial Ownership has a negative and significant effect on Conditions Financial Distress. With the increase in ownership by managers, managers immediately consider the benefits of the decisions taken and also if there are losses that arise as a consequence in making wrong decisions. For further research, it is expected that it can add proxies of Good Corporate Governance to be more complex. In addition, the future studies should employ several other measures to determine financial distress such as Earning Per Share (EPS) or calculating Interest Coverage Ratio (ICR).

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