



## **The Influence of Good Corporate Governance on Financial Distress with Capital Structure as a Moderating Variable**

**Ahmad Ridho Hafidz<sup>1</sup>, Yona Octiani Lestari<sup>2</sup>**

<sup>1,2</sup>Universitas Islam Negeri Maulana Malik Ibrahim Malang/Jl. Gajayana No.50, Dinoyo, Kec. Lowokwaru, Kota Malang/Indonesia

Email: 200502110054@student.uin-malang.ac.id<sup>1</sup>, yonaoctiani@yahoo.com<sup>2</sup>

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**Abstract.** *This study aims to determine the effect of Good Corporate Governance on Financial Distress with Capital Structure as a moderating variable. The population in this study were all Islamic Commercial Banks registered with the Financial Services Authority (OJK) in the 2014-2022 period and the sample was determined using Purposive Sampling Technique. The data analysis technique used is Multiple Linear Regression and Moderation Regression. The results of the study indicate that partially only the Size of the Sharia Supervisory Board and the Composition of Independent Commissioners have a significant negative effect on Financial Distress, while in contrast to Company Size which shows a significant positive effect on Financial Distress. However, Capital Structure is not able to moderate the relationship between Good Corporate Governance and Financial Distress.*

**Abstrak.** Penelitian ini bertujuan untuk mengetahui pengaruh *Good Corporate Governance* terhadap *Financial Distress* dengan Struktur Modal sebagai variabel moderasi. Populasi dalam penelitian ini adalah seluruh Bank Umum Syariah yang terdaftar di Otoritas Jasa Keuangan (OJK) pada periode 2014-2022 dan sampel yang ditentukan dengan menggunakan Teknik *Purposive Sampling*. Teknik analisis data yang digunakan adalah Regresi Linear Berganda dan Regresi Moderasi. Hasil dari penelitian menunjukkan bahwa secara parsial hanya Ukuran Dewan Pengawas Syariah dan Komposisi Komisaris Independen berpengaruh negatif signifikan terhadap *Financial Distress*, sedangkan berbeda dengan Ukuran Perusahaan yang menunjukkan pengaruh positif signifikan terhadap *Financial Distress*. Namun, Struktur Modal tidak mampu memoderasi hubungan antara *Good Corporate Governance* dengan *Financial Distress*.

#### **Keywords:**

*Capital Structure;*  
*Financial*  
*Distress;*

#### **Corresponden author:**

Email: 200502110054@student.uin-malang.ac.id

## **Introduction**

Financial distress refers to a condition in which a company is experiencing financial difficulties or is at a point of imminent bankruptcy (Sa'diah & Utomo, 2021). Companies that are in a financial distress situation tend to force investors to withdraw funds from the company to avoid the risk of loss, which further aggravates the financial condition of a company. Thus, it requires quick and precise decisions from internal parties such as the board of directors and independent commissioners to immediately overcome the company's financial condition and restore investor confidence so as not to massively withdraw their funds.

Dirman (2020) and Maryam & Yuyetta (2019) explain that the existence of good corporate governance in a company can facilitate the company to plan goals and perform a supervisory function over the management. Thus, it can help the board of directors in their duties to plan the company's strategies and policies in order to minimize losses in the company's activities. In addition, the implementation of good corporate governance can also help to improve the supervisory function of the Sharia supervisory board, independent board of commissioners, and institutional ownership, so that the supervisory function of Islamic commercial banks can be carried out more effectively, and decisions made by management are not based on personal interests that can harm the company.

The board of directors has a role in the company to determine the direction of the company's policy and resource strategy in both the long and short term (Bukhori and Rahardja, 2012). The larger the number of board members in a company, the more the supervisory function in the company can be increased by placing each board member in specific areas of the company. This is important for the board of directors to do as a practice to prevent management actions that can harm the interests of shareholders. These actions can also affect decision making, risk management monitoring, internal control and communication in the company, so it can be one of the factors that can minimize the potential of financial distress in a company, especially Islamic commercial banks. This is in line with the research conducted by Ibrahim (2019), Maryam & Yuyetta (2019), Sa'diah & Utomo (2021) and Yuliani & Rahmatiasari (2021), who stated in their research that the board of directors has an impact on financial distress.

Companies with Shari'ah-based operational activities, such as Islamic commercial banks, must have a Shari'ah supervisory board that is responsible for supervising and advising on the company's operational activities related to Shari'ah principles. According to Indriyani & Asytuti (2019), the number of members of the supervisory board must be taken into consideration in order for the supervisory function of the company to be carried out well and effectively. The quality of the implementation of the duties by the Sharia supervisory board must also be considered by the company, because if the supervision is not optimal, the company's reputation may decrease, considering that Islamic commercial banks must necessarily maintain compliance with Sharia principles, which is the basis of shareholders' trust. Therefore, ensuring the implementation of the duties of the Sharia supervisory board and the number of Sharia supervisors in a Sharia-based company is very necessary to maintain the integrity and reputation of the company (Anggreni et al., 2022).

According to the agency theory formulated by Jensen & Meckling (1976), it explains that in a company there is a relationship between one or more principals who hire agents to perform various tasks. In this case, the principal delegates

authority to the agent, including decision making. Jensen and Meckling argue that conflicts of interest often arise between the principal and the agent because the authority given by the principal may provide an opportunity for the agent to act in his own interest to the detriment of the principal. To overcome this conflict of interest, a clear contract between the principal and the agent is needed, a contract that regulates the rights and obligations of each party, as well as to monitor and control the behavior of the agent.

The presence of independent directors in a company is designed to minimize the potential for conflicts of interest between principals and agents by mediating between the two, thereby reducing agency costs. Independent agents can help reduce conflicts of interest by communicating the concerns of shareholders to management and vice versa, ensuring that communication between the two parties remains good. In addition, according to Damanik & Purnamasari (2022), independent directors also play a role in preventing management from taking actions that harm the firm. Thus, the presence of independent commissioners in a company can ensure that good corporate governance practices continue to run well and reduce the potential for financial distress, which is consistent with the research conducted by Affiah & Muslih (2018), Maryam & Yuyetta (2019), Saputri & Sari (2023) and Yuliani & Rahmatiasari (2021) that the composition of independent commissioners can affect financial distress.

Share ownership by large institutions such as government institutions, corporations, foreign financial institutions, and pension funds, or what can be referred to as institutional ownership (Nanda et al., 2021), can have a significant impact on the monitoring function and management performance to reduce the chances of financial distress. Firms with high institutional ownership tend to be more vigilant in all decision making and strategy formulation. This may be because the company has responsibilities related to the shares held by these large institutions. This is in line with the research conducted by Ibrahim (2019) Mulansari & Setiyorini (2019) Nasiroh & Priyadi (2018), who concluded that institutional ownership has an impact on financial distress.

The size of large companies is considered an advantage because they have more resources than smaller companies (Sukandar, 2014). Thus, it can increase shareholders' trust in the company, where public trust plays an important role for the banking industry, especially Islamic commercial banks that operate in the middle of the Indonesian society where the majority adhere to Islam (Hangarabhima, 2023). With high trust in the company, it is hoped that shareholders will not take actions that can harm the company, such as selling their shares massively. This must be considered because it can help the company maintain its financial position and prevent financial distress. This is in line with what was found by Arrum & Wahyono (2021) and Rahman et al. (2022) who explained in their research that the size of the company can affect financial distress.

Putri & Hwihanus (2023) in their research explain that financial distress can occur due to two factors, one of which is internal factors which explain that the onset of financial distress in a company is related to management decisions in managing cash flow for financing activities, losses in operating activities that occurred in a row in the previous few years, and large amounts of debt so that it can have an impact on the company's financial condition which can increase the obligations that must be paid by the company in the future. So this must be considered by the internal company in managing the optimal capital structure so that the company can avoid the phenomenon of financial distress in the future. This is in line with the research conducted by Amanda & Muslih (2020) and Putri & Hwihanus (2023) which explains that capital structure can affect financial distress.

This study was conducted to re-examine the factors that can increase the potential for financial distress in Islamic commercial banks registered with the Financial Services Authority (OJK) by adding several variables such as financial distress using the Springate S-Score analysis model as the dependent variable and the Sharia supervisory board as an independent variable and capital structure as a moderating variable in it. This is done based on the position of the bank itself which plays an important role in the economy of a country, especially Indonesia itself which has a majority Muslim population which makes Islamic commercial banks registered with the Financial Services Authority have a high relevance to the economic conditions in Indonesia.

## Research Methods

This research focuses on Islamic commercial banks registered with the Financial Services Authority (OJK) during the period 2014-2022. Sampling is done using purposive sampling technique with two main criteria, namely, 1) Islamic commercial banks must be registered with the Financial Services Authority consecutively during the 2014-2022 period. 2) Islamic commercial banks must have published financial reports with complete information during 2014-2022. The data used in this study are secondary data obtained from the official website of each selected Islamic commercial bank.

Table 1. Operational Definition of Variables

<b>Variable</b>	<b>Measurement</b>
Board of Directors Size (X1)	Board of Directors Size = $\sum$ Board of Directors
Sharia Supervisory Board size (X2)	Sharia Supervisory Board size = $\sum$ Board of Sharia Supervisory
Composition of Independent Commissioners (X3)	Composition of Independent Commissioners = $\frac{\text{Commissioners Independent}}{\text{Board of Commissioners}}$
Institutional Ownership (X4)	Institutional Ownership = $\frac{\text{Shares Owned by Institutions}}{\text{Number of Shares Outstanding}}$
Company Size (X5)	Company Size = $\ln$ Total Assets
Springate (S-Score) (Y)	Springate (S-Score) = $1,03X_1 + 3,07X_2 + 0,66X_3 + 0,4X_4$
Capital Structure (Z)	Debt to Asset Ratio (DAR) = $\frac{\text{Total Debt}}{\text{Total Assets}}$

This study uses multiple linear regression analysis and moderation regression analysis techniques to examine the effect of good corporate governance on financial distress and the effect of capital structure as a moderating variable on the relationship between good corporate governance and financial distress.

## Results and Discussion

### Multiple Linear Regression Analysis

Table 2 Multiple Linear Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-5,661	2,541		-2,228	0,030
X1	-0,064	0,067	-0,147	-0,961	0,340
X2	-0,669	0,186	-0,656	-3,590	0,001
X3	-1,274	0,303	-0,734	-4,210	0,000
X4	0,393	0,372	0,154	1,057	0,295
X5	0,279	0,095	0,614	2,944	0,005

Source: Processed data, 2024

Based on the results of multiple linear regression analysis in Table 2, it shows that the t-count value of the board size variable (X1) is equal to -0.961 and a t-table value of 2.002 with a Sig. value of 0.340, so it can be concluded that the board of directors has no significant effect on financial distress. Thus, H1 which states that the size of the board of directors has a significant negative effect on financial distress is rejected. The variable size of Sharia board (X2) based on Table 2 has a t-count value of -3.590 and t-table of 2.002 with Sig. value of 0.001, so it can be concluded that the size of the Sharia supervisory board has a significant negative effect on financial distress. Therefore, H2 which states that the size of the Sharia board has a significant negative effect on financial distress is accepted. The independent commissioner composition variable (X3) shows that the t-count value is -4.210 and the t-table is 2.002 with a Sig. 0.000, so it can be concluded that the composition of independent commissioners has a significant negative effect on financial distress. Therefore, H3, which states that the composition of independent commissioners has a significant negative effect on financial distress, is accepted. The institutional ownership variable (X4) based on Table 2 has a t-count value of 1.057 and a t-table of 2.002 with Sig. 0.295, so it can be concluded that institutional ownership has no significant effect on financial distress. Therefore, H4 which states that institutional ownership has a significant negative effect on financial distress is rejected. The company size variable (X5) shows that in Table 2, it has a t-count value of 2.944 and a t-table of 2.002 with a Sig. 0.005, so it can be concluded that company size has a significant positive effect on financial distress. Therefore, H5 which states that firm size has a significant negative effect on financial distress is rejected.

### Moderated Regression Analysis

Table 3 Moderated Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	7,685	8,390		0,916	0,364
X1	0,031	0,196	0,071	0,159	0,875
X2	0,700	1,054	0,686	0,664	0,510
X3	0,762	1,317	0,439	0,579	0,565
X4	-11,383	3,347	-4,471	-3,401	0,001

X5	0,074	0,306	0,164	0,243	0,809
Z	-74,114	50,916	-11,195	-1,456	0,152
X1Z	-0,650	1,095	-0,433	-0,593	0,555
X2Z	-8,560	6,389	-2,874	-1,340	0,186
X3Z	-12,362	8,021	-1,847	-1,541	0,129
X4Z	65,454	18,581	10,417	3,523	0,001
X5Z	1,235	1,906	5,619	0,648	0,520

Source: Processed data, 2024

Based on the results of moderation regression analysis in Table 3, it can be seen that the variable Sig. (X1) of 0.875, Sig. (X2) of 0.510, Sig. (X3) of 0.565, Sig. (X4) of 0.001 and Sig. (X5) of 0.809. The moderating effect of X1 and Z shows a value of 0.555, the value of interaction moderating variable between X2 and Z is 0.186, the value of interaction moderating variable between X3 and Z is 0.129, the value of interaction moderating variable between X4 and Z is 0.001, and the value of interaction moderating variable between X5 and Z is 0.520. In this case, it can be concluded that capital structure is not able to moderate the relationship between overall good corporate governance and financial distress, but the results of the analysis also show that capital structure can moderate the relationship between institutional ownership and financial distress.

### Discussion

Hypothesis one predicts that the size of the board of directors negatively affects financial distress. However, the results of the multiple linear regression analysis indicate that the size of the board of directors does not significantly affect financial distress. According to agency theory, companies often experience conflicts of interest between agents and principals caused by information asymmetry between the two parties. This differs from the results of the multiple linear regression analysis, which show that the size of the board of directors does not influence financial distress. This can occur because the board of directors is highly dependent on the decisions of the General Meeting of Shareholders (GMS). Even though the board of directors has comprehensive knowledge of the company's condition, they still have to make decisions based on the outcomes of the GMS, which involves shareholders. Therefore, regardless of the number of directors in a company, it will not affect the company's ability to overcome financial distress (Arrum & Wahyono, 2021).

Law Number 40 Article 92 Paragraph 4 of 2007 stipulates that in the general meeting of shareholders, the management duties and authorities among members of the board of directors are divided between at least two or more members. This leads to problems for the board of directors, such as reduced communication and coordination abilities to control management and manage the company due to the large number of directors, resulting in divided management authority. Thus, the size of the board of directors in a company, particularly in Islamic commercial banks, cannot influence the potential occurrence of financial distress in a company. However, these research results contradict the findings of Ibrahim (2019), Maryam & Yuyetta (2019), Sa'diah & Utomo (2021), which state that the board of directors significantly influences financial distress.

Hypothesis two states that the size of the Sharia supervisory board has a significant negative effect on financial distress. Based on the results of the multiple linear regression analysis in Table 2, which shows that the size of the Sharia supervisory board has a significant negative effect on financial distress, H2 is

accepted. Thus, the number of directors plays a role in reducing the risk of financial distress in Islamic commercial banks. The larger the number of members of the Sharia supervisory board, the more meticulous and effective the supervision of the operational activities of Islamic commercial banks. With a greater number of members, the Sharia supervisory board can identify and manage risks more efficiently due to their diverse knowledge, experience, and expertise.

A larger Sharia supervisory board in an Islamic commercial bank also tightens supervision of the bank's compliance with Sharia-based operational activities, assisting management in avoiding practices that increase high financial risk, such as excessive speculation or the use of financial instruments that do not comply with Sharia principles. Thus, adherence to Sharia principles can help minimize the risk of financial distress that can arise from practices that do not align with Sharia principles.

Hypothesis three states that the composition of independent commissioners has a significant negative effect on financial distress. Based on the results of the multiple linear regression analysis in Table 2, which shows that the composition of independent commissioners has a significant negative effect on financial distress, H3 is accepted. It can be concluded that the presence of independent commissioners on the board of commissioners can reduce the potential for financial distress. This aligns with agency theory proposed by Jensen and Meckling, which explains that conflicts of interest often arise between agents and principals in a company due to information asymmetry between the two parties, necessitating mechanisms to monitor and control the behavior of agents. The presence of independent commissioners in Islamic commercial banks acts as a supervisor of the actions of the board of directors and the board of commissioners to ensure the implementation of good corporate governance and serves as an intermediary between shareholders and the board of directors and commissioners, thereby reducing the potential for financial distress. However, these research findings contradict the findings of Ibrahim (2019), Kurniasanti & Musdholifah (2018) and Mulansari & Setiyorini (2019), which state that the composition of independent commissioners does not significantly affect financial distress.

Hypothesis four predicts that institutional ownership negatively affects financial distress. However, the results of the multiple linear regression analysis indicate that institutional ownership does not significantly affect financial distress. This implies that institutional ownership does not have sufficient strength to supervise and control management, thus allowing management the opportunity to benefit themselves over the interests of the Islamic commercial bank. This situation can lead to conflicts of interest due to differing interests between management and shareholders. These research findings contradict the findings of Ibrahim (2019), Mulansari & Setiyorini (2019) and Yuliani & Rahmatiasari (2021), which state that institutional ownership affects financial distress.

Hypothesis five predicts that company size negatively affects financial distress. However, the results of the multiple linear regression analysis indicate that company size has a significantly positive effect on financial distress, meaning that as the company size increases, the risk of financial distress in Islamic commercial banks also increases. This can occur because as the company size increases, its operational and financial activities become more complex, thereby increasing the potential for financial distress. Companies that start growing larger tend to expand their operations, thus being forced to take on greater risks. Additionally, Islamic commercial banks tend to have more complex financial structures, with more debt obligations and other financial commitments, thereby increasing the risk of financial distress. However, these research findings contradict the findings of Kurniasanti &

Musdholifah (2018) and Santoso et al. (2018), which state that company size does not have a significant effect on financial distress.

Hypothesis six predicts that capital structure can moderate the relationship between good corporate governance and financial distress. However, the results of the moderation regression analysis indicate that capital structure cannot moderate the relationship between good corporate governance and financial distress. Although in agency theory, the board of directors and the board of commissioners are tasked with setting policy directions and resource strategies for the company, a good capital structure does not always reduce the risk of financial distress. Similarly, the presence of independent commissioners and institutional ownership, even though they play supervisory roles in the company, does not always effectively reduce the risk of financial distress. Effective risk management alone is not sufficient to have a significant impact; effective fund management strategies are also required. Companies need strategies for proper internal fund allocation to avoid the risk of financial distress. However, these research findings contradict the findings of Amanda & Muslih (2020) and Putri & Hwihanus (2023).

## **Conclusion and Recommendations**

This study aims to examine the effect of good corporate governance on financial distress with capital structure as a moderating variable in Islamic commercial banks listed with the Financial Services Authority from 2014 to 2022. The following conclusions are based on the results of the regression analysis. The variable size of the board of directors does not significantly affect financial distress because the board of directors requires shareholder approval at the general meeting of shareholders to make decisions. Additionally, a larger board of directors can affect the authority possessed by directors, leading to divided authority and management within the company. The variable size of the Sharia supervisory board has a significant negative effect on financial distress, indicating that the presence of a Sharia supervisory board in an Islamic commercial bank can reduce the risk of financial distress. The variable composition of independent commissioners has a significant negative effect on financial distress, suggesting that the presence of independent commissioners on the board of commissioners of an Islamic commercial bank influences the reduction of financial distress risk. The variable institutional ownership does not affect financial distress because the share ownership of Islamic commercial banks by large institutions is not evenly distributed, resulting in insufficient ability to supervise and control management. The variable company size has a significantly positive effect on financial distress, indicating that the larger the company size, the higher the risk of financial distress in Islamic commercial banks. As for the moderating variable, capital structure cannot moderate the relationship between good corporate governance and financial distress because an optimal capital structure alone is insufficient to reduce the risk of financial distress. Effective internal fund management strategies are also needed to minimize the risk of financial distress in Islamic commercial banks.

Based on the results of this study, it is recommended that future research consider other variables that may affect financial distress, including the impact if these independent variables are tested simultaneously. Additionally, company management is advised to develop appropriate strategies for the utilization of capital to avoid financial distress.

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