



JOURNAL OF ACCOUNTING AND BUSINESS EDUCATION

P-ISSN 2528-7281 E-ISSN 2528-729X

E-mail: jabe.journal@um.ac.id

<http://journal2.um.ac.id/index.php/jabe/>

How Corporate Governance Determines a Company's Financial Performance and The Likelihood of Financial Distress

Rohmah Wulansuci

Accounting Department, Faculty of Economics and Business, State University of Malang

Email: rohmah.wulansuci98@gmail.com

DOI: <http://dx.doi.org/10.17977/jabe.v7i2.37384>

Abstract: This study aims to analyze the role of intellectual capital as a moderating variable on the influence of corporate governance on financial performance and governance on the possibility of financial distress. This study uses panel data regression to analyze 412 units of observation from 103 manufacturing companies listed on the Indonesia Stock Exchange in 2018-2021. The results of the study show that partially, both governance and intellectual capital have no significant effect on financial performance or on the possibility of financial distress. However, when governance is interacted with the intellectual capital variable and moderation testing is carried out, it is known that the interaction variable produces a positive coefficient on financial performance and a negative coefficient on the possibility of financial distress. Meanwhile, the direct effect of intellectual capital on corporate governance is not significant. This proves that in this study intellectual capital acts as a pure moderating variable.

The results of this study imply that in the absence of high intellectual capital, corporate governance is proven to be inefficient in improving its financial performance and unable to protect the company from the risk of experiencing financial difficulties. Structurally, manufacturing companies in Indonesia already have various main organs needed to carry out good corporate governance mechanisms, but in practice these organs are allegedly not functional in carrying out their duties and roles in managing the company's business, so that governance becomes ineffective in influencing performance company finance.

Article History

Received:

1 January 2023

Revised:

22 February 2023

Accepted:

15 March 2023

Keywords

Governance, Financial Performance, Intellectual Capital, Agency Theory, Financial Distress, Likelihood

Citation: Wulansuci, R. (2023). How Corporate Governance Determines a Company's Financial Performance and The Likelihood of Financial Distress. *Journal of Accounting and Business Education*, 7(2), 70-83

INTRODUCTION

The concept of corporate governance plays a crucial role in the business world. Corporate governance has become a critical issue worldwide, particularly following the global financial crisis that plunged economies into recession (Hassan, 2015). Corporate governance can be defined as the processes and structures used by companies to direct and manage their business affairs, thereby achieving prosperity and enhancing corporate accountability as the ultimate goal (Zabri et al., 2016). The alignment of governance mechanisms with practices is crucial for successful corporate performance. Therefore, good corporate governance practices have become a prerequisite for every company to manage its business effectively in the global market (Orindaru et al., 2021). Bocean and Barbu (2007) revealed that governance can play a significant role in a company's financial performance. Financial performance is the company's economic achievement over a specific period, encompassing the collection and allocation of

finances, measured by capital adequacy, liquidity, solvency, efficiency, leverage, and profitability, as well as the company's ability to manage and control its own resources (Fatihudin et al., 2018).

The application of corporate governance based on agency theory can be explained by how the relationship between company management as an agent is morally responsible for optimizing the principal's profits and will receive compensation according to the contract in return. According to Siagian et al., (2013), through a series of good governance mechanisms, companies can reduce the risk of conflict between agents and principals. The effectiveness and success of governance implementation can be seen from how prepared a company is to face various economic conditions. The COVID-19 pandemic, which has lasted for more than 3 years, has created a risk of a systemic crisis in the global economy and has also caused a decline in financial performance in various business entities (Devi et al., 2020). According to the OECD, when a company is in a financial crisis, it is revealed that there are severe deficiencies in its corporate governance. Therefore, currently the concept of governance plays a crucial and primary role in preventing companies from experiencing financial difficulties (Lakshan & Wijekoon, 2012). Through good governance mechanisms, a company can mitigate the risk of financial distress that may be faced in the future. The real reason financial distress occur is due to the company's inability to manage and maintain the stability of its financial performance in all conditions (Mufidah & Kholidah, 2017).

Daily et al. (2003) explain that financial distress and corporate bankruptcy are closely related to corporate governance mechanisms. According to Hodgson et al. (2011), good governance practices will strengthen a company's financial performance. At the same time, these practices will protect the company from the risk of experiencing financial distress (H. X. Li et al., 2008 and Parker et al., 2002). From the existing literature, it can be concluded that empirical results for this theme are still very diverse and inconsistent. This is thought to be due to the presence of other variables that may influence the influence of governance on financial performance and the possibility of financial distress that are not included in the test model.

Based on resource-based theory, to improve its long-term financial performance, a company must have a competitive advantage over its competitors. According to Madhani (2010), to create competitive advantage and sustainable performance, a company must use input resources that are valuable, rare, difficult to imitate, and non-substitutable. The Resource-Based View (RBV) considers intellectual capital as a strategic asset that can be used to optimize company performance (Nkundabanyanga et al., 2014). RBV can help company managers understand why employee competencies are considered the most important asset and, at the same time, appreciate how these assets can be used to improve business performance (Madhani, 2010). Sullivan (2000) defines intellectual capital as knowledge or experience that can be translated into economic benefits. Previously, Sveiby (1997) classified the components of intellectual capital as employee (individual) competencies, internal structure, and external structure of the company.

Guthrie et al. (2012) conducted critical research examining the use of intellectual capital in corporate management. The findings, which suggest that intellectual capital influences corporate financial performance, were presented by Soewarno and Tjahjadi (2020) and Olarewaju and Msomi (2021). Previously, Fathi et al. (2013) found a significant positive relationship between intellectual capital and the value-added efficiency of structural capital components, with three financial performance measures (ROE, ROA, and GR). Meanwhile, research by Mondal and Ghosh (2014) and Garcia Castro et al. (2021) showed that the relationship between Value Added of Intellectual Capital (VAIC) and several financial performance indicators are varies.

Huang and Lui (2005) argue that intellectual capital is crucial for sustaining organizational growth along with effective corporate governance, this component can better explain variance in a company's financial performance. Agency conflicts can be reduced by the collective power of strong corporate governance and efficient intellectual capital (Khan & Ali, 2017). Stabryła (2012) in his book states that the combined effect of corporate governance and intellectual capital can increase company value efficiently. Companies that have high intellectual capital, it is unlikely that the board of directors (principals) and managers (agents) will make company decisions that are detrimental to the company (Zingales & Rajan, 2000).

The previous explanation shows that intellectual capital can influence a company's financial performance directly and indirectly, namely by demonstrating the role of interactions that strengthen the influence of governance on financial performance. At the same time, this interaction of intellectual capital will strengthen the negative influence of governance on the likelihood of a company experiencing financial distress. Therefore, the purpose of this study is to determine the relationship between governance practices and financial performance and its role in mitigating the risk of potential financial distress by involving intellectual capital as a moderating variable.

LITERATURE REVIEW AND HYPOTHESES

Over the past few decades, numerous empirical studies have examined the impact of corporate governance on financial performance. A comprehensive overview of the available literature indicates a lack of consensus by researchers. However, a widely held view is that good corporate governance practices are associated with improved company performance. Previous research has linked corporate governance to company performance assessments using Tobin's Q as a proxy. Several studies have also attempted to examine the correlation between corporate governance indices with the financial performance.

Several studies have shown a significant positive impact, such as those conducted by [Orîndaru et al. \(2021\)](#) on public companies in Romania and [Arora and Sharma \(2016\)](#) on a sample of manufacturing industries in India. Previously, [Drobetz et al. \(2004\)](#) concluded that financial performance measures such as Tobin's Q and market-to-book value are significantly related to good corporate governance practices. [Brown and Caylor \(2006\)](#) and [Black et al. \(2006\)](#) found a positive and significant relationship between the governance index and Tobin's Q.

Meanwhile, other research findings indicate the opposite. [Sueyoshi et al. \(2010\)](#) and [Abdullah \(2006\)](#) found an insignificant relationship between governance and company performance. [Shahwan \(2015\)](#) proved that governance was unrelated to company performance. [Ehikioya \(2009\)](#), who examined the relationship between governance structure and company performance in 107 companies listed on the Nigerian Stock Exchange, found a positive relationship between ownership concentration and company performance, while on the other hand, it showed no relationship between board composition and company performance.

In the context of research in Indonesia, [Siagian et al. \(2013\)](#) put forward a positive relationship between governance and firm value through financial performance as a proxy. [Manik et al. \(2019\)](#) also found a positive effect of the governance index on financial performance. Conversely, [Rahayu and Ramadhanti \(2019\)](#) found a negative effect of governance on financial performance. Meanwhile, [Pradito et al. \(2021\)](#) suggested that board size, board independence, and government ownership played no role in explaining the variability in SOE financial performance. These mixed results prompted researchers to re-examine how governance affects corporate financial performance. In studies that yielded less promising results, [Maassen \(1999\)](#) argued that governance has at least an indirect effect on firm performance. Based on the above, the first hypothesis formulated in this study is:

H1: Corporate governance has a positive effect on the company's financial performance.

Resource-based theory views intellectual capital as a crucial asset for maintaining and creating growth opportunities for an organization. According to [Huang and Lui \(2005\)](#), intellectual capital components can better explain variance in a company's financial performance. Meanwhile, the OECD (2006) revealed that intellectual capital management is closely linked to corporate governance mechanisms. According to Grant (1996), in the absence of high levels of intellectual capital, governance tends not to enhance corporate growth. Jensen and Meckling (1976) stated that agency conflicts can be mitigated through the collective power of strong corporate governance and the efficiency of intellectual capital. Based on this explanation, it appears that intellectual capital plays a role in strengthening governance mechanisms in efforts to achieve high financial performance. To empirically test this theoretical argument, the second hypothesis of this study is:

H2: Intellectual capital strengthens the positive influence of governance on corporate financial performance.

The relationship between corporate governance and financial distress has been a subject of academic study since the 1980s. Several strands of research to validate this relationship have focused on clarifying how governance mechanisms in healthy and distressed firms (e.g., firms likely to default) (Daily & Dalton, 1994 and Tamimi, 2012). Daily and Dalton (1994) confirmed a positive relationship between the likelihood of bankruptcy and poor corporate governance practices, as measured by CEO duality and lower director independence. Lee and Yeh (2004) extended the literature by providing evidence that firms with weak governance may increase the risk of default and expropriation by creditors.

In Indonesia, the topic of corporate governance became popular after the 1998 Asian financial crisis. As a result, the Indonesian economy continued to decline and a prolonged crisis ensued. Many believe the cause of this prolonged crisis in Indonesia was weak corporate governance practices (Wardhani, 2007). Through good corporate governance mechanisms, a company can mitigate the risk of financial distress it may face in the future. Good corporate governance serves as a basis for more effective and efficient resource and risk management, thereby strengthening the company's competitiveness on an ongoing basis (Ansori, 2015). According to Mufidah and Kholidah (2017), financial distress arise from a company's inability to manage and maintain the stability of its financial performance.

The causes of unstable company performance can be explained using agency theory, including the differences in interests between agents and principals, which often result in conflict (Paramastri & Hadiprajitno, 2017). As agents, company managers essentially have a decision-making role in carrying out operational activities aimed at maintaining the company's survival. However, when managerial decisions are not based on the company's best interests, they can lead to potential financial distress and harm the principal (Alexander, 2006; Mayangsari & Andayani, 2015). Based on this description, the third hypothesis in this study is formulated as follows:

H3: Corporate governance has a negative effect on the likelihood of financial distress.

Good corporate governance practices simultaneously strengthen performance and protect companies from the risk of financial distress (Hodgson et al., 2011 and Parker et al., 2002). Companies that implement governance mechanisms should not only rely on the performance of tangible assets, but also need to pay attention to intangible assets to create added value and remain competitive with other companies (Kusmayadi et al., 2015). Resource-based theory views intellectual capital as a form of intangible asset that can strategically optimize a company's financial performance (Nkundabanyanga et al., 2014). According to Mardianto and Jeclyn (2021), good governance also encompasses the application of intellectual capital, such as ensuring that decisions made by managers as agents are based on the principal's interests, not their own. Therefore, companies with strong intellectual capital will strengthen their corporate governance practices to reduce the risk of financial distress. To empirically test this argument, the fourth hypothesis of this study is formulated as follows:

H4: Intellectual capital strengthens the negative influence of governance on the likelihood of financial distress.

METHODS

This research uses a quantitative explanatory approach. The goal is to explain the position of the variables used in the study and to determine the influence of each variable on another. This research focuses on examining the influence of corporate governance practices on financial performance and the likelihood of financial distress, with intellectual capital as a moderating variable.

This study used manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2018-2021 period as the research population. Data were obtained by downloading the companies' annual reports published on the IDX website or directly through each company's website. The initial

sample size was 672 companies. The sampling technique was purposive sampling with the following criteria:

1. Manufacturing companies listed on the IDX consecutively during the 2018-2021 period with complete annual reports.
2. Companies using the rupiah currency in their financial reports.

Table 1. Sample Selection Results

No	Criteria	Qty
1	Manufacturing companies listed on the IDX in 2018	168
2	Manufacturing companies not listed on the IDX consecutively during the observation period (2018-2021)	(13)
3	Manufacturing companies that do not use the rupiah currency in their reporting	(23)
4	Manufacturing companies with incomplete annual report information	(29)
Number of research samples		103
Number of observations over 4 years (2018-2021)		412

Definition and Measurement of Variables

Corporate governance as an independent variable is measured through the ratio of the total score of the Corporate Governance Index (CGI), where the indexes are divided into several aspects whose preparation is based on governance principles. The aspects in the CGI are: board member composition, audit committee, nomination and remuneration committee, shareholder rights, financial and audit relations, and disclosure. Corporate governance is proxied and measured using the CGI by [Manik et al. \(2019\)](#) which consists of 32 indicator item statements. Furthermore, for this study, there are two dependent variables, is are company financial performance measured using the Tobin's Q proxy and the possibility of financial distress determined as the magnitude of the opportunity (probability) of a company experiencing financial difficulties (distress/bankruptcy) compared to the probability of a company with healthy finances (safe/non-bankrupt). The possibility of financial distress is measured using a dummy variable, with the criteria of sample companies that obtain a total z-score <2.90 given a value of 1 (distress) and companies with a total z-score >2.90 given a value of 0 (safe).

To assess the impact of corporate governance practices on financial distress, the Altman Z-Score method is one of the early warning models frequently used to assess the risk of financial distress (Yi, 2012). This model was introduced by Altman in 1968 as a good predictor of bankruptcy. The following Z-Score equation by Altman & Hotchkiss (2006) will be used to measure the likelihood of financial distress in this study:

$$Z' - Score = 0,717X_1 + 0,847X_2 + 3,107X_3 + 0,420X_4 + 0,998X_5$$

Information:

$X_1 = \text{working capital} / \text{total assets}$

$X_2 = \text{retained earnings} / \text{total assets}$

$X_3 = \text{earnings before interest and taxes} / \text{total assets}$

$X_4 = \text{total equity} / \text{total debt}$

$X_5 = \text{sales} / \text{total assets}$

Intellectual capital as a moderating variable in this research is the difference between production value (output) and the resources or costs incurred by the company for the production process (input) so

that added value can be obtained. In this research, intellectual capital is measured using Pulic's (1998) value-added intellectual capital coefficient (Value-Added Intellectual Coefficient / VAIC).

Analysis Techniques

This research uses pooled data (panel data). The data analysis model used is statistical analysis, where data processing uses the Eviews-12 program. The data analysis used in this research consists of descriptive statistical analysis, panel data regression analysis, classical model assumption testing and uniformity, and hypothesis testing. The panel data regression model to test the first hypothesis is represented through the equation model as follows:

$$PER_{it} = \alpha + \beta_1(CGI_{it}) + \beta_2(CIR_{it}) + \beta_3(LEV_{it}) + E_{it} \dots\dots\dots(1)$$

To determine the position of intellectual capital as a moderating variable in the relationship between corporate governance and financial performance, a model equation was created which contains elements of the interaction of governance with intellectual capital. The following is a regression model to test the moderating variable:

$$PER_{it} = \alpha + \beta_1(CGI_{it}) + \beta_2(CIR_{it}) + \beta_3(LEV_{it}) + \beta_4(VAIC_{it}) + \beta_4(CGI * VAIC_{it}) + E_{it} \dots\dots\dots(2)$$

Information:

- PER* : Financial Performance (as measured by Tobin's Q)
- α : Constanta
- β : Regression Coefficients
- CGI* : Corporate Governance Index Score
- CIR* : Capital Intensity Ratio (Total Assets : Total Sales)
- LEV* : Leverage Ratio (Total Debt : Total Assets)
- VAIC* : Value Added Intellectual Capital
- CGI*VAIC*: The interaction between corporate governance and intellectual capital
- E* : error rate

Next, testing the second dependent variable which is a dummy using logistic regression analysis. In logistic regression, there is no need to test the assumption of normality of data on independent variables because the independent variables used are a mixture of continuous and categorical variables (Ghozali, 2016). The logistic regression model to test the influence of governance on the probability of financial distress is represented as follows:

$$\ln \frac{FD}{1 - FD} = \alpha + \beta_1(CGI_{it}) + \beta_2(CIR_{it}) + \beta_3(LEV_{it}) + E_{it}$$

To test the moderating role of intellectual capital on the relationship between governance and the possibility of financial distress, a logistic moderation regression equation model was created as follows:

$$\ln \frac{FD}{1 - FD} = \alpha + \beta_1(CGI_{it}) + \beta_2(CIR_{it}) + \beta_3(LEV_{it}) + \beta_4(VAIC_{it}) + \beta_4(CGI * VAIC_{it}) + E_{it}$$

Information:

- FD* : Financial Distress, Dummy Variable (total z-score <2.90 = 1, and >2.90 = 0)
- CGI*VAIC*: The interaction between corporate governance and intellectual capital

The criteria for testing hypotheses 3 and 4 are as follows:

1. The confidence level is 95% (significance level 0.05).
2. The criteria for accepting or rejecting the hypothesis are based on significance. If the α value is <0.05 , the hypothesis is accepted.

Before conducting the analysis using the equation model above, a goodness of fit test and overall model fit are first performed.

RESULTS AND DISCUSSION

Before testing the hypothesis, the researcher first conducted a classical assumption test. The test results demonstrated a normal distribution of the data, no outliers, and no multicollinearity, heteroscedasticity, or autocorrelation issues. Therefore, the test could proceed to the regression analysis stage. Because this study uses panel data regression analysis to test the research hypothesis, a series of tests were conducted before conducting the regression analysis to determine the most appropriate regression estimation model.

Based on the equation model determination test that has been conducted, the results obtained that the Random Effect Model (REM) is the best model to estimate the financial performance of the company in this study. Based on the results of the analysis using the REM model contained in Table 2 below, it shows that the probability value for the governance variable is 0.8251 (>0.05), meaning that governance does not have a significant influence on the dependent variable of financial performance. Meanwhile, for the two control variables, namely the capital intensity ratio and leverage, the probability value for the capital intensity ratio variable is 0.3222 (>0.05), meaning that partially the capital intensity ratio does not affect financial performance. Meanwhile, the leverage variable has a probability value of 0.0026 (<0.05), which partially means that leverage affects financial performance.

Furthermore, for the role of the intellectual capital variable, the probability value obtained was 0.1046 (>0.05), meaning that intellectual capital does not directly affect the company's financial performance. However, when the intellectual capital variable was interacted with another independent variable used in this study, namely corporate governance, the test results showed that this interaction variable had a probability value of 0.0417 (<0.05). This indicates that the role of intellectual capital in this study is a pure moderating variable that can strengthen the influence of governance on the company's financial performance.

Table 2. Panel Data Regression Analysis

Variabel	Regression Model		
	Random Effect Model		
	Coefficients	t	Prob.
_cons	1,1762	1,10	0,2698
Corporate Governance	0,2970	0,22	0,8251
Capital Intensity Ratio	-0,0144	-0,99	0,3222
Leverage	0,7747	3,03	0,0026
Intellectual Capital	-0,2233	-1,63	0,1046
Corporate Governance*Intellectual Capital	0,3578	2,04	0,0417
Number of Obs		412	
F		3,47	
Prob > F		0.0043	
Adjusted R-Square		0.0292	

Hypothesis Testing Results

Based on the series of tests conducted, the results of this research's hypothesis testing are summarized in the following table.

Table 3. Hypothesis Testing Results

Influence between variables	Beta (coefficient)	Sig.	Result
Corporate Governance → Financial Performance	0.9486	0.4890	H1 Ditolak
Corporate Governance*Intellectual Capital → Financial Performance	0.3578	0.0417	H2 Diterima
Corporate Governance → Likelihood of Financial Distress	1.7353	0.1993	H3 Ditolak
Corporate Governance*Intellectual Capital → Likelihood of Financial Distress	-3.2457	0.0000	H4 Diterima

Sources: data processed by researchers

The Impact of Corporate Governance on Financial Performance and the Likelihood of Financial Distress

The results of the study rejected Hypotheses 1 and 3, showed that governance variables did not have a significant impact on a company's financial performance, and at the same time, were proven unable to protect companies from the risk of experiencing financial distress. These results do not support the findings of [Drobotz et al. \(2004\)](#) and [Orindaru et al. \(2021\)](#), which proved a significant relationship between governance and financial performance, as well as the findings of [Lee and Yeh \(2004\)](#) and [Damayanti and Kusumaningtias \(2020\)](#), which stated that good governance can reduce the risk/possibility of a company experiencing financial distress. However, this study supports the results of [Sueyoshi et al. \(2010\)](#) and [Shahwan \(2015\)](#), which found no effect of governance on a company's financial performance, and the findings of [Bodroastuti \(2019\)](#), which provided evidence that a company's risk of experiencing financial distress is not solely determined by the level of corporate governance implementation.

The insignificant relationship between corporate governance and financial performance and the likelihood of financial distress indicates that the variance of corporate governance does not covariate sufficiently with the variation in financial performance or the variation in the value of the likelihood of financial distress. It is known that in its application, governance is strongly influenced by many factors both external and internal to the corporate governance mechanism itself ([Elsayed & Wahba, 2013](#)). Therefore, including other predictor variables that usually interact with corporate governance can provide different value variations and may be able to have a more significant impact on financial performance and the likelihood of financial distress.

According to [Pradito et al. \(2021\)](#), the implementation of good corporate governance principles in Indonesia is heavily influenced by cultural and historical factors. Complexity and diversity complicate efforts to create a sound management concept. According to [Kadri \(2022\)](#), the composition and structure of good corporate governance mechanisms will strengthen internal controls for financial oversight, thus positively impacting a company's financial performance. However, this study found that companies with a comprehensive corporate governance structure did not significantly impact their financial performance.

The board of commissioners, as a corporate governance organ, carries out a supervisory function. Supervisory knowledge is a form of good governance implementation because it can influence the quality of financial information and external parties' trust in the company ([Wijaya & Firmansyah, 2021](#)). The existence of a board of commissioners in a company, in fact, cannot significantly improve the company's financial performance. This indicates that manufacturing companies in Indonesia only fulfill their governance functions structurally. As illustrated, it is suspected that the board of commissioners does not optimally provide advice and evaluation on performance direction, resulting in a decline in the supervisory function. When the board of commissioners is no longer functional in carrying out its duties

and responsibilities, governance becomes incapable of strengthening the company's financial performance.

The results of this study indicate that the implementation of good corporate governance is not only limited to maintaining corporate governance organs such as the existence of a board of commissioners and an audit committee structurally within the company, but how these organs are filled with individuals who have the capability and commitment to implement the principles of corporate governance. The presence of governance as a solution to create more conducive activities and avoid the company from the trap of financial scandals will be difficult to achieve if the parties within the company itself are not optimal in implementing the principles of governance. Consequently, governance ultimately becomes unable to protect the company from the risk of experiencing financial distress.

The results of this study also provide evidence that the implementation of governance has not been able to achieve optimal employment contracts and efficient company performance as stated in agency theory. [Elsayed and Wahba \(2013\)](#) and [Wahba \(2015\)](#) revealed that the relationship between governance mechanisms and financial performance is not a monotonic one. This is due to the interaction of different governance mechanisms, which can substitute for or complement each other. Therefore, the extent to which governance influences a company's financial performance is determined by both the governance components themselves and factors outside of corporate governance.

Of the two explanatory control variables analyzed, the capital intensity ratio was shown to have no effect on financial performance. Meanwhile, the leverage variable was shown to have a significant positive effect on financial performance. These results align with research by [Siregar et al. \(2019\)](#) and [Elsayed & Paton \(2005\)](#). A possible explanation is that higher leverage can increase pressure on managers (agents) to reduce their opportunistic behavior and moral hazard, ultimately increasing firm value, particularly financial performance. This argument aligns with Jensen's (1986) use of the control hypothesis, which posits the role of leverage as a monitoring function in companies with poor governance practices. Leverage can act as a disciplinary mechanism that has the potential to address agency problems, particularly in companies in developing countries ([Shahwan, 2015](#)).

The Moderating Role of Intellectual Capital on the Influence of Corporate Governance on Financial Performance and the Likelihood of Financial Distress

The results of the study, which accepted hypotheses 2 and 4, showed that in the absence of high intellectual capital, governance variables proved inefficient in improving financial performance, while at the same time strengthening the negative influence of governance on the possibility of corporate financial distress. Meanwhile, testing the direct influence of intellectual capital variables on financial performance yielded insignificant results. Therefore, it can be interpreted that the role of intellectual capital in this study is a pure moderating variable. Pure moderation is a variable that moderates the relationship between predictor variables and affected variables, where pure moderating variables interact with predictor variables without being predictor variables ([Solimun, 2010](#)).

Based on the significant results of the moderating variable test, the question of why previous studies regarding the influence of corporate governance on financial performance and the likelihood of financial distress remains inconsistent can be answered. The interaction component of governance and intellectual capital has been shown to better explain variance in financial performance than the direct influence of governance on financial performance or the likelihood of financial distress.

Respecting a company's employees, who are seen as human capital, through the fulfillment of their rights has been proven to encourage them to perform better. Providing adequate salaries and remuneration to the board of directors and commissioners, as well as setting aside a portion of company profits for training and employee development, has been shown to increase their loyalty to the company. This strong sense of loyalty encourages members of the board of directors and commissioners to work together to achieve the company's goals by seriously implementing the principles of good corporate governance. For other employees, having their rights protected and their welfare met increasing their motivation to work. High employee motivation will undoubtedly increase productivity. Through increased productivity, the company's financial performance will also improve.

The success of the moderation test results in this study supports the premise of resource-based theory, which states that in implementing governance mechanisms, companies should not only rely on the performance of tangible assets, but also consider their intangible assets to create added value and achieve competitive advantages, which ultimately can improve financial performance (Madyan & Fikir, 2019). Intellectual capital is a form of intangible asset that strategically optimizes company performance (Nkundabanyanga et al., 2014). The results of this study are in line with Grant's (1996) opinion, which states that governance tends not to significantly increase company growth if it is not balanced with good intellectual capital management.

The moderating role of intellectual capital in the negative impact of governance on financial distress supports the statement of Mardianto and Jeclyn (2021), who stated that good governance encompasses the application of intellectual capital itself. To ensure the company operates in accordance with its objectives, members of the board of commissioners can utilize their intellectual capital in carrying out their oversight function (Anik et al., 2021). Furthermore, regarding other governance organs, according to Ellba and Putri (2022), the size and work experience of audit committee members can improve the quality of internal control, thereby minimizing the occurrence of various disturbances that could destabilize the company's financial performance.

Based on the test results, it can be explained that structurally, manufacturing companies in Indonesia already have various key organs needed to implement good corporate governance mechanisms. However, in practice, these organs are suspected of being non-functional. Consequently, governance does not directly significantly impact the company's financial performance. However, it is known that when these structural components work by utilizing existing human resources, company performance can be improved.

Human capital, as a component of intellectual capital, can significantly impact a company's performance. This is because human capital supports other intellectual capital components, namely structural capital and customer capital (Putra, 2017). In addition to establishing various good corporate governance structures as a company's structural capital, maintaining human capital by valuing all forms of knowledge, skills, and experience possessed by each company employee is an effort to produce optimal intellectual performance. When a company is able to treat its employees not only as input resources but also as capital, the company's uniqueness and excellence can be created (Maharani & Fuad, 2020).

These results provide empirical evidence for the previously established theoretical argument that companies with strong intellectual capital will strengthen their corporate governance practices to improve financial performance while reducing the risk of financial distress. This finding may motivate companies to enhance the performance potential of their intellectual capital due to its beneficial impact on governance. The collaboration between good corporate governance and intellectual capital management can ultimately create value for the company, thus protecting it from potential financial distress.

CONCLUSION

The results of this study, which found no significant influence between governance and financial performance and the likelihood of financial distress, theoretically, these results cannot justify the agency relationship perspective. However, the use of agency theory can still be explained when the governance variable is interacted with intellectual capital, which is novel in this study. The results of the moderation test indicate that intellectual capital can significantly strengthen governance in improving financial performance and is also able to protect the company from the risk of experiencing financial distress. The results of this moderation test also provide empirical evidence for the use of resources based on theory through the presence of intellectual capital as a moderating variable, which is considered a strategic asset that can optimize company performance through added value and competitive advantages built by the company.

The use of the Corporate Governance Index (CGI) as a proxy for corporate governance has limitations, namely that some index indicator items are indicated to be homogeneous. Suggestions for further research is when using the CGI proxy to measure corporate governance or other indexes in the

form of a list of statements consisting of several indicators as a research tool, a homogeneity test should be conducted on the research tool to be used first. Future research can also examine the effect of governance on financial performance using a qualitative or mixed approach in a sample of companies at risk of financial distress. This research is conducted to understand in depth the obstacles and problems companies face in implementing governance principles and to explore the role of other variables or factors that significantly influence company performance.

REFERENCES

- Abdullah, S. N. (2006). Board structure and ownership in Malaysia: The case of distressed listed companies. *Corporate Governance*, 6(5), 582–594. <https://doi.org/10.1108/14720700610706072>
- Alexander, K. (2006). Corporate governance and banks: The role of regulation in reducing the principal-agent problem. *Journal of Banking Regulation*, 7(1–2), 17–40. <https://doi.org/10.1057/palgrave.jbr.2340003>
- Anik, S., Chariri, A., & Isgiyarta, J. (2021). *The Effect of Intellectual Capital and Good Corporate Governance on Financial Performance and Corporate Value : A Case Study in Indonesia*. 8(4), 391–402. <https://doi.org/10.13106/jafeb.2021.vol8.no4.0391>
- Ansori. (2015). Toward a Media History of Documents. <https://airnavindonesia.co.id/gcg#:~:text=Penerapan Tata Kelola Perusahaan Yang Baik diyakini mampu memperkuat posisi,corporate value dan kepercayaan investor.>
- Arora, A., & Sharma, C. (2016). Corporate governance and firm performance in developing countries: evidence from India. *Corporate Governance (Bingley)*, 16(2), 420–436. <https://doi.org/10.1108/CG-01-2016-0018>
- Black, B. S., Jang, H., & Kim, W. (2006). Does corporate governance predict firms' market values? Evidence from Korea. *Journal of Law, Economics, and Organization*, 22(2), 366–413. <https://doi.org/10.1093/jleo/ewj018>
- Bodroastuti, T. (2009). Pengaruh Struktur Corporate Governance terhadap Financial Distress. *Jurnal Ilmiah Aset*, 11(2), 170–182.
- Daily, C. M., & Dalton, D. R. (1994). Bankruptcy and Corporate Governance: The Impact of Board Composition and Structure. *Academy of Management Journal*, 37(6), 1603–1617. <https://doi.org/10.5465/256801>
- Daily, C. M., Dalton, D. R., & Cannella, A. A. (2003). Corporate Governance : Decades of Dialogue and Data Author (s): Catherine M . Daily , Dan R . Dalton and Albert A . Cannella Jr . Published by: Academy of Management Stable URL : <http://www.jstor.com/stable/30040727> REFERENCES Linked references are ava. *The Academy of Management Review*, 28(3), 371–382.
- Devi, S., Warasniasih, N. M. S., & Masdiantini, P. R. (2020). The Impact of COVID-19 Pandemic on the Financial Performance of Firms on the Indonesia Stock Exchange. *Journal of Economics, Business, & Accountancy Ventura*, 23(2). <https://doi.org/10.14414/jebav.v23i2.2313>
- Drobetz, W., Schillhofer, A., & Zimmermann, H. (2004). Corporate governance and expected stock returns: Evidence from Germany. *European Financial Management*, 10(2), 267–293. <https://doi.org/10.1111/j.1354-7798.2004.00250.x>
- Ellba, A., & Putri, G. (2022). *THE EFFECT OF PROFITABILITY , COMPANY SIZE , BOARD OF COMMISSIONERS , AND AUDIT COMMITTEE ON SUSTAINABILITY REPORT DISCLOSURE*. 6(2), 48–59.

- Elsayed, K., & Wahba, H. (2013). Reinvestigating the relationship between ownership structure and inventory management: A corporate governance perspective. *International Journal of Production Economics*, 143(1), 207–218. <https://doi.org/10.1016/j.ijpe.2013.01.011>
- Fatihudin, D., Jusni, & Mochklas, M. (2018). How measuring financial performance. *International Journal of Civil Engineering and Technology*, 9(6), 553–557.
- García Castro, J. P., Duque Ramírez, D. F., & Moscoso Escobar, J. (2021). The relationship between intellectual capital and financial performance in Colombian listed banking entities. *Asia Pacific Management Review*, 26(4), 237–247. <https://doi.org/10.1016/j.apmr.2021.03.002>
- Guthrie, J., Ricceri, F., & Dumay, J. (2012). Reflections and projections: A decade of Intellectual Capital Accounting. *The British Accounting Review*, 44(2), 68–82. <https://doi.org/10.1016/j.bar.2012.03.004>
- Hassan Al-Tamimi, H. A. (2012). The effects of corporate governance on performance and financial distress: The experience of UAE national banks. *Journal of Financial Regulation and Compliance*, 20(2), 169–181. <https://doi.org/10.1108/13581981211218315>
- Hassan, R. (2015). Diversity, Corporate Governance and Implication on Firm Financial Performance. *Global Business and Management Research: An International Journal*, 7(2). <http://www.gbmr.ioksp.com/pdf/vol.7no.2/V7N2-4.pdf>
- Hodgson, A., Lhaopadchan, S., & Buakes, S. (2011). How informative is the Thai corporate governance index? A financial approach. *International Journal of Accounting and Information Management*, 19(1), 53–79. <https://doi.org/10.1108/18347641111105935>
- Huang, C. J., & Lui, C. J. (2005). Exploration for the relationship between innovation, IT and performance. *Journal of Intellectual Capital*, 6(2), 237–252. <https://doi.org/10.1108/14691930510592825>
- Khan, S. N., & Ali, E. I. E. (2017). The Moderating Role of Intellectual Capital Between Enterprise Risk Management and Firm Performance: A Conceptual Review. *American Journal of Social Sciences and Humanities*, 2(1), 9–15. <https://doi.org/10.20448/801.21.9.15>
- Kusmayadi, D., Rudiana, D., & Badruzaman, J. (2015). *Good Corporate Governance*. 249.
- Lakshan, A. M. I., & Wijekoon, W. M. H. N. (2012). Corporate Governance and Corporate Failure. *Procedia Economics and Finance*, 2(Af), 191–198. [https://doi.org/10.1016/s2212-5671\(12\)00079-2](https://doi.org/10.1016/s2212-5671(12)00079-2)
- Lee, T. S., & Yeh, Y. H. (2004). Corporate governance and financial distress: Evidence from Taiwan. *Corporate Governance: An International Review*, 12(3), 378–388. <https://doi.org/10.1111/j.1467-8683.2004.00379.x>
- Li, H. X., Wang, Z. J., & Deng, X. L. (2008). Ownership, independent directors, agency costs and financial distress: Evidence from Chinese listed companies. *Corporate Governance*, 8(5), 622–636. <https://doi.org/10.1108/14720700810913287>
- Madhani, P. (2010). Resource Based View (RBV) of Competitive Advantage: An Overview. ... *BASED VIEW: CONCEPTS AND PRACTICES*, Pankaj ... http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1578704
- Maharani, T., & Fuad, K. (2020). The effect of human capital, structural capital, customer capital, managerial ownership, and leverage toward profitability of company. *Journal of Advanced Multidisciplinary Research*, 1(1), 46. <https://doi.org/10.30659/jamr.1.1.46-62>
- Manik, I., Putra, S., & Dewayanto, T. (2019). Analisis Pengaruh Good Corporate Governance Index Dan Kepemilikan Institusional Terhadap Kinerja Perusahaan. *Diponegoro Journal of Accounting*,

- 8(4), 1–15. <http://ejournal-s1.undip.ac.id/index.php/accounting>
- Mardianto, & Jeclyn. (2021). Analisis Tata Kelola Perusahaan Terhadap Modal Intelektual Dengan Ukuran Perusahaan Sebagai Variabel Moderasi. *Conference on Management, Business, Innovation, Education and Social Science*, 1(1), 1015–1023.
- Mayangsari, L. P., & Andayani. (2015). Pengaruh Good Corporate Governance dan Kinerja Keuangan di Indonesia, isu mengenai corporate governance mengemuka setelah krisis ekonomi yang berkepanjangan sejak tahun 1998 dan saat terjadinya beberapa skandal di dunia bisnis, antara lain kasus PT. Ki. *Jurnal Ilmu & Riset Akuntansi*, 4(4), 1–18.
- Mondal, A., & Ghosh, S. K. (2012). Intellectual capital and financial performance of Indian banks. *Journal of Intellectual Capital*, 13(4), 515–530. <https://doi.org/10.1108/14691931211276115>
- Mufidah, A., & Kholidah, A. N. (2017). *The Determinants of Financial Distress of Basic Industry and Chemical Companies Listed in Indonesia Stock Exchange*. 01.
- Nkundabanyanga, S. K., Ntayi, J. M., Ahiauzu, A., & Seijaaka, S. K. (2014). Intellectual capital in ugandan service firms as mediator of board governance and firm performance. *African Journal of Economic and Management Studies*, 5(3), 300–340. <https://doi.org/10.1108/AJEMS-06-2012-0041>
- Olarewaju, O. M., & Msomi, T. S. (2021). Intellectual capital and financial performance of South African development community's general insurance companies. *Heliyon*, 7(4), e06712. <https://doi.org/10.1016/j.heliyon.2021.e06712>
- Orîndaru, A., Popescu, M. F., Alexoaei, A. P., Căescu, Ștefan C., Florescu, M. S., & Orzan, A. O. (2021). Tourism in a post-covid-19 era: Sustainable strategies for industry's recovery. *Sustainability (Switzerland)*, 13(12), 1–22. <https://doi.org/10.3390/su13126781>
- Paramastri, W. W., & Hadiprajitno, P. B. (2017). Pengaruh Mekanisme Tata Kelola Perusahaan terhadap Kesulitan Keuangan (Studi Empiris pada Perusahaan Manufaktur yang Terdaftar di BEI Tahun 2014-2015). *Diponegoro Journal of Accounting*, 6(4), 1–13.
- Parker, S., Peters, G. F., & Turetsky, H. F. (2002). Corporate governance and corporate failure: A survival analysis. *Corporate Governance: The International Journal of Business in Society*, 2(2), 4–12. <https://doi.org/10.1108/14720700210430298>
- Pradito, A. D., Giovanni, A., & Utami, D. W. (2021). Tata Kelola Dan Kinerja Keuangan Badan Usaha Milik Negara (Bumn) Go Public Periode 2014-2018. *Nominal: Barometer Riset Akuntansi Dan Manajemen*, 10(1), 82–101. <https://doi.org/10.21831/nominal.v10i1.32792>
- Putra, M. S. (2017). Pengaruh Human Capital, Structural Capital, Custumor Capital Dan Good Corporate Governance Terhadap Profitabilitas Perusahaan. *E-Journal SI Ak*, Vol. 7 No. 1
- Rahayu, S. M., & Ramadhanti, W. (2019). Corporate governance, intellectual capital, and performance of indonesian public company. *Journal of Economics, Business & Accountancy Ventura*, 21(3), 323. <https://doi.org/10.14414/jebav.v21i3.1470>
- ROBERT M. GRANT. (1996). Toward a knowledge-based theory of the firm. *Strategic Management Journal*, 17(Special Issue), 109–122. <http://proquest.umi.com/pqdweb?RQT=562&MRR=R&TS=1297501326&clientId=27625%5Cnh>
<http://proquest.umi.com/pqdweb?did=11194159&Fmt=7&clientId=27625&RQT=309&VName=P> QD
- Shahwan, T. M. (2015). Crisis de la conciencia nacional en torno al 98. *Historia de La Nación y Del Nacionalismo Español*, 15(5), 543–562.
- Shahwan, T. M., & Habib, A. M. (2020). Does the efficiency of corporate governance and intellectual

- capital affect a firm's financial distress? Evidence from Egypt. *Journal of Intellectual Capital*, 21(3), 403–430. <https://doi.org/10.1108/JIC-06-2019-0143>
- Siagian, F., Siregar, S. V., & Rahadian, Y. (2013). Corporate governance, reporting quality, and firm value: evidence from Indonesia. *Journal of Accounting in Emerging Economies*, 3(1), 4–20. <https://doi.org/10.1108/20440831311287673>
- Soewarno, N., & Tjahjadi, B. (2020). Measures that matter: an empirical investigation of intellectual capital and financial performance of banking firms in Indonesia. *Journal of Intellectual Capital*, 21(6), 1085–1106. <https://doi.org/10.1108/JIC-09-2019-0225>
- Sueyoshi, T., Goto, M., & Omi, Y. (2010). Corporate governance and firm performance: Evidence from Japanese manufacturing industries after the lost decade. *European Journal of Operational Research*, 203(3), 724–736. <https://doi.org/10.1016/j.ejor.2009.09.021>
- Sullivan, P. H. (2000). Valuing intangibles companies – An intellectual capital approach. *Journal of Intellectual Capital*, 1(4), 328–340. <https://doi.org/10.1108/14691930010359234>
- Wardhani, R. (2007). Mekanisme Corporate Governance Dalam Perusahaan Yang Mengalami Permasalahan Keuangan. *Jurnal Akuntansi Dan Keuangan Indonesia*, 4(1), 95–114. <https://doi.org/10.21002/jaki.2007.05>
- Yi, W. (2012). Z-score Model on Financial Crisis Early-Warning of Listed Real Estate Companies in China: a Financial Engineering Perspective. *Systems Engineering Procedia*, 3, 153–157. <https://doi.org/10.1016/j.sepro.2011.11.021>
- Zabri, S. M., Ahmad, K., & Wah, K. K. (2016). Corporate Governance Practices and Firm Performance: Evidence from Top 100 Public Listed Companies in Malaysia. *Procedia Economics and Finance*, 35(October 2015), 287–296. [https://doi.org/10.1016/s2212-5671\(16\)00036-8](https://doi.org/10.1016/s2212-5671(16)00036-8)
- Zingales, L., & Rajan, R. (2000). corporate governance Zingales. *National Bureau of Economic Research*, 3, 1–45.