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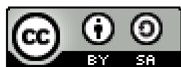

The Influence of Board of Directors Characteristics on Corporate Financial Distress

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Abstract. *This study is based on complementary proposals between agency theory based on the behavioral characteristics of the board of directors. The research examines whether gender diversity on the board, board size, expertise, and board compensation costs affect the likelihood of financial distress of companies. This research falls into the third stage of TKT measurement, which is the proof-of-concept of functions and/or important characteristics analytically and experimentally. This type of research employs a quantitative approach method with combined time series and cross-sectional data (Panel Data). The data collection technique used is secondary data collection, where data is collected from previously existing data. The sample companies in Indonesia listed on the IDX during the period 2019 to 2022. The data analysis method uses the Eviews 12 analysis tool. Research on the characteristics of the Board of Directors and its impact on the financial distress of companies can provide valuable insights into how corporate practices and financial decision-making contribute to the achievement of sustainable development goals (SDGs-8). Based on the research results, it was found that from all the characteristics of the board of directors measured, the accounting expertise possessed by the board of directors had a negative effect on the Company's financial difficulties. While other characteristics did not affect the Company's financial difficulties.*

Keywords*: Board of directors, Board Size, Expertise, Financial Distress, Gender*

1. INTRODUCTION

The corporate board is a governance mechanism that oversees and advises management, influences agency costs, and is responsible for reliable and high-quality accounting information. In recent years, there has been increasing interest in the function of the board, with a focus on regulations or recommendations that encourage independence, size, and most importantly, gender diversity (García & Herrero, 2021). Through its functions, the board of directors supports the decision-making process, as well as other business areas. In particular, it helps the company adopt the right steps to achieve strong performance and continue operating smoothly. Some of these steps prevent the company from getting into financial trouble.

Several previous studies have tested corporate governance variables against bankruptcy. (Kolias *et al*, 2019; Maydah & Serly, 2019; Kisman & Krisandi, 2019). Bankruptcy is a problem that is often faced by a company. Bankruptcy experienced by a company not only harms internal parties but also external parties. According to Kusanti & Andayani, (2015) The parties who are harmed by the bankruptcy of a company are the parties

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who have an interest in the company such as investors, creditors, the government as the party that receives taxes and reduces unemployment. This makes financial distress analysis important for all stakeholders and potential investors before deciding to invest in order to avoid losses. Therefore, symptoms of bankruptcy of a company must be detected as early as possible, especially by management before it is too late and difficult to control.

From an agency theory perspective, gender diversity should provide heterogeneity to the board of directors, resulting in different perspectives, greater independence, and greater control. (Adams & Ferreira, 2009). However, this theory has limitations in establishing the relationship between gender diversity and risk taking. Therefore, gender theory based on behavioral differences between men and women can complement agency theory. Some authors have questioned whether differences in general societal behavior also apply to managerial positions. For example, research based on experimental psychology and economics suggests that women behave differently from men, being more risk-averse, less self-confident, more independent in their thinking, and more ethical. Several studies have explored differences in information processing between men and women, suggesting that female directors are associated with greater quality and quantity of information disclosure and greater transparency (Armstrong *et al*, 2014). Recent financial research shows that gender matters in risk-taking behavior, leadership style, and communication skills in leadership positions Faccio *et al*, (2016) dan Harris *et al*, (2019) shows that companies managed by female CEOs have lower leverage and less volatile earnings. Levi *et al*, (2014) concluded that female directors are more risk averse than male directors, while on the other hand female CEOs are also less confident.

The main key in identifying a company experiencing financial difficulties is their inability to fulfill their obligations (Hatane *et al*, 2019). The company experienced financial difficulties before going bankrupt, at that time the company's financial condition was in a state of crisis. Financial difficulties refer to the period when the company takes out loans but cannot fulfill the obligation to repay them (Zaki *et al*, 2011).

The large number of board of directors can affect the financial condition of the company because every decision made by the company comes from the decisions of the board of directors. According to (Maydah & Serly, 2019) A large board of directors is more effective than a small board of directors in monitoring the financial reporting process.

Although there has been progress in understanding the impact of CG characteristics on corporate financial distress, there is still room to investigate this relationship in more depth. (Hussain *et al*, 2018). A complete understanding requires a more detailed exploration of the relationship between governance characteristics and corporate sustainability dimensions. Several attempts have been made to understand this relationship, but no empirical contribution

has considered the performance of the board of directors on the financial condition of the Company in this relationship.

Based on different and competing theoretical perspectives, research has formulated various arguments for a positive or negative relationship between the characteristics of the board of directors and financial distress. Therefore, it is necessary to conduct further research on the relationship between CG and the Company's financial distress, so that this research can help as a consideration in making the right investment decisions using information in the financial statements. So a problem can be drawn "Do the Characteristics of the Board of Directors affect the company's financial distress?"

2. LITERATURE REVIEW

Agency Theory

Agency theory explains the importance of the role of the board of directors as a supervisor to mitigate conflicts of interest between management and shareholders (Jensen & Meckling, 1976). Characteristics such as board independence and competence are essential to ensure effective oversight.

Characteristics of the Board of Directors

Size of the Board of Directors

Board size is considered a factor that influences the efficiency of decision making. Pernamasari *et al*, (2019) considers that overly large boards can reduce the effectiveness of supervision, while small boards tend to be more efficient but risk having less diverse views.

Diversity of the Board of Directors

Diversity in the board of directors, both in terms of gender, educational background, and professional experience, is believed to improve the quality of decision-making. Levi *et al*, (2014) shows that gender diversity on the board can improve company performance.

Directors' Compensation

Incentives are bonuses given to employees to encourage them to act in the interests of shareholders. These incentives can take the form of stock options or cash-based bonuses (Ardiyanto & Marfiana, 2021). Usually, incentives are related to company performance. When a company succeeds in generating high profits, directors also receive larger bonuses. Taxes have a significant impact on corporate profits, so directors' efforts to reduce tax burdens through tax avoidance can increase corporate profits. According to Armstrong *et al*, (2014), Compensation for executives includes annual salary, annual bonus, annual stock options, and expected payments from long-term plans.

Term of office of the board of directors

The position of the board of directors has always been considered one of the most powerful positions in a company. The strength of the board of directors as measured by their tenure is able to have a major influence on the performance of the Company (Zahroh & Hersugondo, 2021). This may stem from the importance of the position due to the fact that the board of directors is expected to be able to position their industry to generate wealth and optimize future opportunities for stakeholders, and thus are expected to pay more attention to the potential bankruptcy of the Company.

Financial expertise of the board of directors

In addition to managerial expertise, directors with expertise in finance can provide significant benefits to the Company (Ardiyanto & Marfiana, 2021). Expertise in finance can be obtained through formal education or work experience in accounting. In addition, this expertise can also be obtained through positions such as financial director, accounting clerk, chief accountant, auditor, public accountant, president director, or president director (Aifuwa & Embele, 2019). The financial expertise of directors is usually proxied by the proportion of board members who have a financial background, as revealed in research (Robinson *et al*, 2012).

To answer the concept of the problem, a hypothesis development can be made which can be seen in the following framework of thought:

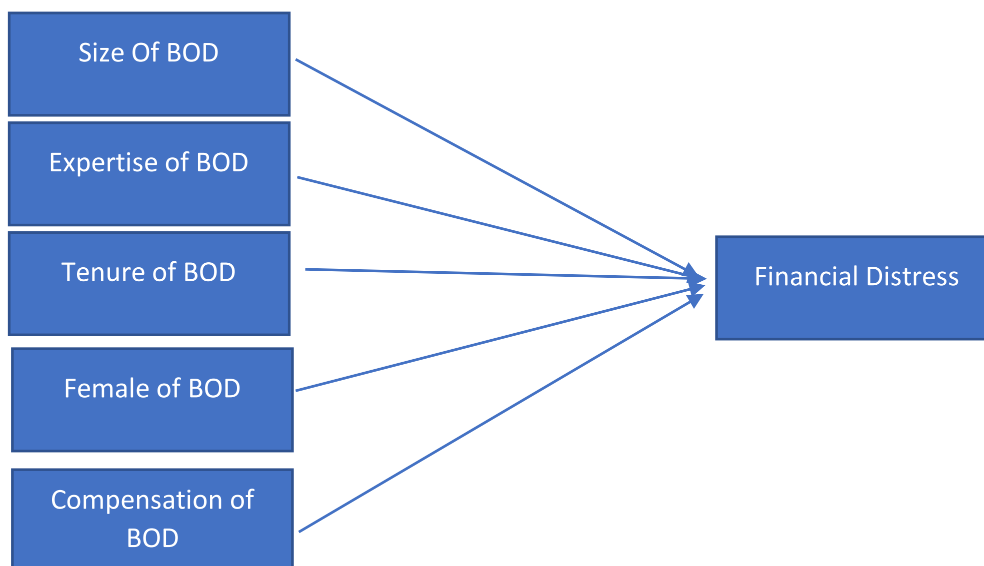

Figure 1. Research Model

The literature on Corporate Governance almost unanimously agrees on the fact that, the commitment to increase accountability and transparency in corporate activities, in addition to economic and financial activities, has grown rapidly among large companies and has become

a relevant topic in corporate management. Through the perspective of agency theory, the following hypothesis is made:

H1 : The size of the board of directors has a negative effect on the financial distress.

H2 : The accounting expertise of the board of directors has a negative impact on financial distress.

H3 : Term of office of the board of directors has a negative impact on financial distress.

H4 : female board of directors has a negative impact on the company's financial difficulties

H5 : Board of director compensation has a negative impact on the company's financial difficulties

3. METHOD

This type of research uses a quantitative approach method with the data collection technique used is secondary data collection, where the data collected from previously existing data. The sample of this study is all manufacturing companies listed on the Indonesia Stock Exchange in 2019-2022. The sampling technique used in this study is the purposive sampling method, namely the sample is selected based on the suitability of the characteristics with the specified sample criteria (considerations) in order to obtain a representative sample. The sample criteria used are; 1) Manufacturing companies listed on the IDX list for the 2019-2022 observation year and have each measured variable indicator.

The operational variables in this study consist of independent variables, namely the characteristics of the board of directors and dependent variables, namely financial difficulties. The following is a table of operational variables:

Table 1. Operational Variables

Variables	Measurement	Source
Financial Distress	Altman Z-score	(Altman *et al*, 2013)
Size of the board of directors	Number of board of directors	Corporate report
Female board of directors	Ratio of female board directors to total number of board directors	Corporate report
Board compensation costs	The nominal amount of the board's compensation costs	Corporate report
Term of office of the board of directors	Average term of office of the board of directors	Corporate report
Financial expertise of the board of directors	Board of directors who have a background in economics and accounting education	Corporate report

Source: Researchers. (2024).

The basic model we estimate to analyze the impact of demographic and structural diversity in boards on environmental performance for Indonesian firms is as follows: (1) Descriptive analysis; (2) Panel Data Regression Analysis, include OLS method or Common Effect Model, Fixed Effect model and Random Effect model; (3) Classical Assumption Test; (4) hypothesis testing.

The regression model is as follows:

$$FD = \alpha + \beta 1 Size + \beta 2 Expert + \beta 3 Tenure + \beta 4 Female + \beta 5 Compensarion\ \varepsilon$$

Where,

FD = Financial distress

Size = Size of the board of directors

Expert = Financial expertise of the board of directors

Tenure = Term of office of the board of directors

Female = Female board of directors

Compensartion = Board compensation costs

4. RESULT

Table 2. Statistic Descriptives

	N	Min	Max	Mean	Std. Dev
Y_Fin Distress	76	0.02	19.69	5.50	4.33
X1_Size	76	5	12	6.36	1.15
X2_Expert	76	0.00	0.75	0.58	0.12
X3_tenur	76	4	8	5.55	1.18
X4_Female	76	0.00	0.67	0.17	0.18
X5_Compensation	76	20.66	26.32	23.53	1.24
Valid N (listwise)	76				

Source: Data Processed. (2024).

Based on the results of the descriptive test, it was obtained that the average number of the Company's board of directors was 5 people. While for accounting and financial expertise on the board of directors, the average company studied had 58 percent of the total existing board of directors. The average term of office of the board of directors was 5 years in one period. Regarding the number of women serving on the board of directors, the average was 17 percent. And the maximum compensation value of the board of directors was 263 billion.

Table 3. Assumption Classic Test Result

Variables	Heteroscedasticity		Multicollinearity	
	t	Sig.	Tolerance	VIF
(Constant)	0.225	0.822		
X1	0.899	0.372	0.931	1.075
X2	-2.555	0.013	0.918	1.089
X3	-1.258	0.212	0.866	1.155
X4	0.228	0.820	0.922	1.085
X5	1.260	0.212	0.952	1.050
Durbin Watson: 1,063				
Asymp Sig. (2-tailed) One Kolmogorov sminorv : 0,200				

Source: Data Processed. (2024).

In the table of classical assumption test results above, it can be seen that all classical assumption tests, starting from the normality test, heteroscedasticity test, multicollinearity test, and classical assumption test, have all been met and are free from classical assumptions.

Table 4. Hypothesis test results

	Model	Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-0.628	9.322		-.067	.947
	X1_Size	0.496	0.427	0.132	1.162	0.249
	X2_Expert	-12.210	3.941	-0.354	-3.099	0.003
	X3_Tenure	-0.543	0.431	-0.148	-1.260	0.212
	X4_Gender	-1.776	2.692	-0.075	-0.660	0.512
	X5_Comp	0.570	0.390	0.164	1.463	0.148

a. Dependent Variable: Financial distress
Adjusted Rsquare: 0.103
Sig F: 0.026

Based on the results of the model suitability test, it can be said that the influence of the independent variable on the dependent is 10.3% while the remaining 89.7% is influenced by other variables not included in the study. The F test value has a sig value of 0.026 <0.01 so that it can be interpreted that the independent variable has a simultaneous effect on the dependent variable. And in the results of the hypothesis test, the variable number of board of directors has a sig value of 0.249> 0.05 so that it can be said that H1 is rejected. While the variable expertise of the board of directors has a sig value of 0.003 <0.05 with a positive coefficient direction, it can be said that the variable of the board of directors who have accounting expertise has a negative effect on the bankruptcy prediction value so that it can be said that H2 is accepted. The variable of the position of the board of directors has a sig value of 0.212> 0.05 so that it can be said that H3 is rejected. The variable of women's positions on the board of directors has a value of 0.512> 0.05 so that it can be said that H4 is rejected. The variable compensation of the board of directors has a sig value of 0.148> 0.05 so that it can be said that H5 is rejected.

Discussion

The number of board of directors on the company's financial difficulties.

Based on the results of the hypothesis, it is said that the number of board of directors does not affect financial difficulties or bankruptcy predictions of companies. This means that although the board of directors has an important role in monitoring and making strategic decisions, bankruptcy is often the result of financial problems that have developed over time. The number of board members may not be enough to influence the day-to-day operational decisions that determine the financial health of the company. This result is the same as Puspitasari et al., (2023) which states that in its implementation in determining company policy, the board of directors has limitations in its activities. However, this result is contrary to Brédart (2014) which says that a larger board of directors is that the increased number of

members increases their disciplinary control over the CEO and the more directors serving on the board, the better connected the firm is to critical resources.

The accounting expertise of the board of directors regarding the Company's financial difficulties

The educational background of board members that is in accordance with the field they work in will be more effective and efficient in making decisions (Astuti & Fitria, 2019). Based on the results of the hypothesis, it shows that the expertise of the board of directors has a negative effect on financial difficulties or predictions of corporate bankruptcy. This shows that the more members of the board of directors who have accounting expertise will be able to identify financial problems earlier, so that directors can take corrective action before the situation gets worse and reduce the possibility of bankruptcy. According to Brédart (2014) a large board has a positive effect on the diversification of expertise.

The term of office of the board of directors regarding the Company's financial difficulties

Based on the results of the hypothesis, it shows that the term of office of the board of directors does not affect the financial difficulties or bankruptcy predictions of the Company. This shows that the term of office, whether long or short, although it provides stability, also cannot hinder adaptation to changes in the business environment so that important decisions are often more influenced by management.

Board of Directors' Gender on Company Financial Distress

Based on the results of the hypothesis, it shows that the gender of the board of directors does not affect the financial difficulties or bankruptcy predictions of the Company. This means that the presence or percentage of women on the board of directors does not have a significant impact on the possibility of the Company experiencing difficulties. Other factors can be caused by the role of women in the position of directors may still be limited by norms so that they affect decision making.

Compensation of the board of directors for the Company's financial difficulties

Based on the results of the hypothesis, it shows that the compensation of the board of directors has no effect on financial difficulties or bankruptcy predictions of the Company. It can be said that the compensation given to the board of directors has no impact on motivation or performance, besides it can also be caused by an indirect relationship between compensation and operational decisions.

5. CONCLUSION

Based on the results of the study, it was found that of all the characteristics of the board of directors measured, the accounting expertise of the board of directors has a negative effect on the Company's financial difficulties. while other characteristics do not affect the Company's financial difficulties. This study has limitations, one of which is not measuring financial ratios to see factors that can affect the Company's financial difficulties. in subsequent studies, financial ratio measurements can be added.

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