Formosa Journal of Multidisciplinary Research (FJMR)
Vol. 4 No. 9, 2025: 4503-4520

The Influence of Credit Risk on Financial Distress with Corporate Governance as a Moderating Variable

Roma Novaldi
Universitas Negeri Padang, Indonesia
Corresponding Author: Roma Novaldi romanovaldi12@gmail.com

A R T I C L E I N F O
Keywords: Credit Risk, Good Corporate Governance, Financial Distress, Profitability, Growth Opportunity

Received : 16, August
Revised : 30, August
Accepted: 27, September

A B S T R A C T
This study aims to analyze the effect of credit risk on financial distress in banking companies in Indonesia and to assess the role of corporate governance (GCG) as a moderating variable. The research employs a quantitative approach with the population consisting of all banking companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period. Secondary data were obtained from annual reports of the companies and analyzed using a moderated regression analysis (MRA) model. The findings reveal that credit risk has a positive effect on financial distress, indicating that the higher the level of non-performing loans, the greater the likelihood of banks experiencing financial distress. Meanwhile, corporate governance does not show a significant role in moderating the relationship between credit risk and financial distress. These findings suggest that Indonesian banks must pay closer attention to credit risk in order to prevent financial distress.

DOI: https://doi.org/10.55927/fjmr.v4i9.438
ISSN-E: 2829-8896
https://npaformosapublisher.org/index.php/fjmr

INTRODUCTION

In early 2020, Indonesia officially confirmed its first case of COVID-19, which subsequently had a major impact on the national economy. Various companies began implementing work-from-home systems and taking operational efficiency measures. However, within months, many companies were unable to survive, particularly micro, small, and medium enterprises (MSMEs), which had previously contributed around 60% to Indonesia's economy. The pressure caused by the pandemic was not only felt by the business world but also by the banking sector, which plays an important role in maintaining economic stability. According to Suretno and Bustam (2020), banks play a role in supporting the development of MSMEs by providing access to capital while also functioning as agents of national development. Although bank lending generally contributes positively to economic growth, the crisis caused by the COVID-19 pandemic since 2020 has actually reduced the performance of banks.

The banking sector has a fundamental contribution to maintaining national economic stability and growth. As one of the main pillars of the financial system, banks play an important role in providing the financing needed by the business world. This strategic position is inseparable from the intermediary function, namely channelling excess public funds to parties experiencing capital shortages. In this mechanism, public trust is a key factor. A high level of trust enables banks to carry out intermediation optimally, thereby increasing profitability and encouraging asset expansion. Thus, public trust can only be maintained if banks remain financially sound and avoid liquidity problems (Putri et al., 2018).

Credit risk refers to the potential for losses that arise when debtors are unable to meet their payment obligations as agreed. One indicator used to assess this level of risk is the Non-Performing Loan (NPL) ratio. A high NPL ratio reflects poor credit management quality. Such management encompasses a series of activities, ranging from loan disbursement and liquidation to the monitoring and supervision of loans granted.

The implementation of good corporate governance principles is one of the central issues in the banking industry. This is inseparable from the experience of the 1997 financial crisis that hit Indonesia and had a serious impact on almost all economic sectors, including the banking sector. The crisis triggered the most severe turmoil in the history of the national banking sector, which led to a significant decline in the performance of banking institutions. In a seminar on banking restructuring in Jakarta in 1998, a number of factors were identified as causing the deterioration of the banking sector. These factors included an increase in the ratio of non-performing loans, which forced banks to bear large provisions for losses, thereby reducing their lending capacity; pressure on liquidity, which reduced public confidence in banks and the government and triggered massive withdrawals; a continuous weakening of bank capital; the inability of many banks to meet their obligations due to the sharp depreciation of the rupiah; and unprofessional banking management practices.

A financial crisis is a condition in which an entity faces difficulties in meeting its financial obligations. This situation can ultimately lead to

bankruptcy, although not all financial crises end this way. When a financial crisis hits a banking institution, it can undermine public confidence, not only in the bank concerned, but also potentially causing a contagion effect on other banks.

This description emphasises that corporate governance plays an important role as a variable that can moderate the relationship between credit risk and financial difficulties. Good governance can strengthen or weaken the influence of credit risk on a bank's financial condition. The relevant theoretical basis supports the importance of this study, making research on 'The Effect of Credit Risk on Financial Difficulties with Corporate Governance as a Moderating Variable' relevant.

LITERATURE REVIEW

Agency Theori

Agency theory was introduced by Jensen and Meckling (1976) to explain the contractual relationship between principals and agents and the various problems that may arise from that relationship. In the context of banking, capital owners act as principals, while management acts as agents authorised to manage the company's resources. This theory emphasises that the role of management as agents is not only to optimise profits but also to maintain the stability and health of the bank so that the interests of capital owners remain protected.

Signalling Theory

The signalling theory introduced by Spence (1973) explains the communication mechanism that arises due to information asymmetry between internal parties of the company, such as management, and external parties, including investors, creditors, and regulators. In such situations, management attempts to send certain signals to the market to convey the actual condition of the company. The provision of these signals is particularly relevant in the context of financial information, where transparency is key to reducing uncertainty and increasing external parties' confidence in the company.

Financial Distress

Lee et al. (2010) state that financial difficulties play an important role in affecting the company's operational continuity and ability to generate profits, which in turn can increase the risk of bankruptcy. This condition generally arises when a company's income is no longer able to cover all of its operational costs and financial obligations. Thus, the greater the liability burden borne by a company, the higher the potential financial risk it must face.

Credit Risk

Credit risk includes several types of risk, including financing concentration risk, counterparty credit risk, and settlement risk. Financing concentration risk arises when the distribution of funds is focused on certain parties or groups, whether within a particular industry, business sector, or geographical area. This condition can lead to significant potential losses and even threaten the continuity of banking operations.

Good Corporate Governance

Good Corporate Governance (GCG) is a mechanism that guides professional company management through the application of the principles of transparency, accountability, responsibility, independence, and fairness. The application of GCG is believed to increase a company's attractiveness to investors because it creates a healthier and more competitive business climate. The Organisation for Economic Co-operation and Development (OECD) emphasises that GCG practices need to support the creation of transparent and efficient markets, maintain consistency in the application of regulations, and ensure clarity in the division of tasks and responsibilities between supervisory bodies, regulators, and implementing parties. Furthermore, Rahardjo (2018:228) outlines the five main principles underlying GCG, namely transparency, accountability, responsibility, independence, and equality and fairness.

Referring to the findings of Aurellie Zulfa et al. (2021) and Celine Alexandra et al. (2022), an increase in the number of non-performing loans accompanied by an increase in liquidity demand has been shown to put serious pressure on banking stability. From this background, it can be understood that banks play a fundamental role in the economy, where lending activities are believed to be able to drive national economic growth. However, the higher the volume of credit distribution, the greater the credit risk that must be faced.

H1: Credit Risk Has a Positive Effect on Financial Distress

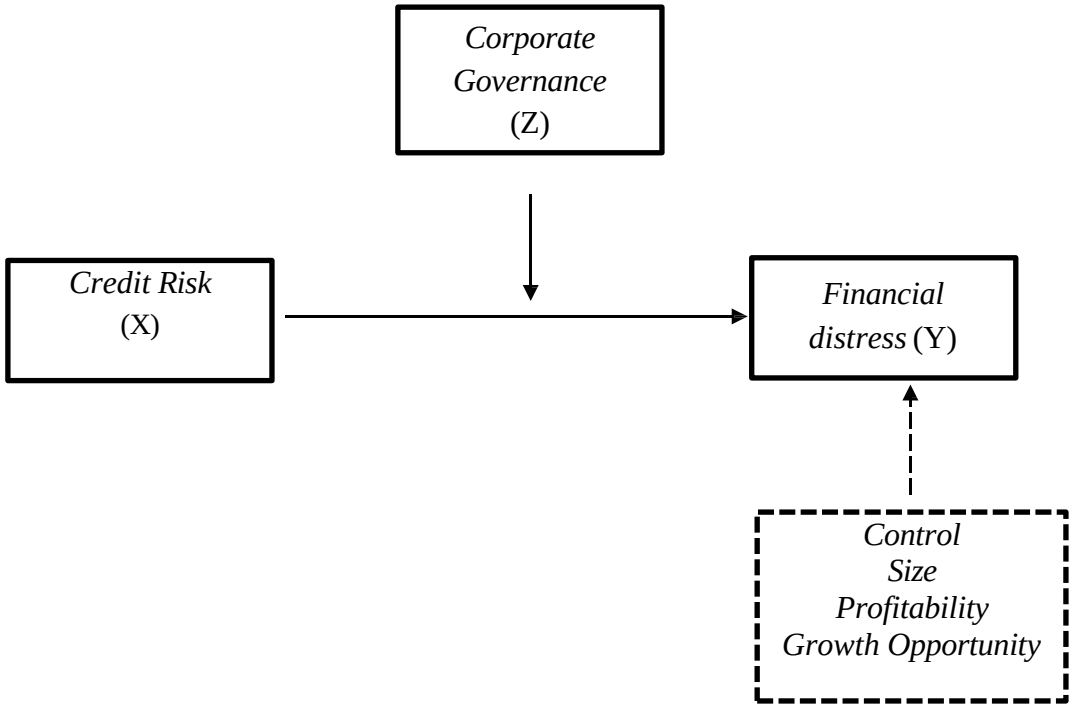
A number of previous studies have shown a correlation between corporate governance and financial difficulties. Yuda and Arifin (2022) found that the implementation of corporate governance has a negative effect on the potential for financial distress. Similar results were also shown by Ika (2020), who examined the relationship between corporate governance and financial difficulties. In addition, a study conducted by Gaos and Mudjiyanti (2021) confirmed that good corporate governance not only affects banking risk but also has a negative influence on the possibility of financial difficulties.

H2: Corporate Governance Negatively Impacts Financial Distress.

The relationship between credit risk and financial distress tends to be positive in the event of negative selection, i.e. when most of the loans disbursed do not yield productive results. Conversely, this relationship can become negative if banks overuse loan loss reserves as a leverage instrument. Thus, it can be concluded that the implementation of good corporate governance has the potential to weaken the positive relationship between credit risk and financial distress.

H3: Corporate Governance Will Weaken the Positive Relationship Between Credit Risk and Financial Distress.

Corporate governance acts as a variable that can moderate the relationship between credit risk and financial distress. This governance mechanism can either strengthen or weaken the influence of credit risk on financial distress. The existence of the gap phenomenon, previous research findings, and relevant theoretical foundations form the basis for this study to examine 'The Effect of Credit Risk on Financial Distress with Corporate Governance as a Moderating Variable.'



Gambar 1. Conceptual Framework

METHODOLOGY

Type of Research

According to Sugiyono (2020:2), a research method is a scientific procedure used to obtain data or information for a specific purpose. In this study, the approach used is the quantitative method. Sugiyono (2021:16) explains that quantitative research is based on a specific sampling paradigm, where data is obtained through research instruments and then analysed using statistical techniques to describe phenomena and test the proposed hypothesis.

Research Object

The objects in this study are companies listed on the Banking Sector Index on the Indonesia Stock Exchange (IDX), with data obtained through the official website www.idx.co.id. The research period covers 2019 to 2023, using information sourced from the annual reports of banking companies listed on the IDX.

Population and Sample

The population is the entire object or subject of research that has certain characteristics in accordance with the study objectives, enabling researchers to conduct analyses and draw conclusions. In this study, the population includes 47 banking companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period.

To determine the sample, a sampling method capable of producing an optimal representation of the population was used. Given that the population

size was relatively small, namely 47 companies, this study used a saturated sampling technique (census), in which all members of the population were used as research samples. Thus, the sample in this study consisted of all banking companies listed on the IDX during the 2019–2023 period.

Data and Data Sources

This study uses a quantitative approach by utilising secondary data. According to Sekaran (2011), secondary data includes information obtained by researchers from previously available sources, both published and unpublished, from within and outside the organisation, including statistical publications, official reports, and other relevant sources. In this study, secondary data was obtained from the annual reports of banking companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period, which were accessed through the official website www.idx.co.id, as well as other supporting sources such as the Indonesian Capital Market Directory (ICMD).

Operational Definition

According to Sugiyono (2018:38), an operational definition is the process of translating a research variable into indicators that can be measured concretely, thereby making it easier for researchers to observe, analyse, and draw conclusions objectively.

Provide a clear and concise description of your research method, population and sample, and data analysis tools.

Table 1. Operational Definition

Variable	Definition	Measurement Tool	Source
Financial Distress	Financial distress is measured using the Altman Z-score method, which helps determine if a company is experiencing financial difficulties.	Z = 6.56X1 + 3.26X2 + 6.72X3 + 1.05X4 X1: Working Capital / Total Assets X2: Retained Earnings / Total Assets X3: EBIT / Total Assets X4: Market Value of Equity / Book Value of Total Debt	Altman, E.I., Hartzell, J., & Peck, M. (1995). "Emerging Market Corporate Bonds: A Scoring System." Salomon Brothers.
Credit Risk	This study measures credit risk using the Non-Performing Loan Ratio (NPLR), where the risk of financial institutions arises when assets decline	NPLR = NPL / Total Loans NPL = Non-performing loans x 100% / Total Credit.	Bank Indonesia (BI) and Financial Services Authority (OJK): POJK No. 15/POJK.03/2017

	in value.		
Corporate Governance	Corporate Governance is a set of mechanisms related to company management, the board of directors, shareholders, and auditors in setting goals and direction.	GCG Self-assessment rated from 0 to 5	Bank Indonesia Circular Letter No. 12/13/DPbS (2010:23)
Size	Company size represents the scale of assets owned by the company. The larger the company, the higher its total assets.	Natural logarithm of total assets	Weston & Thomas (2009), Husnan & Pudjiastuti (2007), Muchlisin (2020)
Profitability	Profitability indicates a company's ability to generate profits.	ROA = Net Income / Total Assets	Corporate Finance Institute (CFI)
Growth Opportunity	Growth opportunity is a combination of potential future investment opportunities with positive Net Present Value and the company's tangible assets.	MBVE = (Shares Outstanding x Closing Price) / Total Equity	Wall Street Prep

Data Analysis Techniques

1. Descriptive Statistics

According to Ghozali (2016), descriptive statistics provide an overview or description of data based on the mean, standard deviation, variance, maximum, sum, range, kurtosis, and skewness.

2. Multiple Linear Regression Analysis

The multiple linear regression model used in this study to express the functional influence between the independent and dependent variables. Ghozali (2016) used SPSS 23.0 for data processing. In this study, the regression equation model used for the Effect of Credit Risk on Financial Distress with Corporate Governance as a Moderating Variable is as follows:

Model 1:

$FD = \alpha + \beta 1CR + \beta 2SIZE + \beta 3PROF + \beta 4GROWTH + \varepsilon$

Model 2 (MRA):
FD = α + β1CR + β2SIZE + β3PROF + β4GROWTH + β5GCG + ε
Model 3
(MRA)= FD α + β1CR + β2SIZE + β3PROF + β4GROWTH + β5GCG + β6CR*GCG + ε
Where:

α	= Constant
CR	= Credit Risk
β1...β3	= Coefficient
GCG	= Ownership Concentration
SIZE	= Firm Size
PROF	=Profitability
GROWTH	=Growth Opportunity

Classical Assumption Test

Before conducting a hypothesis test, a classical assumption test must first be performed. Several basic assumptions must be met, as follows (Ghozali, 2016).

a. Normality Test

As the name suggests, the normality test is a test of the normality of the data. The purpose of the normality test is to test whether the dependent and independent variables in the regression method both have a normal distribution (Ghozali, 2013: 160). A good regression model requires data with a normal or near-normal distribution. In this study, two methods were used to detect whether the data were normally distributed: graphical analysis and statistical analysis.

Graphical analysis is the easiest way to determine the normality of residuals, namely by examining a histogram graph that compares the observed data with a distribution close to normal. Another statistical test that can be used to test the normality of residuals is the non-parametric Kolmogorov-Smirnov (K-S) test. If the significance value of the Kolmogorov-Smirnov (K-S) test exceeds 0.05, the assumption of normality is met.

b. Multicollinearity Test

Multicollinearity occurs when there is a perfect or nearly perfect linear relationship between some or all of the independent variables in a regression model. The multicollinearity test aims to determine whether the regression model detects correlation between the independent variables. A good regression model should have no correlation between the independent variables (Ghozali, 2013: 105).

To test for multicollinearity, analyze the correlation between variables and calculate the tolerance value and variance inflation factor (VIF). Multicollinearity occurs if the tolerance value is less than 0.1, meaning there is no correlation between the independent variables with a value greater than 95%. The VIF value is greater than 10. If the VIF is less than 10, it can be said that the independent variables used in the model are reliable and objective.

c. Autocorrelation Test

There are several methods for testing for autocorrelation, one of which is the Durbin-Watson test. This Durbin-Watson test has a fundamental problem: the exact distribution of the statistic is unknown. However, Durbin and Watson tabulated the du and dl values for the 5% and 1% significance levels, which are known as the Durbin-Watson table.

d. Heteroscedasticity Test

If a model has a non-constant variance, it is called heteroscedasticity. The consequence of a model with a non-constant variance is that the model may still be linear and unbiased, but it may lack minimum variance, making the standard error calculation unreliable, resulting in the model being a Linear Unbiased Estimator (LUE).

In other words, the regression model used must pass the heteroscedasticity test to obtain a BLUE estimator. The author uses the White method to test for the presence of heteroscedasticity in this study. To explain the White method, assume we have the following model:

$$Y_i = \beta + \beta 1X1Z1 + \beta_2X1Z2 + \beta 3X1Z3 ++ \beta 4X1M + \beta 5Z1Z2 + \beta 6Z1Z3 + \beta 7Z2Z3 + \beta 8Z1M + \beta 9Z2M + \beta 10Z3M$$

H0: Homoscedasticity
H1: Heteroscedasticity

The White test steps are as follows: The White heteroscedasticity test is based on the number of samples (n) multiplied by R^2, which then follows a chi-square distribution with as many degrees of freedom as the independent variables excluding the constant in the auxiliary regression. Decision-making regarding heteroscedasticity issues can be seen from the Obs*R-squared probability value:

1. If the Obs*R-squared probability value is greater than $\alpha = 5\%$, then the model does not have a heteroscedasticity problem.
2. If the Obs*R-squared probability value is less than $\alpha = 5$, then the model does have a heteroscedasticity problem.

Coefficient of Determination

The coefficient of determination (R2), as explained by Ghozali (2016), serves as a fundamental indicator for measuring the capacity of a model to explain variations in the dependent variable. If the R2 value is low, this indicates that the ability of the independent variables to predict or explain the dependent variable is very limited. Conversely, an R^2 value close to one indicates that the independent variables contribute almost entirely to the essential information in predicting fluctuations in the dependent variable (Ghozali, 2016).

F Test

The F statistical test (often referred to as the Simultaneous Test) has a crucial function in showing whether all independent variables integrated in the model collectively (simultaneously) have a significant effect on the dependent variable (Ghozali, 2016). The statistical decision-making process in the F test is based on a comparison between the calculated F value produced by the model estimation

and the table F value (critical value) at a certain significance level.

1. If the calculated F value > F table or the probability < the significant value (sig ≤ 0.05), the hypothesis is accepted. This means that the independent variables simultaneously have a significant effect on the dependent variable.
2. the calculated F value < F table or the probability < the significant value (sig ≥ 0.05), the hypothesis is rejected. This means that the independent variables simultaneously do not have a significant effect on the dependent variable.

T-Test

The t-statistic test (or partial test) plays a fundamental role in evaluating the extent to which independent variables individually have a significant effect on fluctuations or variations in the dependent variable (Ghozali, 2016). The process of determining whether this influence is significant or not is carried out by comparing the t-value produced by the model estimation with the t-table value (critical value) as the criterion, namely:

1. If the calculated t-value > t-table or the probability < the significance level (sig ≤ 0.05), then Ha is accepted and Ho is rejected. This means that the independent variable has an effect on the dependent variable.
2. If the calculated t-value < t-table or the probability > the significance level (sig ≥ 0.05), then Ha is rejected and Ho is accepted. This means that the independent variable has no effect on the dependent variable.

RESEARCH RESULT

Table 2. Descriptive Statistic

Variable	N	Descriptive Statistic			
		Min	Max	Mean	Std. Dev
FD	190	0.38	1.81	0.93	0.26
NPL	190	0.00	1.01	0.12	0.27
GCG	190	1.0	3.0	2.01	0.16
SIZE	190	28.55	36.87	31.54	1.64
GROWTH	190	0.02	12.08	1.83	2.05
PROFITABILITY	190	0.00	0.05	0.01	0.01
Valid N (listwise)	190				

Based on the Altman Z-Score table, the average is 0.93 (distress category), the highest is 1.81 (Bank Neo, 2023), and the lowest is 0.38 (Bank Raya & IBK, 2022). The average NPL is 0.12 (healthy), the highest is 1.01 (Bank BSWD, 2023), and the lowest is 0.00 (NOBU, 2019). The average GCG is 2.01 (fair), the highest is 3 (BACA, 2020), and the lowest is 1 (BBCA, 2021). The average bank size (Size) is 31.54, the largest is 37 (BBNI, 2022), and the smallest is 29 (DNAR, 2020). The average ROA is 0.01, the maximum is 0.05, and the minimum is 0.00. Average growth is 1.83, the highest is 12.08 (BBNI, 2021), the lowest is 0.02 (Panin Syariah, 2019).

Table 3. Normality Test

Statistic	Value
N	190
Mean	0.00
Std. Deviasi	0.25
Most Extreme Difference (Absolut)	0.06
Kolmogorov-Smirnov Z	0.06
Asymp. Sig. (2-tailed)	0.07

The results of the One-Sample Kolmogorov-Smirnov test, after removing outliers and transforming, yielded an Asymp. Sig. (2-Tailed) value for six normally distributed variables, exceeding the 0.05 significance level. These test results indicate that the data in the study are normally distributed Tabel 4. Uji Multikoliearitas.

Table 4. Multicollinearity Test

Collinearity Statistics					
Model 1		Model 2		Model 3	
Tolerance	VIF	Tolerance	VIF	Tolerance	VIF
0,982	1,019	0,979	1,021	0,675	1,481
0,929	1,076	0,876	1,142	0,869	1,150
0,977	1,024	0,977	1,024	0,975	1,026
0,916	1,091	0,916	1,092	0,915	1,093
		0,935	1,069	0,306	3,264
				0,283	3,532

It can be seen that all independent variables are uncorrelated with each other because the tolerance values ≥ 0.10 and VIF value ≤ 10 (Gujarati, 1995). Thus, it can be concluded that there is no multicollinearity problem.

Table 5. Autocorrelation Test

Model	Durbin Watson
1	2.250
2	2.253
3	2.264

The autocorrelation test obtained a Durbin Watson (DW) value in model 1 of 2,250, in model 2 2,253, in model 3 2,264. So according to the significance level of 0.05 (5%), if the DW value is between -2 and +2 then there is no autocorrelation.

Table 6. Heteroscedasticity Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.172[a]	0,030	0,024	0,2622449
2	.304[a]	0,092	0,068	0,2563533
3	.305[a]	0,093	0,063	0,2569566

The results of the heteroscedasticity test using the White Test in table 4.6 obtained Chi Square count = N x RsQuare, 190x0.03 = 5.70, Df = n-1 = 190-1 = 189, Chi Square Model 1 (df 189 = 222.076 a = 0.05) Based on the results above, it states that the chi square count < chi square table 5.70 <222.076, so it can be concluded that the data does not experience symptoms of heteroscedasticity. In model 2 Chi Square count = N x RsQuare, 190x0.09 = 17.1. states that the chi square count < chi square table 17.1 <222.076, so it can be concluded that the data does not experience symptoms of heteroscedasticity. In model 3 Chi Square count = N x RsQuare, 190x0.09 = 17.1. states that the calculated chi square < chi square table 17.1<222.076, so it can be concluded that the data does not show symptoms of heteroscedasticity.

Tabel 7. Moderated Regression Analysis

	Model 1			Model 2			Model 3		
	B	**T**	**Sig**	**B**	**T**	**Sig**	**B**	**T**	**Sig**
(Constant)	0,51	1,39	0,16	0,10	0,21	0,83	0,25	0,40	0,68
Credit Risk	0,14	2,09	0,03	0,14	2,14	0,03	-2,15	-0,36	0,71
Size	0,01	0,89	0,37	0,01	1,17	0,24	0,01	1,19	0,23
Growth Opportunity	0,00	0,14	0,88	0,00	0,14	0,88	0,00	0,15	0,87
Profitability	6,26	3,45	0,00	6,31	3,48	0,00	6,28	3,46	0,00
GCG				0,14	1,23	0,21	0,06	0,27	0,78
CR*GCG							1,15	0,38	0,70
R Square		0,10			0,10			0,11	
F Count		5,23			4,50			3,75	
F Sig.		0,00			0,00			0,00	

Moderated Regression Analysis model 1

Financial Distress = -0.11 + -0,81X1 + 0,03C1 + 2,61C2 – -0,00C3 + ε

In Moderated Regression Analysis model 1. The Adjusted R Square value shows a value of 0.10 or 10%. The calculated F value is 5.23 and the significance of F is 0.000. So Sig F <5%. The significance value (p-value) is 0.03 and the regression coefficient value is 0.14. Because the significance of the α value is smaller than 5% (0.03>0.05), the Non-Performing Loan variable has a positive effect on Financial Distress. The significance value (p-value) is 0.37 and the regression coefficient value is 0.01. Because the significance of the α value is smaller than 5% (0.37>0.05), the Size variable has a positive effect on Financial Distress. The significance value (p-value) is 0.00 and the regression coefficient value is 6.26. Because the significance of the α value is smaller than

5% (0.00<0.05), the Profitability variable has a negative effect on Financial Distress. The significance value (p-value) is 0.88 and the regression coefficient value is 0.00. Because the significance value of α is less than 5% (0.88>0.05), the Growth Opportunity variable has a positive effect on Financial Distress.

Moderated Regression Analysis Model 2

Financial Distress = -0,11 + -0.81X1 + 0,03C1 + -0,00C2 – 2,61C3 – -0,05M + ε

In Moderated Regression Analysis model 2, the Adjusted R Square value shows a value of 0.10 or 10%. The calculated F value is 4.50 and the F significance is 0.00, so Sig F <5%. The significance value (p-value) is 0.21 and the regression coefficient is 0.14. Since the significance level α is greater than 5% (0.21 > 0.05), the Good Corporate Governance variable has no partial effect on Financial Distress.

Moderated Regression Analysis Model 3

Financial Distress = -0.11+ -0,81X1 + 0.32C1 + -0.00C2 – 2,61C3 – -0,05M – -0,41X1M + ε

In Moderated Regression Analysis model 3, the Adjusted R Square value shows a value of 0.11 or 11%. The calculated F value is 3.75 and the significance of F is 0.000. So Sig F <5%. The significance value (p-value) is 0.70 and the regression coefficient is 1.15. Since the significance level α is greater than 5% (0.70 > 0.05), the Good Corporate Governance variable partially weakens the relationship between Non-Performing Loan and Financial Distress.

DISCUSSION

The Effect of Credit Risk on Financial Distress

Data analysis and hypothesis testing have concluded that credit risk, proxied by the Non-Performing Loans (NPL) indicator, has a significant positive impact on financial crises. An increase in the NPL ratio reflects a substantial increase in non-performing loans borne by banking institutions, which directly increases credit risk exposure. Thus, the greater the portion of liabilities financed by loans, the higher the potential for the bank to experience financial difficulties.

This condition is caused by the escalation of non-performing loans in financing activities, as reflected in the surge in the NPL ratio. In turn, this situation triggers a decline in interest income, forcing an increase in provisions for loan loss reserves, and eroding the bank's liquidity and profitability. The implication is that an increase in NPLs is not merely an indication of a decline in asset quality, but a major factor driving a crisis in the banking sector.

When banks' revenues decline, their vulnerability to financial difficulties increases sharply. In this context, the function of banks as financial intermediaries requires effective screening mechanisms for prospective borrowers. Failure to screen properly can trigger moral hazard and adverse selection problems, whereby high-risk borrowers replace high-quality borrowers. As a result, the overall quality of the loan portfolio deteriorates, which is manifested in an increase in the NPL ratio.

This increase in NPLs further erodes profitability, increases provisioning costs, and erodes the bank's core capital, thereby exacerbating the potential for

financial difficulties. The empirical findings of this study confirm that banks operating with lower credit risk levels tend to show better resilience to financial crises.

The results of this study are in line with the findings of previous studies, including those by Buchdadi et al. (2020), Gadzo et al. (2019), and Djebali & Zaghdoudi (2020), which consistently conclude that credit risk has an impact on financial crises. Credit risk essentially arises as a logical consequence of lending activities, where the allocation of third-party funds in the form of loans is an essential function of banks to generate interest income. Therefore, proper and proactive credit risk management is crucial to maintaining financial stability and ensuring the operational performance of the banking sector.

The Effect of Corporate Governance on Financial Distress

Based on the results of data analysis and hypothesis testing, this study found that corporate governance, as measured by institutional ownership proxies, did not show a significant positive effect on financial distress. These findings indicate that both institutional and managerial ownership failed to play a crucial role in influencing the financial condition of companies, particularly in preventing distress.

These results are in line with the research by Yuliandriani et al. (2022), which explains that in Indonesian companies, institutional ownership tends to be concentrated in a certain group of parties, thereby limiting the effectiveness of the supervisory function. Investors' main orientation is more focused on short-term profits than on strict supervision of managerial performance. Therefore, institutional ownership does not contribute significantly to improving financial performance or warding off the risk of financial difficulties.

Similar findings were also reported by Utami and Dirman (2022), who concluded that neither institutional ownership nor managerial ownership had a substantial impact on financial difficulties among entities listed on the Indonesia Stock Exchange. Furthermore, Mevania et al. (2022), in their research on basic material sector companies for the 2019–2021 period, confirmed that managerial ownership was not proven to affect financial difficulties. The consistency of these findings reinforces the argument that corporate governance mechanisms that focus on ownership structure are not always effective in the Indonesian market context, especially in certain sectors.

Therefore, the role of institutional and managerial investors as control mechanisms (both external and internal) needs to be examined more deeply, given that the empirical evidence from this study shows that their influence on financial difficulties has been proven to be statistically insignificant.

The Effect of Corporate Governance Moderates the Effect of Credit Risk on Financial Distress

The empirical findings of this study indicate that corporate governance, proxied by institutional ownership, acts as a moderating variable in the causal relationship between credit risk and financial distress. These results show that institutional ownership, as an element of Good Corporate Governance (GCG)

mechanisms, does not affect the intensity of the impact of Non-Performing Loans (NPLs) on the probability of financial distress.

Thus, the effectiveness of corporate governance in its capacity as a moderating variable causes credit risk to become insignificant in explaining financial distress. A substantial implication of this finding is that the implementation of adequate GCG has the potential to reduce the negative impact caused by increased credit risk. Therefore, even though the NPL ratio has escalated, this does not necessarily increase the likelihood of companies experiencing financial distress.

This study is consistent with a number of previous studies. For example, a study by Azizah and Lismawati (2024) on the banking sector listed on the IDX (2020–2022 period) concluded that GCG does not have the ability to strengthen or weaken the influence of capital adequacy and credit risk on financial difficulties, confirming the insignificance of GCG as a moderating variable.

Similar consistency is reinforced by the findings of Maghfiroh, Hartono, and Haryono (2022), which also show that institutional ownership is unable to moderate the effects of profitability and liquidity on financial difficulties. This highlights the weakness in the supervisory function carried out by institutional investors in preventing difficulties. Furthermore, research by Rahmatia et al. (2023) on manufacturing companies also confirms that GCG mechanisms, particularly through the board of commissioners, do not act as moderators in the relationship between profitability, liquidity, or cash flow and financial difficulties.

CONCLUSIONS AND RECOMMENDATIONS

This study provides empirical evidence on the effect of credit risk on financial distress with corporate governance as a moderating variable, using a sample of 113 banking companies listed on the Indonesia Stock Exchange during the period 2019–2023. After conducting analysis and hypothesis testing, the following conclusions were drawn:

1. Credit risk, as proxied by Non-Performing Loans (NPL), has a positive effect on financial distress in banking companies listed on the Indonesia Stock Exchange during 2019–2023.
2. Corporate governance, as proxied by institutional ownership, is not proven to have a positive effect on financial distress in banking companies listed on the Indonesia Stock Exchange during 2019–2023.
3. Corporate governance in the relationship between credit risk and financial distress shows that institutional ownership, as a proxy for Corporate Governance, does not partially influence the relationship between Non-Performing Loans and financial distress in banking companies listed on the Indonesia Stock Exchange during 2019–2023.

This study provides theoretical implications that confirm that credit risk has substantial potential to affect financial distress, where an increase in the non-performing loan (NPL) ratio has been shown to reduce investment returns and increase banks' vulnerability to financial distress. This condition is triggered by the failure of the screening mechanism for prospective borrowers, which raises

issues of moral hazard and adverse selection, resulting in a decline in the quality of the credit portfolio, an increase in NPLs, a reduction in profitability, and an erosion of the bank's core capital.

Furthermore, these findings enrich the literature by showing that the effectiveness of corporate governance (CG) acts as a moderator by strengthening the relationship between non-performing loans and financial difficulties. This strengthening indicates that CG, when implemented effectively as a moderator, causes credit risk to have a significant effect on financial difficulties. Interpretatively, high credit risk supported by effective corporate governance will reduce the potential for financial difficulties within the company. This emphasises that credit risk management, which is the responsibility of management to shareholders, will be more effective if supported by a strong level of oversight from GCG mechanisms.

The escalation of credit risk levels faced by banking institutions correlates positively with an increase in the proportion of liabilities funded through credit instruments. The empirical findings of this study consistently confirm that financial difficulties manifest when there is an increase in non-performing loans (indicated by a high NPL ratio) in the financing portfolio. This condition directly triggers a decline in bank operating income, thereby increasing the institution's vulnerability to potential financial difficulties. Therefore, an effective borrower screening mechanism plays a crucial role, as failure in this process can lead to moral hazard and adverse selection issues that degrade the quality of the credit portfolio.

Furthermore, this study finds that effectively implemented corporate governance (CG) acts as a moderating factor that significantly influences the relationship between credit risk and potential financial crisis. The implication of this moderating role is that a combination of high credit risk and effective CG can reduce the risk of financial crisis in companies. This emphasises that credit risk management, which is the primary responsibility of management to shareholders, will be more effective and mitigative if supported by a strong level of oversight from CGM mechanisms.

ADVANCED RESEARCH

As with most research, this study has several limitations, including:

1. This study was conducted in banking companies listed on the Indonesia Stock Exchange from 2019 to 2023. Therefore, the results may not necessarily apply to companies in other sectors listed in Indonesia. It is recommended to replicate this research model to empirically test it on other companies listed on the Indonesia Stock Exchange
2. This study only examined credit risk, financial distress, and good corporate governance. Therefore, it is recommended that future research include other variables as determinants of financial distress.
3. This study only examined the influence of the mediating variable, namely good corporate governance, on credit risk, which influences financial distress.

ACKNOWLEDGEMENTS

The author expresses his gratitude to God Almighty for all His grace and blessings, enabling the successful completion of this research. He also expresses his gratitude to his supervisors who provided guidance and direction throughout the research process, as well as to all the lecturers in the Master of Management Study Program at Padang State University for their knowledge. He also extends his gratitude to his family, friends, and all those who provided invaluable moral and material support throughout the preparation of this journal.

REFERENCES

Ben Saada, M. (2018). The impact of control quality on the non-performing loans of Tunisian listed banks. *Managerial Auditing Journal*, *33*(1), 2–15. https://doi.org/10.1108/MAJ-01-2017-1506

Berger, A. N., Imbierowicz, B., & Rauch, C. (2016). The Roles of *Corporate governance* in Bank Failures during the Recent Financial Crisis. *Journal of Money, Credit and Banking*, *48*(4), 729–770. https://doi.org/10.1111/jmcb.12316

Buchdadi, A. D., Nguyen, X. T., Putra, F. R., & Dalimunthe, S. (2020). The effect of credit risk and capital adequacy on *Financial Distress* in rural banks. *Accounting*, *6*(6), 967–974. https://doi.org/10.5267/j.ac.2020.7.023

Djebali, N., & Zaghdoudi, K. (2020). Threshold effects of liquidity risk and credit risk on bank stability in the MENA region. *Journal of Policy Modeling*, *42*(5), 1049–1063. https://doi.org/10.1016/j.jpolmod.2020.01.013

Gadzo, S. G., Kportorgbi, H. K., & Gatsi, J. G. (2019). Credit risk and operational risk on financial performance of universal banks in Ghana: A partial least squared structural equation model (PLS SEM) approach. *Cogent Economics and Finance*, *7*(1). https://doi.org/10.1080/23322039.2019.1589406

Islam, N. (2020). *The Keep The Keep 2020 Awards for Excellence in Student Research and Creative Activity Booth Library Awards for Excellence in Student Research and Creativity The Impact of Board Composition and Activity on Non-Performing The Impact of Board Composition and Activity on Non-Performing Loans Loans*. https://thekeep.eiu.edu/lib_awards_2020_docs

Lestari, D. (2018). International Journal of Economics and Financial Issues *Corporate governance*, Capital Reserve, Non-Performing Loan, and Bank Risk Taking. *International Journal of Economics and Financial Issues*, *8*(2), 25–32. http:www.econjournals.com

Mohd-Sanusi, Z., Motjaba-Nia, S., Roosle, N. A., Sari, R. N., & Harjitok, A. (2017). International Journal of Economics and Financial Issues Effects of *Corporate governance* Structures on Enterprise Risk

Management Practices in Malaysia. *International Journal of Economics and Financial Issues*, *7*(1), 6–13. http:www.econjournals.com

Moussa, F. Ben. (2019). The Influence of Internal *Corporate governance* on Bank Credit Risk: An Empirical Analysis for Tunisia. *Global Business Review*, *20*(3), 640–667. https://doi.org/10.1177/0972150919837078

Putri, E. L., Haryanto, S., & Dan Firdaus, R. M. (2018). Mampukah *Good corporate governance* dan Risiko Kredit Sebagai Prediktor *Financial Distress*. In *Universitas Kanjuruhan Malang Jl. S. Supriyadi No* (Vol. 1, Issue 1). http://jurnal.unmer.ac.id/index.php/afre

Switzer, L. N., Tu, Q., & Wang, J. (2018). *Corporate governance* and default risk in financial firms over the post-financial crisis period: International evidence. *Journal of International Financial Markets, Institutions and Money*, *52*, 196–210. https://doi.org/10.1016/j.intfin.2017.09.023

Tahir, M., Shah, S. S. A., Sayal, A. U., & Afridi, M. A. (2020). Loan quality: does bank *corporate governance* matter? *Applied Economics Letters*, *27*(8), 633–636. https://doi.org/10.1080/13504851.2020.1728223

Vallascas, F., Mollah, S., & Keasey, K. (2017). Does the impact of board independence on large bank risks change after the global financial crisis? *Journal of Corporate Finance*, *44*, 149–166. https://doi.org/10.1016/j.jcorpfin.2017.03.011