ANALYSIS THE INFLUENCE OF CORPORATE GOVERNANCE INDEX QUALITY TOWARDS FINANCIAL CONDITION IN STATED OWNED ENTERPRISES (LISTED IN INDONESIA STOCK EXCHANGE 2015-2017)

(Undergraduate Thesis)

By

AYU BUDI SAYATI

FAKULTAS EKONOMI DAN BISNIS
UNIVERSITAS LAMPUNG
BANDAR LAMPUNG
2019
This study aims to analyze the influence of corporate governance index quality and its subindex towards the financial distress in a company, using Altman Z-Score to measure the financial distress of companies. The empirical approach followed in the study involved constructing a comprehensive measure of corporate governance for 48 non-financial companies listed on the Indonesia Stock Exchange in the years 2015-2017. This study used a secondary data from the official website of Indonesian Stock Exchange (www.idx.co.id) and the sample in this study using the purposive sampling techniques. The result of this study shows all the index quality are having a positive relationship towards financial distress, board of directors, board of commissioners, shareholder, and ownership index quality are significantly affecting financial distress while the remuneration, audit, and behaviour index quality are insignificantly affecting the financial distress.

Keywords: Corporate Governance, Index Quality, Financial Condition, Financial Distress
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As one of Requirements to Achieve
BACHELOR OF ECONOMICS

In

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With this stated that my thesis entitled "Analysis The Influence of Corporate Governance Index Quality Towards Financial Distress in Stated Owned Enterprises (Listed in Indonesia Stock Exchange From 2015-2017)" is true of my own work. In this thesis there is no whole or partial of the writings of others by copying or forging in the form of a series of sentences or symbols that show ideas or arguments or thoughts of other authors, which I acknowledge as my own writing, other than that or I take it from someone else's writing without giving the original author's acknowledgment. If in the future proved that my statement is not true, then I am ready to accept sanctions in accordance with applicable regulations.

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BIOGRAPHY

The author was born in Bandar Lampung on December 12th, 1997 with full name Ayu Budi Sayati as the youngest child of 3 siblings. Her father’s name is Mr. Achmad Zahruddin and her mother’s name is Mrs. Ida Budiarty. The older brother’s name is Aryan Candra Budiman, and her older sister’s name is Arini Izzati Fatimah. The author completed her kindergarten education at Taman Kanak-Kanak (TK) Dharma Wanita in 2003, continued and graduated from SD Al-Azhar 1 Bandar Lampung in 2009. Took the junior high school education in SMPN 29 Bandar Lampung, and graduated in 2012. The author completed the senior high school education in SMAN 2 Bandar Lampung, and graduated in 2015.

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During the university life, she joined AIESEC (Association Internationale des Etudiants en Sciences Economiques et Commerciales). Built an organizational career from staff to be manager, and became an organizing committee in many project such as national seminar called youth speak forum. Until she being elected to be vice president of talent management in 2017. She learned how to do a team work, supplied and manage the human resources within the organization, and did her best to fulfilling the needs of organizations.
DEDICATION

*Alhamdulillahi robbilalamin*

Praise be to Allah SWT for all the grace, blessings and grace so great to the author.

I dedicate this thesis to:

**My dear parents, Mr. Achmad Zahruddin and Mrs. Ida Budiarty.**

Incomparable thanks to Mamah and Ayah who always give endless prayer, useful advice, strength in all conditions, and always give support for my ideals. May Allah SWT always provide protection in the world and in the Hereafter for my beloved mother and father.

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**My whole family and friends** who always give encouragement, prayer, and endless support.

**My Almamater, University of Lampung.**
MOTTO

“So which of the favors of your lord would you deny?”

(Qs. Ar-Rahman)

“Live your life as an Exclamation rather than an Explanation”

(Isaac Newton)

“Be thankful for what you have; you’ll end up having more. If you concentrate on what you don’t have, you will never, ever have enough”

(Oprah Winfrey)

“Being an ambitious is not a bad things, or a good things either. Do it ambitiously but do not let it destroy yourself or others.”

(Ayu Budi Sayati)
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The last, for all the help and support, the authors would like to say thank you, may you all get a reply from Allah SWT. The author realizes there are still many shortcomings in the process of writing this thesis; the authors expect a criticism or suggestion that can help the author in improving to be better.

Thus, hopefully this paper can provide benefits for those who read it.

Bandar Lampung, May 14th, 2019

Author,

Ayu Budi Sayati
TABLE OF CONTENTS

COVER PAGE................................................................. i
ABSTRACT ................................................................. ii
TITLE PAGE ............................................................... iii
APPROVING PAGE ........................................................ iv
ADMITTING PAGE ........................................................ v
STUDENT THESIS STATEMENT ......................................... vi
BIOGRAPHY ............................................................. vii
DEDICATION ..................................................................... ix
MOTTO ........................................................................ x
ACKNOWLEDGEMENT ....................................................... xi
LIST OF CONTENT ........................................................ xvi
LIST OF TABLE ............................................................. xx
LIST OF FIGURE ............................................................ xxi
LIST OF APPENDIX ......................................................... xxii

CHAPTER I INTRODUCTION

1.1 Introduction ................................................................... 1
1.2 Problem Formulation ..................................................... 5
1.3 Research Purpose ......................................................... 7
1.4 Research Benefits ......................................................... 7
CHAPTER II LITERATURE REVIEW

2.1 Theoretical Basis ........................................................................................................... 8
  2.1.1 Agency Theory ........................................................................................................ 8
  2.1.2 Signaling Theory .................................................................................................... 9
  2.1.3 Stakeholder Theory ............................................................................................... 10
  2.1.4 Corporate Governance ......................................................................................... 11
  2.1.5 Financial Distress .................................................................................................. 13
  2.1.6 Financial Ratio Analysis ........................................................................................ 15

2.2 Summary of Previous Research .................................................................................. 17

2.3 Research Framework .................................................................................................. 20

2.4 Research Hypothesis ................................................................................................. 20
  2.4.1 The Effect of Board of Director Towards Financial Condition on Firm. ......... 21
  2.4.2 The Effect of Board of Commissioner Towards Financial Condition on Firm.. 21
  2.4.3 The Effect of Remuneration Towards Financial Condition on Firm .......... 22
  2.4.4 The Effect of Shareholder Towards Financial Condition on Firm .......... 23
  2.4.5 The Effect of Ownership Towards Financial Condition on Firm ............ 24
  2.4.6 The Effect of Audit Towards Financial Condition on Firm .................. 24
  2.4.7 The Effect of Behaviour Towards Financial Condition on Firm ........... 25

CHAPTER III RESEARCH METHODOLOGY

3.1 Sample and Population ............................................................................................... 27

3.2 Operational Research Variable .................................................................................. 28
  3.2.1 Dependent Variable .............................................................................................. 28
  3.2.2 Independent Variables ......................................................................................... 29

3.3 Data Analysis Method ................................................................................................ 30
  3.3.1 Descriptive Statistic .............................................................................................. 30
  3.3.2 Classic Assumption Test ....................................................................................... 30
    3.3.2.1 Normality Test ................................................................................................ 30
    3.3.2.2 Multicollinearity Test .................................................................................. 31
    3.3.2.3 Heteroscedasticity Test ............................................................................... 31
    3.3.2.4 Autocorrelation Test .................................................................................. 32
  3.3.3 Multiple Linear Regression Analysis .................................................................... 32
  3.3.4 Hypothesis Testing ............................................................................................... 33
    3.3.4.1 T-test (Partial Test) ...................................................................................... 33
    3.3.4.2 Coefficient of Determination ($R^2$) .......................................................... 33
CHAPTER IV RESULT AND DISCUSSION

4.1 Descriptive Statistic ................................................................. 35
  4.1.1 Financial Condition ............................................................... 36
  4.1.2 Corporate Governance Index ................................................. 36
    4.1.2.1 Board of Director (BOD) ................................................... 37
    4.1.2.2 Board of Commissioner (BOC) ......................................... 37
    4.1.2.3 Remuneration ................................................................. 37
    4.1.2.4 Shareholder ................................................................. 38
    4.1.2.5 Ownership ................................................................. 38
    4.1.2.6 Audit ................................................................. 38
    4.1.2.7 Behaviour ................................................................. 38
  4.2 Classic Assumption Test ............................................................ 39
    4.2.1 Normality Test ................................................................. 39
    4.2.2 Heteroscedasticity Test ..................................................... 40
    4.2.3 Multicolinearity Test ........................................................ 41
    4.2.4 Autocorrelation Test ......................................................... 42
  4.3 Model Testing ........................................................................ 43
    4.3.1 F-Test ........................................................................... 43
  4.4 Multiple Linear Regression Analysis ........................................... 44
  4.5 Hypothesis Testing .................................................................... 47
    4.5.1 T-test (Partial Test) ............................................................ 47
    4.5.2 Coefficient of Determination ($R^2$) ....................................... 48
  4.6 Discussion ................................................................................ 48
    4.6.1 The Effect of Board of Director Index Towards Financial Condition ......................................................... 48
    4.6.2 The Effect of Board of Commissioner Index Towards Financial Condition .............................................. 49
    4.6.3 The Effect of Remuneration Index Towards Financial Condition ............................................................. 49
    4.6.4 The Effect Shareholder Index Towards Financial Condition ................................................................. 49
    4.6.5 The Effect of Ownership Index Towards Financial Condition ............................................................. 50
    4.6.6 The Effect of Audit Index Towards Financial Condition ................................................................. 50
    4.6.7 The Effect of Behaviour Index Towards Financial Condition ............................................................. 50

CHAPTER V CONCLUSIONS AND SUGGESTIONS

5.1 Conclusions ............................................................................ 51
5.2 Research Limitations ................................................................. 52
5.3 Suggestions ............................................................................ 52

REFERENCES

APPENDIX
# LIST OF TABLE

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1.1</td>
<td>List of Companies Can Not Pay Dividend in 2018</td>
</tr>
<tr>
<td>Table 2.1</td>
<td>Previous Research</td>
</tr>
<tr>
<td>Table 4.1</td>
<td>Descriptive Statistics</td>
</tr>
<tr>
<td>Table 4.2</td>
<td>Normality Test Table Result</td>
</tr>
<tr>
<td>Table 4.3</td>
<td>Multicollinearity Test Table Result</td>
</tr>
<tr>
<td>Table 4.4</td>
<td>Autocorrelation Test Table Result</td>
</tr>
<tr>
<td>Table 4.5</td>
<td>F-Test</td>
</tr>
<tr>
<td>Table 4.6</td>
<td>Multiple Regression Analysis Result</td>
</tr>
<tr>
<td>Table 4.7</td>
<td>$R^2$ Test Table Result</td>
</tr>
</tbody>
</table>
# LIST OF FIGURE

<table>
<thead>
<tr>
<th>Figure</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 4.1 The Result of Heteroscedasticity Test</td>
<td>40</td>
</tr>
</tbody>
</table>
LIST OF APPENDIX

Appendix

Appendix 1 : SOE’s Sample List Taken
Appendix 2 : Z-Score List of SOE’s
Appendix 3 : List of SOE’s Board of Director Index Score
Appendix 4 : List of SOE’s Board of Commissioner Index Score
Appendix 5 : List of SOE’s Remuneration Index Score
Appendix 6 : List of SOE’s Shareholder Index Score
Appendix 7 : List of SOE’s Ownership Index Score
Appendix 8 : List of SOE’s Audit Index Score
Appendix 9 : List of SOE’s Behaviour Index Score
Appendix 10 : List of SOE’s Compliance Score Index 2015
Appendix 11 : List of SOE’s Compliance Score Index 2016
Appendix 12 : List of SOE’s Compliance Score Index 2017
Appendix 13 : Descriptive Statistic Result
Appendix 14 : Normality Test Result (Kolmogorov-Smirnov Test)
Appendix 15 : Heterosdasticity Test Result (Scatterplot)
Appendix 16 : Multicollinearity Test Result
Appendix 17 : Autocorellation Test (Run-Test)
Appendix 18 : Multiple Linear Regression Analysis Result
Appendix 19 : T-Test (Partial) Result
Appendix 20 : Coefficient of Determination ($R^2$) Result
Appendix 21 : ANOVA Table Result
Appendix 22 : News Tittle and Sources Table
I. PRELIMINARY

1.1 Introduction

Starting from the economic crisis experienced by the world in 1998 and impacting on Indonesia, corporate governance began to be introduced in Indonesia in 1998 to public companies in Indonesia. Initially, corporate governance was used to improve records on the Indonesia Stock Exchange (Hereby IDX) which was formerly known as the Jakarta Stock Exchange (BEJ). Over time, corporate governance has turned into a mechanism that helps companies manage their management well, corporate governance represents a set of mechanisms intended to reduce agency risks resulting from information asymmetry Asbaugh et al. (2004). It can be conclude that having a good corporate governance system in a company is proven to increase the value of the company itself, corporate governance can also create healthy market competition.

Elloumi et al. (2001) stated that capital markets, users of financial statements and the accounting profession have recently expressed some concerns on firm’s failure and the weakness in firm’s corporate governance structure, because, many companies failed because did not pay attention to good corporate governance, as evidenced, many issues that circulates about the failures of the companies that stem from having no strong corporate governance. Also Hamdani (2016) stated
that one of the causes of financial distress in Indonesia is because, allegedly as a result of basis ethics and corporate governance weakness.

State-Owned Enterprises (Hereby SOE’s) is an enterprises that effort completely, a merger or miner that is owned by the State. Mostly the state-owned enterprises already using and implementing the good corporate governance to run the business, but nowadays many state-owned enterprises are in financial distress. Because their operating results unable to meet its obligations. In the year of 2017 the media was broadcast the news about state-owned enterprises that cannot pay its dividends for 2018. As stated by Finance Minister Sri Mulyani said that 21 state-owned enterprises that can not pay their dividend. According to Mrs. Mulyani, the loss was stems from two things, first, company loss because they can not compete. Second, company claimed still in process of restructuring, because of that reason companies could not pay the dividends.

Table 1.1 List of Companies Can Not Pay Dividend in 2018

<table>
<thead>
<tr>
<th>No.</th>
<th>Companies Can Not Compete</th>
<th>Companies in Process Restructuring</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PT Garuda Indonesia (Persero) Tbk</td>
<td>PT Ninda Karya</td>
</tr>
<tr>
<td>2</td>
<td>Perum Bulog</td>
<td>PT Kertas Kraft Aceh (Persero)</td>
</tr>
<tr>
<td>3</td>
<td>PT Krakatau Steel (Persero) Tbk</td>
<td>PT Industri Sandang Nusantara (Persero)</td>
</tr>
<tr>
<td>4</td>
<td>PT PAL</td>
<td>PT Istaka Karya (Persero)</td>
</tr>
<tr>
<td>5</td>
<td>PT Dok Perkapalan Surabaya (Persero) Tbk</td>
<td>PT Kertas Leces (Persero)</td>
</tr>
<tr>
<td>6</td>
<td>PT Kimia Farma</td>
<td>PT Primissima (Persero)</td>
</tr>
<tr>
<td>7</td>
<td>PT Balai Pustaka (Persero)</td>
<td>PT Merpati Nusantara Airlines</td>
</tr>
<tr>
<td>8</td>
<td>PT Boma Bisma Indra</td>
<td>PT Survey Udara Penas (Persero)</td>
</tr>
<tr>
<td>9</td>
<td>Perum PFN</td>
<td>PT Iglas (Persero)</td>
</tr>
<tr>
<td>10</td>
<td>PT Berdikari (Persero)</td>
<td>PT Djakarta Lloyd (Persero)</td>
</tr>
<tr>
<td>11</td>
<td></td>
<td>PT Varuna Tirta Prakasya (Persero)</td>
</tr>
</tbody>
</table>

Source: Can be seen in Appendix
Refers to Kowalewski (2016) researching the influence of corporate governance and corporate performance towards the financial distress of companies in financial crisis 2008, he was making a table of Corporate Governance Index (CGI) consisting of some index such as; CGI-Management, CGI-Board, CGI-Remuneration, CGI-Shareholder, CGI-Ownership, CGI-Audit, CGI-Behaviour and it’s subindices to assess the influence of those index towards the financial distress in Polandia. Kowalewski research was using the data from domestic firm that listed in Warsaw Stock Exchange (WSE). Different things found in Indonesia, that Indonesia has a two-tier board system that distinguishes the performance of Board of Directors and Board of Commissioners. The structure contained in the two-tier board system are:

1. Board of Directors that consisting of all managing directors such as CEO (C-Level Management).
2. Board of Commissioners this consists of independent non-executive directors and non-executive directors who are not independent.

Due to the two-tier board system adopted by Indonesia, the CGI that you will use changes into:

a. Board of Directors index that will measures the management, structure and procedures of executive level,
b. Board of Commissioners index that will measures the board of supervisory in the company,
c. Remuneration index that will measures the remuneration policy and employees ownership,
d. Shareholder index that will measures the rights and obligations of shareholder,
e. Ownership index that will measures the structure of ownership and the rights of
ownership,

f. Audit index that will measures the quality of audit and the financial disclosures
of company,

g. Behaviour index that will measures the disclosure and the transparency on the
CSR, code on ethics, also audit transparancy.

From the CGI mention above, this study will assessing each Indonesia’s SOE as
one indicator to assess which index is very influential in financial distress that is
being experienced by the company. This study using CGI indices, because it is
provide detailed and relevant information about companies governance which will
be connected with fcompany’s financial condition.

Financial distress define a company’s financial performance declines before the
bankruptcy or liquidation. Bankruptcy or liquidation can be prevented by
analyzing the causes of financial distress itself and repair the causes if there is an
error. Those errors can be sourced from various aspects, it can be the
management, companies cultures, employee’s behaviour, and others. This study
considered companies in times of financial distress if within 2 consecutive years
or so the company could not pay its dividend (Platt and Platt, 2016).

These studies refers to research conducted by Kowalewski (2016), who is
researching on the influence of corporate governance and corporate performance
towards company performance, as for the difference from this and previous
research is:
1. This study will use the financial distress that will be measured by Altman Z-Score. Where on previous research used the company's performance to indicate the financial distress in companies that will be measured by Return on Assets (ROA) Ratio and Tobins'q.

2. In corporate governance index research on previous research mentioned the CGI-Board and CGI-Management that will be revamped in this study be Directors and Commissioners.

3. Each index will be count “1” if the company has the governance index, and “0” otherwise.

Based on the issues and an explanation which has been described above, this study will take the title “Analysis The Influence of Corporate Governance Index Quality Towards Financial Condition in State-Owned Enterprises (Listed in Indonesia Stock Exchange)”

1.2 Problem Formulation

Based on the explanation above, this study will connect the relationship between CGI towards the financial distress in a companies. Because, the CGI can indicate the financial distress in the companies. The Board of Directors is very influential on performance management company and also the quality of the Executive Level Management, Board of Commissioner also having an important role to assess the supervisory board in a company’s. No less important, influential remuneration can also on the quality of work of workers and also the ownership in the company, this supported by Kasmir (2016) research. Shareholder quantifies the degree to which the company informs relevant corporate facts to outside
stakeholders (Kowalewski, 2016). Even farther the ownership giving a role to the structure of ownership in a companies, and the rights of the ownership itself. Audit is giving a role of the audit quality and the diclousure of the companies which are listed in a financial statements. And the last is behaviour that giving a role in social behaviour of a companies. From this description, brings up questions that turned into a formulation of a problem and can be inferred by this study, including:

1. Is Board of Directors index affected the financial condition in the company positively?
2. Is Board of Commissioners index affected the financial condition in the company positively?
3. Is Remuneration index affected the financial condition in the company positively?
4. Is Shareholder index affected the financial condition in the company positively?
5. Is Ownership index affected the financial condition in the company positively?
6. Is Audit index affected the financial condition in the company positively?
7. Is Behaviour index affected the condition distress in the company positively?
1.3 Research Purpose

The purpose of this study is to analyze the influence of CGI and its subindex towards the financial condition in a company, using the Altman Z-Score to measure the financial distress of companies.

1.4 Benefits of The Research

1. Benefits for The Companies

This research can help company to identify corporate governance indexes that affect their financial distress, so company can understand the problems that occur and also focus on addressing the problem appropriately.

2. Benefits for Academics

This research can contribute knowledge to further research that will add or improve research on corporate governance and financial distress.

3. Benefits for Stakeholders and Investors

This research can provide information about the financial condition of a company, which can be used as a reference or consideration by stakeholders and investors before investing their shares.
II. LITERATURE REVIEW

2.1 Theoretical Basis

2.1.1 Agency Theory

Jensen and Meckling (1976) define agency theory as a contractual relationship between a person or several people (acting as principal) and someone or several other people (acting as agents) who serve on behalf of the principal's interests and include delegating this study to make decisions to the agent. Companies that have a duty called as an agent become a key in the company's activities and have an obligation to the lender or shareholder called as principal, the agent’s obligation is to provide transparency and information about the condition of the company, but often occurs agent to make a decision without considering the principal, agent only makes decisions for his own concerns.

Financial statements as a source of information for all company activities also have an important role to explain the condition of a company to the principal, so principal can monitoring company even though the agency is not responsible for carrying out its duties (providing information transparently to the principal). The information contained in financial statements can be calculated and obtained using financial ratios, and the results can be used for decision making. For example, in the financial statements indicate the amount of debt, equity, company profits. By measuring it using existing financial ratios, the principal can get information
about the company's ability to continue to survive, and even predict the
bankruptcy and success of the company. From the information obtained, the
principal can make his decision, such as continuing to invest capital in the
company or not.

Agency problems have a direct and indirect impact on the company. The direct
impact of agency problems is in the form of costs that only benefit management
without the benefit of shareholders, for example, management accommodation
costs such as houses and luxury cars, or bonus payments without looking at the
company's performance. While the indirect impact of agency problems is the loss
of opportunities to benefit from investments that they can make, this is because
management tends not to dare to invest because it is afraid to take investment
risks that can harm the management's personal interests (Westerfield & Jordan,
2011).

2.1.2 Signaling Theory

Signaling theory was introduced in Spence (1973) research with a title “Job
Market Signaling”. Information is one of an important element for investor,
because it is provide evidence, record, disclosure and everything about company.
So Spence (1973) was creating a signaling criteria to adding power for decisions
making. This theory was redeveloped by Ross (1977), explaining that company
executives who have better information about company will be compelled to
convey this information to investors. Such information is usually in the form of an
annual financial report that contains information on the state of the company, past
records and the state of the company, and can also reflect the performance of a
Complete, relevant, accurate and timely information is needed by investors in the capital market as an analytical tool for making investment decisions (Jogiyanto, 2013).

### 2.1.3 Stakeholder Theory

Stakeholder theory arises because there is an awareness that company is not independent and need others, such as, shareholders, lenders or creditors, the community, the government, and much more. It was developed by Freeman (1983). The company operates to achieve its goals and interests, it must also provide benefits to its stakeholders. Tunggal (2008) states that approaches in stakeholder theory can be divided into three approaches, namely:

1. Descriptive Approach

The descriptive approach basically states that, stakeholders are simply a description of the reality of how a company operates. Stakeholder theory in a descriptive approach, aims to understand how managers handle stakeholder interests while carrying out the interests of the company. Managers are required to direct their energy towards all stakeholders, not only to the owners of the company.

2. Instrumental Approach

Stakeholder theory in the instrumental approach states that, one of the strategies of the company management to produce better corporate performance is to pay attention to stakeholders. This is supported by empirical evidence revealed by Lawrence & Weber (2008), which shows at least more than 450 companies stated their commitment to stakeholders in their annual reports had better financial
performance compared to companies that did not have commitments. The instrumental approach aims to study the consequences borne by the company, by looking at the management of stakeholder relations and the various objectives of corporate governance that have been achieved.

3. Normative Approach

Stakeholder theory in a normative approach states that every person or group who contributed to the value of a company has the moral right to receive rewards from the company, and this is an obligation for management to fulfill what the stakeholders are entitled to. The normative approach also aims to identify moral or philosophical guidelines related to the activities or management of the company. The relationship between the theory of stakeholders and research is how companies can provide benefits to stakeholders, as in CGI-Ownership, CGI-Shareholder and also a CGI-Behavior that describes how the company works for the common good.

2.1.4 Corporate Governance

Corporate governance is a regulation that turns into a mechanism to help companies manage their management well. The application of a good mechanism is also called good corporate governance. Principal guidelines for implementing corporate governance are divided into three roles, namely:

1. The Role of The State

Contribute positively in shaping legislation regarding corporate governance and preventing corruption and nepotism.
2. The Role of Business World
Contribute to implementing good corporate governance in the company.

3. The Role of Society
Carry out social control by giving attention and concern to community services carried out by state administrators and to activities and products or services produced by the business world, through the delivery of opinions objectively and responsibly. As for the principles that are owned by good corporate governance, such as:

a. Transparency
To maintain objectivity in conducting business, companies must provide material and relevant information in a way that is easily accessible and understood by stakeholders. The company must take the initiative to disclose not only the problems required by legislation, but also important matters for decision making by shareholders, creditors and other stakeholders.

b. Accountability
Companies must be able to account for their performance transparently and fairly. For this reason, the company must be managed correctly, measured and in accordance with the interests of the company while taking into account the interests of shareholders and other stakeholders. Accountability is a prerequisite needed to achieve sustainable performance.

c. Responsibility
The company must comply with the laws and regulations and carry out responsibilities towards the community and the environment so that long-term business continuity can be maintained and recognized as a good corporate citizen.
d. Independency

To facilitate the implementation of the GCG principle, companies must be managed independently so that each company organ does not dominate each other and cannot be intervened by other parties.

e. Fairness

In carrying out its activities, companies must always pay attention to the interests of shareholders and other stakeholders based on the principle of fairness and equality.

2.1.5 **Financial Distress**

Financial distress is a situation where the financial condition of a company is not healthy or is experiencing a critical period. Financial distress occurs before a company experiences bankruptcy, a company that experiences financial distress usually cannot pay its dividend within two years or more. A company experiencing financial distress will be trying to figure a way out to solve the problem of the financials such as loan capital, do the merger, or even shut down their business as an option in addressing the problem of financial difficulties are being encountered. The condition of financial distress can be distinguished into two, namely:
1. Technical Insolvency

This technical insolvency is temporary, because the company cannot pay its short-term debt and cannot fulfill its obligations.

2. Bankruptcy Insolvency

It is more serious and emerges when the total debt value exceeds the total value of the company's assets or negative company equity value. According to Fachrudin (2008), the causes of financial difficulties or financial distress are explained in the Trinity Causes of financial difficulties, namely as follows:

a. Neoclassical model

Financial distress and bankruptcy occurred if the allocation of resources within the company is not right. Management that is less able to allocate resources (assets) in the company for company operations.

b. Financial model

Mixing right assets but financial structure is wrong with liquidity constraints. This means that even though the company can survive in the long run, it must also go bankrupt in the short term.

c. Corporate governance model

According to this model, bankruptcy has a mixture of assets and financial structures that are correct but poorly managed. This inefficiency drives the company to become old of the market as a consequence of problems in unsolved corporate governance.
### 2.1.6 Financial Ratio Analysis

Financial ratios are tools to assess company’s performance based on the value and amount stated in the financial statement. According to Purwanti (2005), financial ratios can be grouped into five basic categories, namely:

1. **Liquidity**

   Liquidity is the company's ability to pay off its short-term obligations that have matured. The liquidity ratio is a good indicator whether the company has problems in managing cash flows or not. The sizes that are often used are:
   
   a. **Current Ratio (CR)** is a comparison between current assets and current debt which aims to measure the company's ability to pay off its short liabilities.
   
   b. **Quick Ratio (QR)** which is almost the same as the current ratio but does not take into account inventories because inventory is the most illiquid current assets (not easily sold, and if sold usually by credit). Quick ratio is calculated by subtracting inventory from current assets, then dividing the remainder with current debt.

2. **Sensitivity**

   Shows the proportion of debt usage to finance investments, the calculation there are two ways, first pay attention to the data in the balance sheet to assess how much loan funds are used in the company; second, measuring debt risk from the income statement to assess how much the fixed interest expense (interest plus principal) can be covered by operating profit. The sensitivity ratio consists of:
   
   a. **Total debt to total assets**, measures the percentage of use of funds from creditors calculated by dividing the total debt by total assets.
   
   b. **Debt equity ratio**, the ratio between total debt and capital
c. Time interest earned, calculated by dividing profit before interest and tax (EBIT) with interest expense. This ratio measures how far profits can be reduced without making it difficult for the company to fulfill its annual interest payment obligations.

3. Productivity

The productivity ratio is how effective the company uses company resources. This ratio is calculated by comparing sales with supporting assets for the sale, meaning that this ratio assumes that a "decent" comparison must exist between sales and various other assets such as: inventory, accounts receivable, fixed assets, and so on. The productivity ratio includes: inventory turnover, fixed asset turnover, account receivable turnover, and total assets turnover.

4. Profitability

Profitability ratio measures a company's ability to generate profits. There are many ways to measure profitability so the measurements are linked to sales generated, assets used, and investments made by shareholders. The profitability ratio consists of:

b. Margin on sales profit, calculated by dividing profit after tax with sales

c. Return on total assets, the ratio between profit after tax and total assets to measure the return on total investment.

d. Return on net worth, the ratio between after-tax profit and own capital to measure the level of investment returns of the owner's own capital.

5. Market

Applied to analysis ratio of go public company. The company's ability to create value, especially for shareholders and potential investors. Market ratio consists of:
a. Price earnings ratio, is the ratio between stock market price and price per share. If this ratio is lower than the ratio of similar industries, it could be an indication that investment in the company's shares is more risky than the industry average.

b. Market to book value, the comparison between stock market value and stock book value, is also an indication that investors value the company.

### 2.2 Summary of Previous Research

<table>
<thead>
<tr>
<th>No.</th>
<th>This study (year)</th>
<th>Research Title</th>
<th>Variable</th>
<th>Research Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Elloumi and Gueyle (2001)</td>
<td>Financial Distress and Corporate Governance: An Empirical Analysis</td>
<td><strong>Independent Variable:</strong> Outside Directors</td>
<td>The result showed us that board composition (outside directors) are giving a contribution in financial distress.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>Dependent Variable:</strong> Financial distress status on firm, CEO turnover in financially distressed firm.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Valenti et al. (2011)</td>
<td>The Effects of Firm Performance on Corporate Governance</td>
<td><strong>Independent Variable:</strong> Firm Performance</td>
<td>The result showed that prior negative change in firm performance was significantly related to a decrease in the overall number of directors and a decrease in the number of outside directors.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>Dependent Variable:</strong> Corporate Governance (Board Composition)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Kamaludin and Pribadi</td>
<td>Prediksi Financial</td>
<td><strong>Independent Variable:</strong></td>
<td>This shows that companies that do not</td>
</tr>
<tr>
<td>Year</td>
<td>Author</td>
<td>Title</td>
<td>Independent Variable</td>
<td>Dependent Variable</td>
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<tr>
<td>2011</td>
<td>Kasus Industri Manufaktur Pendekatan Model Regresi Logistik.</td>
<td>Financial Ratio’s</td>
<td>Financial Distress</td>
<td>experience the problem of Financial Distress have a high CR, GPM, and ITO ratio, while those in the group of companies that experience Financial Distress have high ROE and LEV ratios, and in the gray area group companies have only a few financial problems.</td>
</tr>
<tr>
<td>2016</td>
<td>Kowalewski</td>
<td>Corporate Governance and Corporate Performance: Financial Crisis (2008)</td>
<td>Corporate Governance Index for the companies listed on the WSE 2006-2010</td>
<td>Companies Performance (ROA &amp; Tobins’q)</td>
</tr>
<tr>
<td>2016</td>
<td>Purves</td>
<td>Are Organization Destined to Fail?</td>
<td>non-financial factors (management, board of directors composition,</td>
<td>Non-financial factors associated with the organization studied impacted their success or failure.</td>
</tr>
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</table>

4

5
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<tr>
<th>#</th>
<th>Author(s)</th>
<th>Independent Variable:</th>
<th>Dependent Variable:</th>
<th>Control Variable:</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Al-Hadi et al. (2017)</td>
<td>Corporate Social Responsibility Performance, Financial Distress and Firm Life Cycle: Evidence From Australia</td>
<td>Dependent Variable: Firm status (Success or Failure)</td>
<td>Positive CSR performance significantly reduces financial distress of the firm. In addition, the negative association between positive CSR activities and financial distress is magnified for firms in mature stage of life cycle.</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Ali and Nasir (2018)</td>
<td>Corporate Governance and Financial Distress: Malaysia Perspective</td>
<td>Independent Variable: Corporate Governance Mechanism</td>
<td>Dependent Variable: Board of Directors</td>
<td>The result found that board activity has a significant relationship with financial distressed companies.</td>
</tr>
</tbody>
</table>
2.3 Research Framework

Corporate Governance Index

- Board of Director
- Board of Commissioners
- Remuneration
- Shareholder
- Ownership
- Audit
- Behaviour

H1
H2
H3
H4
H5
H6
H7

Financial Condition

2.4 Research Hypothesis

The core concepts of all hypothesis in this study is independent variable positively affecting the dependent variable. Because the independent variable of this study is corporate governance index which means the more indexes that company has, the better quality of its corporate governance. And its indicate that company more likely not to experiencing financial distress.
2.4.1 The Effect of Board of Directors Towards Financial Condition on Firm

In a company, the role of the board needed to run and regulate management and the strategies used to advance the business. Indonesia adopts a two-tier system, where the board has two different functions. The board functions to manage all management in the company and acts as the company's executive. The board is called The Board of Directors.

Hendratni et al. (2018) did the research and found out that Board of Directors is having a positive relationship towards financial distress, (Helena et al., 2018; Fahlevi et al. 2019) also found the same result that board of directors are positive significantly affecting financial condition. According to this study, board of directors holds the entire company’s management control, the board of directors must have a positive influence on the company’s financial condition. Therefore, this study conclude the hypothesis as follows:

H₁ = Board of Directors Index Quality Are Affecting The Financial Condition On Firm Positively.

2.4.2 The Effect of Board of Commissioners Towards Financial Condition on Firm

If the board of directors holds control of the existing management in the company, the board of commissioners is there to oversee the supervisory in a company. In Indonesia, the board of commissioners and the board of directors has equal levels. This was explained in the 1995 Limited Liability Law, because the two councils were appointed and dismissed by the Annual General Meeting of Shareholders (Hereby AGMS).
Because of these regulations, the board of commissioners who should act to observe the board of directors does not have anything to dismiss the board of directors if there are things that are not in accordance with the rules. This study conclude that the existence of the board of commissioners negatively influence the financial condition.

Manzanaque et al. (2015) stated that the higher proportion of independents board, and the number of councils, the less financial distress would be. Also Helena et al. (2018) and supported by Wardhani (2007) was found that there is an insignificant influence between the proportion of Independent Board of Commissioner on Financial distress. Radifan et al. (2015) also found that there is a positive relationship and significant between Board of Commissioners and Financial Distress. This study draws hypothesis conclusions as follows:

\[ H_2 = \text{Board of Commissioners Index Quality Are Affecting The Financial Condition On Firm Positively.} \]

2.4.3 The Effect of Remuneration Towards Financial Condition on Firm

Remuneration exists as a form of motivation for workers in carrying out their tasks or in achieving their targets. The remuneration system for each company is different, some provide remuneration because workers reach their targets, or some provide remuneration because these workers have special skills or skills that others do not have.

Kurawa and Saidu (2014) found that there is a positive and significant relationship between remuneration and financial performance, which is also supported by Khalid et al. (2014) stated that having a high association between remuneration
and financial perfomance are the key to be effective. In Probohudono et al. (2016) research, found that distress status was influencing the remuneration. Because remuneration can also said as a form of motivation for workers, this study conclude that remuneration has a positive effect on financial distress and draws hypothesis conclusions as follows:

\[ H_3 = \text{Remmuneration Index Quality Are Affecting The Financial Condition On Firm Positively.} \]

2.4.4 The Effect of Shareholder Towards Financial Condition on Firm

Shareholders are people who invest their money into shares in a company, in other words shareholders are part of the owner of the company depending on the lot and at least the shareholders invest their money. Mardiyanti et al. (2013) said that company has a responsibility to satisfied and prosperous the shareholder. Also several studies (Partasaraty et al., 2006; Suherman et al., 2010; Elston & Goldberg, 2001; Samuel et al., 2016) found there is a positive relationship between shareholder and financial condition. For the illustrating, if company has a good profit, means that shareholder also got a good shares. For this reason, this study conclude that shareholders have a positive relationship and effect on financial distress experienced by the company. This study draws hypothesis conclusions as follows:

\[ H_4 = \text{Shareholder Index Quality Are Affecting The Financial Condition On Firm Positively.} \]
2.4.5 The Effect of Ownership Towards Financial Condition on Firm

Ownership explains the structure itself and also the rights as the owner of the business. The ownership structure is determined by the amount of shares they invest, the rights of ownership have been determined at the beginning of the agreement and contract. The company must also always hold a AGMS on a regular basis, so their rights must be clear.

Radifan and Yuyetta (2015) found that there is a positive and significant relationship between ownership towards financial distress, which is also supported by Manzaneque et al. (2015), Mayangsari (2015), Yudha and Fuad (2014), Avelia and Tarigan (2017). Each of, which found out that there is a positive relationship between ownership and financial condition. From these reasons this study conclude that ownership index does not have a positive relationship to financial distress in the company. So this study draws the hypothesis conclusions as follows:

\[ H_5 = \text{Ownership Index Quality Are Affecting The Financial Condition On Firm Positively.} \]

2.4.6 The Effect of Audit Towards Financial Condition on Firm

The definition of audit according to PSAK (Statement of Financial Audit Standards) is a systematic process that aims to obtain and evaluate the evidence collected on statements or assertions about economic actions, events and see the level of relationship between statement or assertion and reality, and communicate the results to those concerned.
In this study CGI-Audit functions explain the audit quality owned by the company, as well as financial disclosure contained in financial statements such as costs that should be shown and listed in financial statements. From this explanation, according to this study, CGI-Audit does have a positive impact on financial distress, this is supported by Helena et al. (2018) research found out that Audit index has a positive relationship and significant towards financial distress and it is supported by Hanifah and Purwanto (2015) also Radifan and Yuyetta (2015). Therefore, the writer draws hypothesis conclusions as follows:

\[ H_6 = \text{Audit Index Quality Are Affecting The Financial Condition On Firm Positively.} \]

2.4.7 The Effect of Behaviour Towards Financial Condition on Firm

CGI-Behaviour in this study describes the disclosure and transparency of information provided by the company. Such as, CSR policies, employee code of ethics, and other regulations. Information that will later be published will attract the attention of stakeholders, including those who will invest in the company. Corporate social responsibility is nothing but maximizing the value of your company over a long period of time, because in the long term, social and environmental issues become financial issues. (Harvard Business Review, 2015, as cited in Flammer et al., 2019). Also Al-Hadi et al. (2017), found that CSR was empirically associated with financial distress. And it was supported by Attig et al. (2013) research result.

Financial distress has an impact on CSR strategies and modifies the attitude of a set of firms towards responsible behaviour (Mejac et al., 2014). If the information explain clearly, it can give opportunities to get the investment. The more people
investing in the company it will affect the financial distress. Therefore, this study draws the hypothesis conclusions as follows:

\[ H_7 = \text{Behaviour Index Quality Are Affecting The Financial Condition On Firm Positively.} \]
III. RESEARCH METHODOLOGY

3.1 Sample and Population

Population in this study is State-Owned Enterprises that listed in Indonesia Stock Exchange (IDX). This study use the non-financial sector as its population. The sample used a purposive sampling technique. Purposive Sampling is a sampling technique that is tailored to the objectives of the related research. The criteria used for sampling in this study are:

1. Non-Financial State-Owned Enterprises that listed in www.idx.co.id from 2015-2017 period, because companies can be said to experience financial distress if they cannot pay their dividends for 2 years or more.

2. Companies taken must have published their financial statements on the website www.idx.co.id in the period of the taken, from 2015-2017.

3. Companies that are taken have the information needed by this study.

4. Companies that do not have a complete financial statement data are removed from the sample.

In this study the data used is secondary data, because the data from the Indonesia Stock Exchange website, i.e. www.idx.co.id.
3.2 Operational Research Variable

3.2.1 Dependent Variable

Dependent variable is a variable that is bound and influenced by other variables (independent variables). This study use financial distress on firm to be the dependent variable. Financial distress will be the main focus in this research. Financial distress in this study will be measured using Altman Z-score. Altman (2000) was revised the formulation and distinguished measurements between manufacturing companies and non manufacturers, because the product outputs between manufacturing and non manufacturing companies is different. For the formula the manufacturing company has 5 coefficients as follows:

\[
Z\text{-Score} = 0.717X_1 + 0.847X_2 + 3.107X_3 + 0.420X_4 + 0.998X_5
\]

with the discriminant zone as follows:

If \(Z > 2.9\) = “safe” Zone

If \(1.23 < Z < 2.9\) = “Gray” Zone

If \(Z < 1.23\) = “Distress” Zone

And the formula for non-manufacturing company has 4 coefficients as follows:

\[
Z\text{-Score} = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4
\]

With the discriminant zone as follows:

If \(Z > 2.9\) = “safe” Zone

If \(1.22 < Z < 2.9\) = “Gray” Zone

If \(Z < 1.22\) = “Distress” Zone
Where:

\[ X_1 = \frac{\text{Working Capital}}{\text{Total Asset}} \]

\[ X_2 = \frac{\text{Retained Earnings}}{\text{Total Asset}} \]

\[ X_3 = \frac{\text{Earnings Before Interest and Taxes}}{\text{Total Asset}} \]

\[ X_4 = \frac{\text{Market Value of Equity}}{\text{Book Value of Total Debt}} \]

\[ X_5 = \frac{\text{Sales}}{\text{Total Asset}} \]

Based on the zone concept by Altman, this study is transforming the values of Altman Z-Score that >2.9 will be represented by 3, >1.22 <2.9 or >1.23 <2.9 will be represented by 2, and Z <1.22 or <1.23 will be presented by 1.

3.2.2 Independent Variables

Independent variable is a variable that is free and influence the other variable (dependent variables). This study use corporate governance index to be the independent variable and will be influencing the financial distress (dependent variable).

According to Kowalewski (2016), The CGI attempts to assess the governance of the companies, and how protected outside investors are against expropriation, thus providing a measure that involves a balance of power between insiders and outsiders. As a result, the sub-index management (in this study will be modified as directors) measures the structure and procedures of the executive management of the company, and the subindex supervisory board (in this study will be modified as commissioners) assesses that of the supervisory board. Remuneration measures management and supervisory board remuneration and its ownership in the company. Shareholder quantifies the degree to which the company informs relevant corporate facts to outside stakeholders. Ownership structure measures the
ownership structure quality of the company, especially for the rights of the minority shareholders. Audit measures and assesses the quality of audits and financial disclosures. Finally, the subindex corporate behaviour evaluates the social behaviour of the company.

3.3 Data Analysis Method

3.3.1 Descriptive Statistic

Descriptive statistics is the method used to present information from a group of data, in order to be more concise. According to Ghozali (2012), descriptive statistics are used to give a description of a data that is seen from the mean, standard deviation, and maximum-minimum. The mean is used to estimate the estimated population size from the sample. Descriptive statistic is used to see if a whole of the sample is qualified.

3.3.2 Classic Assumption Test

This study will use the classic assumption test to see the result of the data is meet the best criteria to be analyze by multiple linear regression analysis, and this study will do the normality test, heteroscedasticity test, multicollinearity test and autocorrelation test.

3.3.2.1 Normality Test

According to (Ghozali, 2016) normality test is tested to see whether independent and dependent or both variable is normal distributed. If the variable is not normal distributed, it will decreasing the statistical test. And we can not run the T-test, because the normal data is needed. Data normality test can be done with One Sample Kolmogorov Smirnov, under the condition:
1. If significant value is $> 0.1$ then the data is normal distributed.
2. If significant value is $< 0.1$ then the data is not normal distributed.

Besides the One Sample Kolmogorov Smirnov, there is another way to do the normality test. It is Graphical Analysis (P-P Plot) that will used in this study.

### 3.3.2.2 Multicolinearity Test

Multicolinearity test is aimed to see if there is correlation between the independent variables. According to (Ghozali, 2016:103) a good regression model should not have a correlation between the independent variables, if the independent variable is correlated, then this variable is not orthogonal. Orthogonal variable is an independent variable whose correlation value between variables is zero. A decisions making for multicolinearity test is under the condition:

1. Multicolinearity can be seen from Variance Inflation Factor (VIF) and Tolerance.
2. The Tolerance value is $> 0.01$ and VIF value is $< 10$.

### 3.3.2.3 Heteroscedasticity Test

In multiple linear regression analysis is also need to be tested regarding to the residual variant from one observation to another observation. If the residual has the same variant, Homoscedasticity occurs and if the variance is not same or different it is called Heteroscedasticity. If there is no heteroscedasticity, then the regression is good (Sunyoto, 2016).
3.3.2.4 Autocorrelation Test

Autocorrelation is a condition where there is a correlation between residual value this year with the previous years error rated (t-1). And autocorrelation test is aimed to test those correlation. A good regression model has no correlation between residual value this year with the previous years error rates or free from it.

To detect the autocorrelation presence we can use Durbin Watson test (DW test), Langrage Multiplier (LM Test), Q Statistics test, and Run test that will be used in this study. Autocorrelation with run test having a criteria and under the conditon:

1. There is an autocorrelation, if the value of Asymp. Sig. (2-tailed) < 0.1.
2. There is no autocorrelation, if the value of Asymp. Sig. (2-tailed) > 0.1.

3.3.3 Multiple Linear Regression Analysis

After doing the classic assumption test then we will do the multiple linear regression analysis. In this study, multiple linear regression analysis is used to determine the simultaneously effects between Board of Directors (BOD), Board of Commissioner (BOC), Remuneration (REM), Shareholder (SHDR), Ownership (OWN), Audit (ADT), and Behaviour (BHVR) index in companies towards the Financial Condition (Z-Score). The equation for testing the overall hypothesis in this study is:

\[ Y = \alpha 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \beta 5X5 + \beta 6X6 + \beta 7X7 + \epsilon t \]

Explanation:
- \( Y \) : Financial Condition (Z-Score)
- \( \alpha 0 \) : Constanta
- \( \beta x \) : Coefficient
- \( X_1 \) : BOD
- \( X_2 \) : BOC
- \( X_3 \) : REM
- \( X_4 \) : SHDR
3.3.4 Hypothesis Testing

The hypotheses in this study will be test with t-test and also Coefficient Determinant, with the following explanations:

3.3.4.1 T – Test (Partial Test)

T – test used to test how far the independent variables influencing partially the dependent variable. The basic decision making used in the t test is as follows:

1. If the significance probability value is > 0.1, the hypothesis is rejected. It means that the independent variable has no significant effect on the dependent variable.

2. If the probability of significance is < 0.1, the hypothesis is accepted. It means that the independent variable influence significant to the dependent variable.

3.3.4.2 Coefficient of Determination ($R^2$)

According to (Moore et al., 2013) the R-squared, also called the coefficient of determination, which is the proportion of variance (%) in the dependent variable that can be explained by the independent variable. Hence, as a rule of thumb for interpreting the strength of a relationship based on its R-squared value (use the absolute value of the R-squared value to make all values positive):

1. If R-squared value < 0.3 this value is generally considered a None or Very weak effect size,
2. If R-squared value $0.3 < r < 0.5$ this value is generally considered a weak or low effect size,

3. If R-squared value $0.5 < r < 0.7$ this value is generally considered a Moderate effect size,

4. If R-squared value $r > 0.7$ this value is generally considered strong effect size.
V. CONCLUSION AND SUGGESTIONS

5.1 Conclusion

From the discussions in the previous chapter about the influence of board of directors, board of commissioner, remuneration, shareholder, ownership, audit, and behaviour index quality towards financial distress in SOE’s that listed in Indonesia Stock Exchange from 2015-2017. Then it can be concluded several things as follows:

1. Independent variable board of directors indicates the quality of its index measurable from relationship between internal directorships with external parties has a significantly affecting the financial distress.

2. Independent variable board of commissioners indicates the quality of its index measurable from the number of board and the compositions of independent board has significantly affecting the financial distress.

3. Independent variable remuneration indicates the quality of its index measurable from the components remuneration disclosure and compensation for the workers and supervisory has insignificantly affecting the financial distress.
4. Independent variable shareholder indicates the quality of its index measurable from equity shares and shareholder voting rights has significantly affecting the financial distress.

5. Independent variable ownership indicates the quality of its index measurable from composition of ownerships has significantly affecting the financial distress.

6. Independent variable audit indicates the quality of its index measurable from transparency and auditor composition has not affecting the financial distress.

7. Independent variable behaviour indicates the quality of its index measurable from code of ethics and CSR policies has not affecting the financial distress.

5.2 Research Limitations

Based on the research and explanation from a whole of this study, the following are limitations owned by this study:

1. This study only used Altman Z-Score as a tool to predicting the financial condition.

2. Periods taken only from years 2015-2017, so the observations taken only 48.

3. This study only use SOE’s that listed in Indonesia Stock Exchange, so that's not focus on one sectors.

5.3 Suggestion

Based on the research and explanation from a whole of this study, the following are suggestions that this study can give for the next research:
1. Expected for further research is using the other models to predicting the bankruptcy in firm, so it can be compared by one model to another models.

2. Expected for further research is adding the periods taken, so the number of observations are increased and the result will be more varied.

3. Expected for further research to enlarge the research sample, and use the focus sectors. So the result will be more focus and the data will be more widespread.
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