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Corporate Governance, Leverage, and Financial Distress: The Mediating Role of Profitability in Indonesian Property and Real Estate Firms

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Abstract

Financial distress remains a persistent threat for capital-intensive industries, and Indonesia's property and real estate sector illustrates this vulnerability clearly, given its heavy reliance on debt financing to fund land acquisition, construction, and infrastructure development. This study investigates whether board composition — captured through the board of commissioners and the board of directors — together with leverage, predicts financial distress among listed property and real estate firms, and whether profitability channels these effects. Secondary data were drawn from 39 firms listed on the Indonesia Stock Exchange during 2022–2024, selected through purposive sampling and yielding 117 firm-year observations. Data were analyzed using Partial Least Squares–Structural Equation Modeling (PLS-SEM) in SmartPLS 4, with bootstrapping used to test both direct and indirect (mediated) effects. The results show that the board of directors and leverage each significantly and negatively predict financial distress, while the board of commissioners does not. Profitability itself does not significantly predict financial distress and fails to mediate the relationships between governance, leverage, and distress. The study concludes that directorial effectiveness and debt-structure management, rather than current profitability, are the more relevant levers for managing distress risk in this sector.

Keywords: Corporate Governance; Financial Distress; Leverage; Profitability; Property And Real Estate

INTRODUCTION

Keeping a firm financially sound has grown harder as competitive pressure across Indonesian industries intensifies. Firms today are expected not only to perform well operationally but also to keep their financing structure and internal oversight functioning

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properly; falling short on either can push a company toward financial distress — a state in which it can no longer reliably meet its obligations to creditors (Abdillah, 2023). The warning signs are familiar: shrinking profitability, erratic cash flow, and a mounting debt load. Because distress ultimately threatens a firm's survival, understanding what drives it has remained a live question for researchers and practitioners alike (Puspaningsih et al., 2024).

Property and real estate companies sit unusually close to this risk. Land acquisition, construction, and infrastructure development all demand large amounts of capital, which typically pushes firms in this sector toward heavier debt financing than most industries require, while their performance simultaneously rides on macroeconomic swings in interest rates, consumer purchasing power, and market liquidity. Two well-known Indonesian cases show how quickly this exposure can turn into genuine distress. In 2020, PT Modernland Realty Tbk was temporarily suspended from trading on the Indonesia Stock Exchange after it failed to redeem maturing bonds Saragih (2020), and later sought a debt moratorium amid going-concern concerns. That same year, PT Cowell Development Tbk faced a bankruptcy petition from creditor PT Multi Cakra Kencana Abadi over an unpaid debt of roughly IDR 53.4 billion Al Faruq (2020), alongside a separate suspension-of-payment claim filed by PT Mega Sukses (Ciptaning, 2020). Both cases trace back to the same root cause: liquidity pressure that had been building long before the formal insolvency proceedings began.

Two mechanisms are commonly proposed as safeguards against this trajectory. The first is corporate governance, represented here by the board of commissioners, which supervises management, and the board of directors, which makes strategic and operational decisions; stronger governance is expected to discipline management and reduce the odds of distress. The second is leverage: a heavier reliance on debt raises fixed financing costs that can strain liquidity if earnings fall short (Hulu et al., 2025). Profitability is often treated as the bridge connecting the two, since firms that earn more are assumed to be better equipped to absorb debt-servicing pressure and cover for governance weaknesses (Siregar et al., 2024).

Evidence on how these factors actually relate to distress, however, is far from settled. Wati & Januarti (2025) found that the board of commissioners reduced financial distress among transportation and tourism firms while the board of directors had no measurable effect, whereas Shavila & Purwanto (2025) found the opposite pattern in a different sample. Findings on leverage diverge just as sharply Hermuningsih et al. (2022) report a positive effect of leverage on distress, while Burhanudin and Setiawati (2024) report a negative one. This inconsistency, layered on top of mixed evidence about how governance and leverage

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relate to profitability itself, points to a genuine gap worth revisiting in a different empirical setting.

This study addresses that gap by testing the governance-leverage-distress relationship, with profitability as a mediator, among property and real estate firms listed on the Indonesia Stock Exchange during 2022–2024 — a sector chosen precisely because its capital intensity and elevated leverage make for a more demanding test than the transportation and tourism context examined by (Wati & Januarti, 2025). Rather than treating each variable's relationship to profitability as a separate hypothesis, this study frames its inquiry around a single, integrated hypothesis: that governance and leverage jointly shape financial distress, with profitability serving as the channel through which part of that influence flows.

THEORETICAL REVIEW

Agency theory offers the organizing lens for this study. It describes the firm as a set of contracts between principals (owners) and agents (management), where the agent is delegated authority to run the business on the principal's behalf; because the two parties' interests rarely align perfectly, this delegation opens the door to agency conflict (Jensen & Meckling, 1976). Governance structures — a supervisory board of commissioners and an executive board of directors — exist to narrow that gap, while creditors, once debt enters the picture, add a further layer of external monitoring pressure on management to remain disciplined.

Applied to financial distress, agency theory suggests that firms with more effective oversight and decision-making structures should be better positioned to avoid the kind of mismanagement that leads to distress (Platt & Platt, 2002). A well-functioning board of commissioners is expected to catch problems in management's financial decisions before they compound; a capable board of directors is expected to make sounder strategic and operational calls that keep the firm on stable footing. Leverage complicates this picture while heavy debt raises fixed obligations that can tip a weakly governed firm into distress, debt that is well-managed and backed by creditor confidence can instead signal financing access and operational scale — a pattern documented in capital-intensive sectors such as property and real estate (Bachtiar & Handayani, 2022), (Bukhari & Rozalinda, 2022). Profitability, meanwhile, is theorized as a downstream consequence of governance quality: boards that monitor and decide well are expected, in principle, to produce stronger earnings Fitriyani (2021), Ningrum et al. (2024), and stronger earnings are in turn expected to cushion a firm against distress (Yoganata & Fitria, 2024). Whether that full chain actually holds remains an empirical question rather than a given, since profitability's link to distress has itself

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produced mixed findings across prior studies (Safitri & Purwaningsih, 2023), (Wahyuningtiyas & Retnani, 2021).

The study tested the hypothesis that the board of commissioners, the board of directors, and leverage significantly affect financial distress among property and real estate companies listed on the Indonesia Stock Exchange during 2022–2024, with profitability mediating these relationships.

METHOD

Research Design. This study used a quantitative, explanatory design based on secondary panel data, estimated through Partial Least Squares–Structural Equation Modeling (PLS-SEM). The exogenous variables were the board of commissioners, the board of directors, and leverage; profitability served as the mediating variable; and financial distress was the endogenous outcome.

Population and Sample. The population comprised all property and real estate companies listed on the Indonesia Stock Exchange during 2022–2024. A purposive sampling procedure was applied, requiring firms to have published complete financial statements and annual reports throughout the period and to be free of special-monitoring-board status. Of 80 firms initially identified, 27 were excluded for incomplete disclosures and 14 for special-monitoring status, leaving a final sample of 39 firms. Combined with the three-year observation window, this yielded 117 firm-year observations.

Data Source and Collection. Data were obtained through documentation of each sample firm's audited financial statements and annual reports, retrieved from the Indonesia Stock Exchange's official website (www.idx.co.id). Variable Measurement. The board of commissioners and board of directors were each measured as a simple headcount of their members. Leverage was measured using the Debt-to-Asset Ratio (total liabilities divided by total assets). Profitability was measured using Return on Assets (net income divided by total assets). Financial distress was measured using the Altman Z-Score, a composite index combining liquidity, profitability, leverage, and asset-utilization ratios: $Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$.

Data Analysis. All variables in this study are single-indicator constructs, so the measurement model was evaluated only for convergent validity (outer loadings). The structural model was evaluated through R^2, F^2 (effect size), path coefficients, and specific indirect effects, all estimated via bootstrapping in SmartPLS 4 using a one-tailed test at the 5% significance level (accepted where t-statistic > 1.645 and $p < .05$).

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RESULTS

Table 1. Descriptive Statistics

Variable	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*
Board of Commissioners	117	2,000	16,000	3,778	2,446
Board of Directors	117	2,000	10,000	3,966	2,213
DAR (Leverage)	117	0,002	1,541	0,414	0,274
ROA (Profitability)	117	-0,090	0,428	0,023	0,067
Z-Score (Financial Distress)	117	-1,950	109,408	4,505	13,409

Source: Output SmartPLS 4

Table 1 shows considerable spread across the sample, particularly in board size (2 to 16 commissioners; 2 to 10 directors) and in the Z-Score (-1.950 to 109.408), indicating that the 39 sample firms varied widely in both governance structure and financial health across 2022–2024.

Testing the Hypothesis

Because each construct in this study relies on a single indicator, every outer loading equals 1.000 — well above the 0.70 convergent-validity threshold — confirming that each measure directly represents its intended construct.

Table 2. R-Square

Variable	*Original sample (O)*	*Sample mean (M)*	*Standard deviation (STDEV)*	*T statistics (|O/STDEV|)*	*P values*
Financial distress	0.159	0.198	0.074	2.148	0.016
Profitability	0.037	0.071	0.046	0.813	0.208

Source: Output SmartPLS 4

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Table 3. Effect Size (F^2)

Variable	*F-Square*	Keterangan
Board of Commissioners → Financial Distress	0.000	None
Board of Commissioners → Profitability	0.032	Small
Board of Directors → Financial Distress	0.015	None
Board of Directors → Profitability	0.001	None
Leverage → Financial Distress	0.149	Small
Leverage → Profitability	0.002	None
Profitability → Financial Distress	0.005	None

Source: Output SmartPLS 4

Table 4. Path Coefficients (Direct Effects)

Variabel	Original sample (O)	T statistics (|O/STDEV|)	P-Values	Result
Board of Commissioners → Financial Distress	-0.011	0.091	0.464	Not Supported
Board of Directors → Financial Distress	-0.132	2.379	0.009	Supported
Leverage → Financial Distress	-0.362	7.110	0.000	Supported
Profitability → Financial Distress	0.066	1.189	0.117	Not Supported
Board of Commissioners → Profitability	0.211	2.213	0.013	Supporting Path
Board of Directors → Profitability	-0.037	0.462	0.322	Supporting Path
Leverage→Profitability	0.041	0.277	0.391	Supporting Path

Source: Output SmartPLS 4

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Table 5: Specific Indirect Effects (Mediation Test)

Variable	β	*T statistics (|O/STDEV|)*	P-*Values*	Result
Board of Commissioners → Profitability → Financial Distress	0.014	0.849	0.198	Not Significant
Board of Directors → Profitability → Financial Distress	-0.002	0.329	0.371	Not Significant
Leverage → Profitability → Financial Distress	0.003	0.156	0.438	Not Significant

Source: Output SmartPLS 4

Taken together, Tables 4 and 5 show that the hypothesis is only partially supported. The board of directors and leverage each significantly and negatively predict financial distress, while the board of commissioners does not. The board of commissioners, in turn, significantly and positively predicts profitability (β = 0.211, p = .013) — the only governance path to reach significance on that side of the model — but profitability itself does not significantly predict financial distress (p = .117), and none of the three indirect paths in Table 5 reach significance. The mediation component of the hypothesis is therefore not supported.

DISCUSSION

The finding that the board of commissioners does not significantly predict financial distress (β = -0.011, p = .464) suggests that supervisory effectiveness in this sector depends on the quality of oversight rather than simply how many people sit on the board. Muafiroh & Hidajat (2021) and Rustyaningrum & Rohman (2021) similarly found no significant link between commissioner board size and distress in Indonesian manufacturing and banking firms Achyani & Kusumawati, 2023) report the same null result across a broader mix of sectors.

The board of directors, by contrast, shows a significant negative effect on financial distress (β = -0.132, p = .009). This is consistent with Prasetya & Hindasah (2024), who argue that a broader base of expertise among directors sharpens the strategic and operational decisions that keep a firm out of trouble, and it matches the empirical results of (Alexandra et al., 2022) and (Puspaningsih et al., 2024).

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Leverage also significantly predicts financial distress, but in the opposite direction from what capital-structure caution would suggest (β = -0.362, p < .001): higher leverage is associated with lower, not higher, distress. Bachtiar & Handayani (2022) report the same negative direction among manufacturing firms, and Bukhari & Rozalinda (2022) find a comparable pattern once firm size is taken into account. Read through the lens of this sector's dynamics, the result likely reflects the fact that property and real estate firms able to secure substantial financing typically do so because creditors already trust their repayment capacity and project pipeline heavier borrowing here signals financing access and scale more than fragility.

Profitability's non-significant effect on distress (β = 0.066, p = .117) indicates that earning capacity alone does not determine whether a property or real estate firm avoids financial trouble, a null result also reported by Wahyuningtiyas & Retnani (2021). The one governance path that did reach significance — the board of commissioners raising profitability (β = 0.211, p = .013) — never gets the chance to influence distress, since the profitability–distress link itself is absent. Whatever protection the board of directors and leverage offer against financial distress in this sector therefore appears to operate directly, bypassing profitability entirely.

CONCLUSION

Among the mechanisms tested, only the board of directors and leverage emerge as significant, direct predictors of financial distress among Indonesian property and real estate firms during 2022–2024. The board of commissioners and profitability do not predict distress on their own, and profitability does not mediate the effects of governance or leverage on distress. The hypothesized model is therefore only partially supported.

Recommendations. Firms in this sector would likely gain more from strengthening the decision-making effectiveness of their board of directors and managing debt structure deliberately than from pursuing profitability improvements as a distress-prevention strategy on their own. Regulators and industry associations may also consider encouraging qualitative governance disclosures rather than relying on board size alone.

LIMITATIONS AND SUGGESTIONS FOR FURTHER STUDY

This study is limited to a single sector observed over three years, and it proxies corporate governance solely through board size rather than qualitative attributes such as independence, expertise, or meeting frequency. The relatively low R^2 values further indicate that much of the variation in financial distress lies outside the variables examined here. Future research could extend the sample across sectors and a longer time frame, incorporate

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additional predictors such as liquidity, firm size, or sales growth, and test richer governance proxies beyond simple board headcounts.

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