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The Influence Of Audit Committee, Operating Capacity, And Group Size On Financial Distress

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Abstract

This study aims to analyze the effect of audit committee, operating capacity, and group size on financial distress. This type of research is quantitative using secondary data obtained from the Indonesia Stock Exchange (IDX) and each group's official website. The analysis technique used in this study is panel data regression assisted by EViews 12 software. The study was conducted on LQ45 Index groups. The data sampling technique used purposive sampling, resulting in a total sample of 102 observations from 17 groups over the 2020 to 2025 observation period. The results showed that simultaneously, the audit committee, operating capacity, and group size significantly affected financial distress. Partially, operating capacity has a significant effect on financial distress, while audit committee and group size have no effect on financial distress.

Keywords: Financial Distress, Audit Committee, Operating Capacity, Group Size.

INTRODUCTION

Post-pandemic economic recovery dynamics and escalating global geopolitical tensions between 2020 and 2025 have severely disrupted energy supply chains, triggered surges in raw material prices, and compressed corporate profit margins across emerging markets. When rising production and operating expenses erode operating cash flows while short-term and long-term debt obligations mature, entities face heightened vulnerability to financial distress. Financial distress represents an early warning stage of deteriorating financial health prior to actual bankruptcy, characterized by an entity's inability to fulfill maturing financial obligations due to insufficient liquidity and operating cash inflows (Idawati, 2020; J. Wijaya & Suhendah, 2023). Crucially, even blue-chip groups included in the LQ45 Index on the Indonesia Stock Exchange (IDX)—which are characterized by high liquidity and large market capitalization—are not entirely immune

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to financial distress, as demonstrated by the severe debt restructuring and negative equity crisis experienced by former LQ45 constituent PT Sri Rejeki Isman Tbk (SRIL).

From a theoretical perspective, corporate susceptibility to financial distress is explained through Agency Theory (Jensen & Meckling, 1976) and Signaling Theory (Spence, 1973). Under Agency Theory, information asymmetry and divergent interests between owners (principals) and managers (agents) can foster managerial opportunism, excessive operational costs, or delayed risk disclosure that exacerbate financial distress (Setyawan & Aryati, 2023; Kartika et al., 2020). Effective corporate governance mechanisms—specifically an independent and active audit committee—serve to align managerial actions with stakeholder interests and safeguard going-concern stability. Meanwhile, Signaling Theory posits that financial ratios and governance disclosures transmit credible signals to investors and creditors regarding an entity's operational efficiency, asset productivity, and financial resilience (J. Wijaya & Suhendah, 2023; Dewanti, 2023).

Despite extensive academic attention, prior empirical findings regarding internal determinants of financial distress remain inconclusive across sectors and observation windows:

- **Audit Committee:** Robbani & Ritonga (2024) and Rachmawati & Rohman (2024) find that the audit committee significantly affects financial distress by strengthening internal control and financial reporting oversight, whereas Romadhoni et al. (2024) and Hamdini et al. (2025) report no significant effect.
- **Operating Capacity:** Islamiati et al. (2024), Silalahi et al. (2022), and Putri et al. (2024) demonstrate that operating capacity significantly influences financial distress, whereas Nabila & Putri (2024) find no statistically significant relationship.
- **Group Size:** Kristianti & Khairudin (2024) and Afridayani (2023) report that group size significantly affects financial distress, while Nasution et al. (2024) and Wahyudi et al. (2024) find that group size has no significant effect.

Objectives and Research Methodology

To resolve these empirical inconsistencies within a post-pandemic and recovery timeframe, this article intends to:

- Analyze the simultaneous effect of the audit committee, operating capacity, and group size on financial distress (H1).
- Examine the partial effect of the audit committee on financial distress (H2).
- Examine the partial effect of operating capacity on financial distress (H3).
- Examine the partial effect of group size on financial distress (H4).

This study employs an associative quantitative research design utilizing secondary panel data extracted from audited annual financial statements and annual reports

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published on the Indonesia Stock Exchange (www.idx.co.id) and official corporate websites for the 2020–2025 period. From the population of 45 LQ45 Index constituents, purposive sampling was applied using three criteria: (1) groups consistently listed in the LQ45 Index throughout 2020–2025, (2) groups publishing complete audited financial statements and annual reports during 2020–2025, and (3) groups disclosing complete data on audit committee membership and financial ratios required for variable measurement. This procedure yielded 17 qualifying groups over six consecutive years, forming a balanced panel dataset of 102 observations.

Table 1: Operational Definition and Measurement of Research Variables

Variable	Symbol	Operational Measurement	Scale
Financial Distress	Y	Modified Altman Z-Score: Z = 6.56X1 + 3.26X2 + 6.72X3 + 1.05X4 (X1 = Working Capital/Total Assets; X2 = Retained Earnings/Total Assets; X3 = EBT/Total Assets; X4 = Book Value of Equity/Total Liabilities)	Ratio
Audit Committee	X1	Total number of audit committee members serving in the group	Nominal
Operating Capacity	X2	Total Asset Turnover (TATO) = Sales / Total Assets	Ratio
Group Size	X3	Size = Ln(Total Assets)	Ratio

Data analysis was conducted using EViews 12 through descriptive statistics, panel regression model selection tests (Chow test, Hausman test, and Lagrange Multiplier test), classical assumption diagnostics (Jarque-Bera normality, pairwise correlation multicollinearity, Glejser heteroskedasticity, and Durbin-Watson autocorrelation tests), and panel data regression modeling formulated as follows:

$$Yit = \beta 0 + \beta 1X1it + \beta 2X2it + \beta 3X3it + \varepsilon it$$

DISCUSSION

Descriptive Statistical Analysis and Model Specification

Descriptive statistics across the 102 observations reveal notable variation in financial health despite the blue-chip profile of LQ45 Index constituents. Financial Distress (Y) records a mean modified Altman Z-Score of 4.996908 with a standard deviation of 3.480275, spanning from a minimum of -0.865457 to a maximum of 13.23917; this confirms that several large-cap groups entered the distress zone during

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the 2020–2025 observation window. Audit Committee (X1) shows a mean of 3.656863 (minimum 3.000000, maximum 8.000000, SD 1.038803), demonstrating full compliance with Financial Services Authority Regulation No. 55/POJK.04/2015 requiring at least three audit committee members. Operating Capacity (X2) averages 0.744861 (minimum 0.131179, maximum 2.317043, SD 0.491354), reflecting cross-industry differences in asset turnover intensity. Group Size (X3) exhibits a mean of 32.03108 (minimum 30.40649, maximum 33.86025, SD 0.859029), indicating a consistently massive asset scale across all sampled groups.

Panel model selection tests confirm that the Random Effect Model (REM) is the most appropriate estimator. Specifically, the Chow test produces a Cross-section F probability of 0.0000 (< 0.05), rejecting the Common Effect Model in favor of the Fixed Effect Model; the Hausman test yields a Cross-section random probability of 0.3139 (> 0.05), indicating that the Random Effect Model is preferable to the Fixed Effect Model; and the Lagrange Multiplier test shows a Breusch-Pagan probability of 0.0000 (< 0.05), confirming REM over CEM. Furthermore, classical assumption diagnostics verify that the model is free from econometric violations: residuals follow a normal distribution (Jarque-Bera = 5.315863, p = 0.070093 > 0.05), pairwise correlations among independent variables remain well below the 0.85 threshold (-0.1494, 0.3198, and -0.5850), Glejser heteroskedasticity probabilities exceed 0.05 (0.7166, 0.8217, and 0.6892), and the Durbin-Watson statistic (1.117371) lies within the acceptable -2 to +2 range.

Table 2: Random Effect Model Panel Regression and Hypothesis Testing Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Decision
Constant (C)	-25.90624	15.92536	-1.626729	0.1070	—
Audit Committee (X1)	-0.460058	0.265157	-1.735043	0.0859	H2 Rejected
Operating Capacity (X2)	2.403023	0.745401	3.223798	0.0017	H3 Accepted
Group Size (X3)	0.961429	0.499707	1.923986	0.0573	H4 Rejected
R-squared / Adjusted R-squared	**0.154086 / 0.128191**				**—**
F-statistic / Prob(F-statistic)	**5.950346 / 0.000903**				**H1 Accepted**

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Interpretation of Empirical Findings

Based on the Random Effect Model estimation in Table 2, the panel regression equation is formulated as Yit = -25.90624 - 0.460058X1it + 2.403023X2it + 0.961429X3it + εit. The hypothesis testing results are interpreted as follows:

1. **Simultaneous Effect of Audit Committee, Operating Capacity, and Group Size on Financial Distress (H1 Accepted):** The F-test produces an F-statistic of 5.950346 with a significance probability of 0.000903 (< 0.05), confirming that the audit committee, operating capacity, and group size jointly exert a statistically significant effect on financial distress and account for 12.82% of its adjusted variance (Adjusted R-squared = 0.128191). Consistent with Agency Theory and Signaling Theory, corporate governance oversight, asset turnover productivity, and asset scale interact collectively as an integrated financial defense system that shapes external stakeholder confidence in corporate going-concern stability (Candrayani et al., 2024; J. R. J. Wijaya & Henryanto, 2022).
2. **Partial Effect of Audit Committee on Financial Distress (H2 Rejected):** The audit committee yields a regression coefficient of -0.460058 with t = -1.735043 and p = 0.0859 (> 0.05), indicating no statistically significant partial effect on financial distress. Although Agency Theory posits that audit committees curb managerial opportunism, mere member headcount among LQ45 entities largely reflects administrative compliance with POJK No. 55/POJK.04/2015 rather than substantive intervention in operational liquidity and working capital risks. Under Signaling Theory, capital market participants prioritize tangible cash-flow resilience over formal committee size alone, aligning with Hamdini et al. (2025) and Romadhoni et al. (2024).
3. **Partial Effect of Operating Capacity on Financial Distress (H3 Accepted):** Operating capacity demonstrates a positive and highly significant partial effect on financial distress (β = 2.403023, t = 3.223798, p = 0.0017 < 0.05). Supporting Tinambunan & Mu'arif (2024) and Putri et al. (2024), aggressive asset turnover and high operational intensity among large-cap groups—when accompanied by escalating production costs, credit sales expansion, or delayed receivable collection—can strain net operating cash inflows and heighten financial distress exposure if cost efficiency is not strictly maintained.
4. **Partial Effect of Group Size on Financial Distress (H4 Rejected):** Group size records a coefficient of 0.961429 with t = 1.923986 and p = 0.0573 (> 0.05), demonstrating no statistically significant partial effect at the 5% significance level. Because all sampled LQ45 constituents already possess massive total asset bases and established market standing, incremental variations in asset scale do not differentiate financial distress vulnerability. Moreover, larger total assets entail higher

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fixed overhead and organizational complexity, meaning asset scale alone cannot shield an entity from financial distress without disciplined cash-flow management (Nafisah et al., 2023; Wahyudi et al., 2024).

CONCLUSION

This study investigates the determinants of financial distress among 17 LQ45 Index groups on the Indonesia Stock Exchange over the 2020–2025 period. Simultaneously, the audit committee, operating capacity, and group size significantly influence financial distress. Partially, operating capacity exerts a positive and statistically significant effect on financial distress, whereas the audit committee and group size do not demonstrate statistically significant partial effects at the 5% significance level.

Practically, corporate management within large-cap groups should pair high asset turnover strategies with strict operational cost control and working capital discipline, while empowering audit committees to perform substantive risk oversight beyond regulatory compliance. Investors and creditors should likewise look beyond blue-chip index status or total asset scale by prioritizing operational efficiency and cash-flow quality when assessing credit and investment risks. Future research is encouraged to expand the sample across non-LQ45 industry sectors, incorporate macroeconomic or leverage variables, and measure audit committee effectiveness through qualitative attributes such as meeting frequency and financial expertise.

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