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FACTORS AFFECTING FINANCIAL DISTRESS IN TRADING COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE

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Abstract:
This study aims to analyze the effect of the debt-to-asset ratio (DAR), business strategy, board of directors, and earnings management on financial distress in trading companies listed on the Indonesia Stock Exchange during the 2022–2024 period, with firm size serving as a moderating variable. This study employed a quantitative approach using secondary data in the form of companies' financial statements obtained from the official website of the Indonesia Stock Exchange. The sample consisted of 36 companies selected from a population of 62 through a purposive sampling technique, resulting in 108 observations. Data were analyzed using descriptive statistics, panel data regression, and Moderated Regression Analysis (MRA), with model selection conducted through the Chow test and Hausman test. The results indicate that DAR has a negative and significant effect on financial distress, while business strategy has a positive and significant effect on financial distress. Meanwhile, the board of directors and earnings management do not have a significant effect on financial distress. In addition, firm size is not able to moderate the effect of DAR on financial distress. This study is expected to provide useful insights for management and investors in understanding the factors that influence the risk of financial distress.

Keywords: Financial distress, Debt to asset ratio (DAR), Business strategy, Board of directors, Earnings management, Firm size.

INTRODUCTION

Financial distress has become an important issue in financial studies because it reflects a company's declining ability to meet its financial obligations and may represent the initial stage leading to bankruptcy. In the trading sector, this risk tends to be higher because companies are highly dependent on consumer purchasing power, sales volume, and changes in market dynamics. The shift in consumer behavior from physical stores to e-commerce has also increased pressure on the operational efficiency of trading companies. Several studies have confirmed that financial distress is influenced by weak internal financial conditions and high vulnerability to external changes (Kristanti et al., 2022; Nyale, 2020; Madan & Wang, 2024). These conditions indicate that the trading sector provides a relevant context for examining the determinants of financial distress.

One of the internal factors frequently associated with financial distress is the debt-to-asset ratio (DAR), which indicates the extent to which a company's assets are financed by debt. Proper management of the funding structure can help companies maintain financial balance and reduce the risk of distress, particularly when they are still able to manage their liabilities efficiently (Arhinful et al., 2025). In addition, business strategy also plays an important role because an inappropriate strategy may reduce cost efficiency, weaken competitiveness, and increase financial pressure on the company. Conversely, an appropriate business strategy can help companies adapt to market changes and maintain sustainable performance (Diab et al., 2025; Agustia et al., 2020).

From a corporate governance perspective, the board of directors has supervisory and strategic decision-making functions that may reduce the risk of financial distress. Effective governance,

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including an adequate board structure, has been proven to strengthen managerial oversight and reduce the likelihood of bankruptcy (Younas et al., 2021; Purwaningsih & Safitri, 2022). On the other hand, earnings management often emerges when companies face financial pressure, as management attempts to present performance that appears stable to investors. However, this practice tends to provide only short-term effects and may, in the long run, worsen the risk of financial distress (Thu, 2023).

In addition to these variables, firm size is considered capable of influencing a company's level of resilience in dealing with financial pressure. Larger companies generally have better access to funding, lower capital costs, and stronger operational capacity, which may weaken the effect of leverage on financial distress. Nevertheless, previous studies concerning the role of firm size as a moderating variable have produced inconsistent findings across industrial sectors (Ramadani & Ratmono, 2023).

This study is motivated by previous research gaps, particularly the study by Kristanti et al. (2022), which was still limited to certain sectoral and regional contexts. Therefore, this study simultaneously examines the effects of the debt-to-asset ratio, business strategy, board of directors, and earnings management on financial distress in trading companies listed on the Indonesia Stock Exchange, with firm size as a moderating variable. This study is expected to enrich the literature on financial distress in the trading sector and provide practical insights for management and investors in detecting and mitigating the risk of corporate financial distress.

Signaling theory. Signaling theory explains that information conveyed by a company to external parties will be interpreted as a signal regarding the company's condition and prospects. In the context of this study, debt ratios, business strategy, and financial distress conditions may serve as signals that influence investors' and creditors' assessments of a company's financial health. Information indicating high financial pressure will be perceived as a negative signal, whereas sound financial management and appropriate strategies may serve as positive signals to the market (Spence, 1973; Healy, 1998).

Agency Theory. Agency theory explains the relationship between company owners (principals) and management (agents), which may give rise to conflicts of interest. Management does not always act in accordance with the interests of the owners; therefore, monitoring mechanisms are required to reduce opportunistic behavior. In this study, the board of directors constitutes an important part of the governance mechanism that can strengthen oversight, improve the quality of strategic decision-making, and reduce the risk of financial distress (Jensen & Meckling, 1976; Hahn & Lasfer, 2016).

Financial Distress. Financial distress is a condition in which a company experiences a decline in financial health, making it difficult to meet its financial obligations. This condition is often regarded as an early stage preceding bankruptcy. Financial distress may be indicated by weak cash flow, declining debt repayment capacity, and a reduction in company equity. Previous literature shows that financial distress is influenced by a combination of financial factors, strategy, governance, and firm characteristics (Whitaker, 1999; Madan & Wang, 2024; Ramadani & Ratmono, 2023).

Debt to Asset Ratio (DAR). The debt-to-asset ratio (DAR) is a ratio that indicates the proportion of a company's assets financed by debt. This ratio is used to assess the company's level of leverage. A high DAR indicates greater dependence on external financing, which may increase financial pressure if the company is unable to manage its obligations effectively. However, the proportional use of debt may also help companies meet financing needs and maintain operations.

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Therefore, DAR is considered one of the important indicators in explaining the potential for financial distress (Modigliani & Miller, 1958; Arhinful et al., 2025; Vithessonthi & Tongurai, 2021).

Business Strategy. Business strategy refers to a company's long-term policy direction in achieving competitive advantage. An appropriate strategy enables a company to adapt to market changes, manage resources efficiently, and maintain business sustainability. Conversely, an ineffective strategy may increase costs, reduce competitiveness, and heighten the risk of financial distress. Therefore, business strategy is regarded as one of the relevant non-financial factors in explaining a company's financial condition (Porter, 1998; Maiti, 2018; Diab et al., 2025).

Board of Directors. The board of directors plays an important role in corporate oversight and strategic decision-making. An effective board can strengthen governance, reduce agency conflicts, and improve a company's ability to deal with financial pressure. Several studies indicate that board characteristics, such as meeting frequency, oversight quality, and the effectiveness of board structure, are associated with a company's ability to reduce the risk of financial distress (Jensen, 1993; Vafeas, 1999; Lu et al., 2022; Younas et al., 2021).

Earnings Management. Earnings management refers to management actions intended to influence earnings reporting in order to achieve certain objectives, such as maintaining the company's image or meeting market expectations. This practice often arises when companies experience financial pressure. Although it may create an impression of stability in the short term, earnings management may worsen financial conditions in the long term because it reflects lower earnings quality and weaker financial reporting transparency. Therefore, earnings management is viewed as a variable that may increase the risk of financial distress (Healy, 1998; Thu, 2023; Meryana & Erna Setiany, 2021).

Firm Size. Firm size reflects the scale of a company's operations. Larger companies generally have stronger resources, broader access to financing, and greater financial flexibility than smaller firms. In this study, firm size is positioned as a moderating variable because, theoretically, it may weaken the effect of leverage on financial distress. However, previous studies have shown that the moderating role of firm size is not consistent across industrial sectors, making its examination in the trading sector still relevant (Machfoedz, 1994; Ramadani & Ratmono, 2023; Ginn & Saadaoui, 2024).

Relationships Among Variables. Based on the theoretical foundations and previous empirical studies, financial distress is influenced by financial aspects, strategy, governance, and firm characteristics. DAR reflects debt pressure, business strategy describes a company's adaptive capability, the board of directors represents the quality of oversight, and earnings management reflects the potential distortion of financial information. Meanwhile, firm size is expected to moderate the relationship between DAR and financial distress. Accordingly, this study examines the effects of the debt-to-asset ratio, business strategy, board of directors, and earnings management on financial distress, with firm size as a moderating variable.

METHODS

This study employed a quantitative approach with a causal research design to analyze the effects of the debt-to-asset ratio (DAR), business strategy, board of directors, and earnings management on financial distress, with firm size serving as a moderating variable. The population consisted of 62 trading companies listed on the Indonesia Stock Exchange (IDX) during the 2022–2024 period. The sample was selected using a purposive sampling technique, resulting in 36 companies that met the research criteria, with a total of 108 observations. The data used were secondary in the form of annual financial statements obtained from the official website of the Indonesian Stock Exchange. The dependent variable, namely financial distress, was measured using

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the Altman Z-Score model, which classifies companies into healthy, grey area, and distress-risk categories based on specific score thresholds (Altman, 1968). DAR was measured by comparing total debt to total assets to indicate the company's level of leverage (Liu & Li, 2025). Business strategy was proxied by the asset turnover ratio, which reflects the company's effectiveness in utilizing its assets to generate sales (Agustia et al., 2020). The board of directors was measured based on the frequency of board meetings within one year, while earnings management was measured using an earnings management proxy reflecting the tendency of companies to modify reported earnings. Meanwhile, firm size was used as a moderating variable to examine whether company size influences the relationship between DAR and financial distress. Data analysis was conducted using descriptive statistics, panel data regression, and Moderated Regression Analysis (MRA). The panel data regression model was selected through the Chow test and the Hausman test to determine the most appropriate estimation model.

RESULTS AND DISCUSSION

This study used 108 observations of trading sector companies listed on the Indonesia Stock Exchange during the 2022–2024 period. These observations were obtained after removing extreme data from the initial 150 financial statement data points of 50 companies, so that the data used became more representative for analysis. The variables analyzed consisted of financial distress as the dependent variable, debt to asset ratio (DAR), business strategy, board of directors, and earnings management as the independent variables, and firm size as the moderating variable.

Based on the descriptive statistical results, the mean value of financial distress was 3.554389 with a standard deviation of 1.735027, indicating that the level of financial distress among the sample companies was in the moderate category with relatively low variation. The DAR variable had a mean of 0.499320, indicating that nearly half of the companies' assets were financed by debt. Business strategy had a mean of 1.559235 with a standard deviation of 0.821085, indicating variation in the implementation of business strategies across companies. The board of directors variable had a mean of 16.61111 with a standard deviation of 4.727793, indicating that the number of board members was relatively stable. Earnings management had a mean of 0.089262 and a standard deviation of 0.119277, suggesting that earnings management practices among the sample companies were relatively low. Meanwhile, firm size had a mean of 23.63322 with a standard deviation of 5.527751, indicating differences in company size across the research sample.

Table 1. Descriptive Statistics

DESCRIPTIVE STATISTICS						
	Y	**X1**	**X2**	**X3**	**X4**	**X5**
Mean	3,554389	0,499320	1,559235	16,61111	0,089262	23,63322
Median	3,373220	0,500037	1,398448	16,00000	0,114140	26,27201
Maximum	7,939154	1,049057	3,480177	40,00000	0,265690	30,30649
Minimum	0,456670	0,030830	0,073792	12,00000	-0,789566	14,62983
Std.Dev	1,735027	0,233695	0,821085	4,727793	0,119277	5,527751
Skewness	0,407595	0,434399	0,617784	2,698630	-4,169225	-0,494531
Kurtosis	2,686020	2,509246	2,776232	13,03275	29,47935	1,576762
Jarquera-Bera	3,434033	4,480418	7,095141	584,0395	3468,086	13,51733
Probability	0,179601	0,106436	0,028795	0,000000	0,000000	0,001161
Sum	383,8740	53,92660	168,3974	1794,000	9,640333	2552,388

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Sum Sq. Dev	322,1039	5,843641	72,13729	2391,667	1,522299	3269,496
Observations	108	108	108	108	108	108

Source: EViews 13 (processed by the researcher, 2025).

The panel regression model selection indicated that the fixed effect model was the most appropriate model. It was evidenced by the Chow test results, which showed a Prob. Cross-section F value of 0.0050 and a Prob. Cross-section Chi-square value of 0.0012, both of which were lower than 0.05. These findings were reinforced by the Hausman test, which produced a probability value of 0.0002; therefore, the fixed effect model was selected as the final estimation model. Furthermore, the classical assumption tests showed that the model met the required criteria, with normally distributed residuals (probability 0.088 > 0.05), no multicollinearity because all VIF values were below 10, no heteroskedasticity (Prob. ObsR-squared = 0.1113 > 0.05), and no autocorrelation (Prob. ObsR-squared = 0.0950 > 0.05).

The partial test results showed that the debt-to-asset ratio had a significant effect on financial distress, with a t-statistic value of -2.415 and a significance value of 0.018 < 0.05; therefore, the first hypothesis was accepted. Business strategy also had a significant effect on financial distress, with a t-statistic value of 4.818 and a significance value of 0.000 < 0.05; thus, the second hypothesis was accepted. In contrast, the board of directors had no significant effect on financial distress, with a significance value of 0.840 > 0.05; therefore, the third hypothesis was rejected. Earnings management also had no significant effect, with a significance value of 0.116 > 0.05; thus, the fourth hypothesis was rejected. In the moderating model, the interaction between DAR and firm size had a significance value of 0.676 > 0.05, indicating that firm size was unable to moderate the effect of DAR on financial distress.

Table 2. Summary of Hypothesis Testing Results

Hypothesis	Description	t-statistic Value	Significance Value	Decision	Conclusion
H1	*Debt-to-Asset Ratio affects Financial Distress*	-2,415	0,018 < 0,05	Accepted	*Debt-to-Asset Ratio has a positive and significant effect on Financial Distress.*
H2	*Business Strategy affects Financial Distress*	4,818	0,000 < 0,05	Accepted	*Business Strategy has a negative and significant effect on Financial Distress.*
H3	*The Board of Directors affects Financial Distress*	0,201	0,84 > 0,05	Rejected	*The Board of Directors has no significant effect on Financial Distress*
H4	*Earnings Management Affects Financial Distress*	1,593	0,116 > 0,05	Rejected	*Earnings Management has no significant effect on Financial Distress*
H5	*Firm Size moderates the effect of Debt-to-Asset Ratio on Financial Distress*	0,419	0,676 > 0,05	Rejected	*Firm Size moderates the effect of Debt-to-Asset Ratio on Financial Distress.*

Source: EViews 13 (processed by the researcher, 2025).

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Simultaneously, the F-test results showed that the model without moderation had a Prob. (F-statistic) value of 0.0000 < 0.05, meaning that DAR, business strategy, board of directors, and earnings management jointly had a significant effect on financial distress. In the moderating model, the Prob. (F-statistic) The value was also 0.0000 < 0.05, indicating that the model remained significant after including the moderating interaction. In addition, the Adjusted R^2 value in the model without moderation was 0.869, meaning that 86.9% of the variation in financial distress could be explained by the independent variables in the model. In the moderating model, the Adjusted R^2 value was 0.866, indicating that 86.6% of the variation in financial distress could be explained by the variables in the model, while the remaining variation was influenced by other factors outside the study.

The Effect of Debt-to-Asset Ratio on Financial Distress. The results of this study indicate that the debt-to-asset ratio (DAR) has a negative and significant effect on financial distress. This finding suggests that the use of debt within a proportional limit may help trading companies strengthen their operational capital, maintain business continuity, and improve the efficiency of asset utilization. In this context, debt does not always serve as a source of financial pressure, but may also function as a financing instrument that supports corporate stability when managed carefully. This finding is in line with the studies of Vithessonthi and Tongurai (2021) and Ugur et al. (2022), which emphasize that controlled leverage management can help companies maintain financial stability and reduce the risk of financial distress. This result is also consistent with Arhinful et al. (2025), who state that proportional external financing management can help companies avoid excessive financial pressure.

The Effect of Business Strategy on Financial Distress. This study finds that business strategy has a positive and significant effect on financial distress. It means that the more aggressive the business strategy orientation adopted by a company, the greater the financial pressure it may face. Strategies that require intensive expansion, innovation, or market penetration generally demand substantial investment and increase financing needs, thereby raising the risk of financial distress if they are not supported by adequate operational capacity and cash flow. This finding is consistent with Porter (1998), who argues that strategies that are not implemented effectively may increase costs and reduce a company's competitiveness. This result also supports Diab et al. (2025) and Handoyo et al. (2023), who found that non-adaptive or inappropriate business strategies can increase the likelihood of financial pressure. Therefore, in the trading sector, business strategy is not only a tool for growth but may also become a source of risk when it is overly aggressive or inconsistent with market conditions.

The Effect of the Board of Directors on Financial Distress. The results show that the board of directors has no significant effect on financial distress. This finding indicates that the frequency of board meetings, as the proxy used in this study, is not sufficient to explain the financial pressure experienced by trading companies. In practice, a higher number of meetings does not necessarily reflect effective supervision, high-quality strategic decisions, or the board's ability to anticipate financial problems. Therefore, measurement based solely on meeting intensity tends to reflect formal activity rather than the actual quality of governance. This finding does not support the studies of Vafeas (1999), Heykal et al (2024), Bettinelli et al. (2023), Lu et al. (2022), Mariano et al. (2021), and Younas et al. (2021), which emphasize that board characteristics and effectiveness can help reduce the risk of financial distress. Thus, in the context of Indonesian trading companies, the role of the board of directors is better understood through more comprehensive governance indicators, such as independence, competence, and the quality of oversight, rather than merely meeting frequency.

The Effect of Earnings Management on Financial Distress. This study also shows that earnings management has no significant effect on financial distress. This finding indicates that

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earnings management practices among the trading companies included in the sample have not become a major factor in determining financial pressure. One possible explanation is that financial distress in this sector is more strongly influenced by operational factors, funding structure, and business strategy than by accrual manipulation. In addition, earnings management practices often have only a short-term effect on market perceptions, while their impact on actual financial conditions may not be immediately visible within a limited observation period. This finding is not fully consistent with Thu (2023) and Meryana and Erna Setiany (2021), who state that earnings management may worsen the risk of financial distress in the long term. Therefore, in this study, earnings management has not been proven to be a major determinant of financial distress in trading companies.

The Effect of Debt to Asset Ratio on Financial Distress with Firm Size as a Moderating Variable. The moderation test results show that firm size is unable to moderate the effect of the debt-to-asset ratio on financial distress. This finding indicates that company size does not necessarily strengthen or weaken the relationship between leverage and financial pressure in the trading sector. Theoretically, larger companies have broader access to financing, higher operational efficiency, and stronger market confidence, which should enable them to withstand the impact of debt better. However, in this study, these advantages were not proven strong enough to alter the effect of DAR on financial distress. This finding is consistent with Ramadani and Ratmono (2023), who found that the moderating effect of firm size is not always consistent across industries. Thus, in Indonesian trading companies, the risk of financial distress is more strongly determined by the quality of debt management itself than by company size.

CONCLUSION

This study aims to analyze the effects of the debt-to-asset ratio (DAR), business strategy, board of directors, and earnings management on financial distress in trading sector companies listed on the Indonesia Stock Exchange during the 2022–2024 period, with firm size as a moderating variable. The results show that DAR has a negative and significant effect on financial distress, indicating that proportional debt management can still help companies maintain financial stability. Business strategy has a positive and significant effect on financial distress, suggesting that increasingly aggressive business strategies or strategies that are not aligned with company conditions may intensify financial pressure. Meanwhile, the board of directors and earnings management do not have a significant effect on financial distress. In addition, firm size is also unable to moderate the effect of DAR on financial distress.

Overall, these findings indicate that financial distress in trading companies is more strongly influenced by funding structure and business strategy than by board mechanisms, earnings management practices, or company size. This study contributes to enriching the literature on financial distress in Indonesia's trading sector. Practically, the findings may serve as a consideration for company management and investors in managing the risk of financial difficulties, particularly through leverage control and the formulation of more adaptive business strategies. Future studies are recommended to include additional variables, expand the research sector, and use more comprehensive governance proxies in order to provide a broader understanding of the factors affecting financial distress.

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