icameka
THE 2ND INTERNATIONAL CONFERENCE
ACCOUNTING, MANAGEMENT, ECONOMICS, UNISKA
E-ISSN 3089-1566
Proceeding Accounting, Management, Economics Uniska Volume 2, 2025, pp 154-165
"The Role of Research in Economics, Management, Accounting to Realizing Sustainable Development"

Organizing for Survival: Exploring the Role of Good Corporate Governance in Preventing Financial Distress

Maylaf Majid Faisa[1], Rohmawati Kusumaningtias [2*]
[1]*State University of Surabaya*
***Email:** maylafmajid.22030@mhs.unesa.ac.id, rohmawatikusumaningtias@unesa.ac.id

ABSTRACT

This study explores how good corporate governance can help prevent financial distress in companies. In a rapidly changing business world, the implementation of good corporate governance is considered to improve company performance to achieve long-term success. The purpose of this study is to show that the implementation of GCG can reduce the risk of financial distress. This study uses a literature review methodology by analyzing articles on the role of GCG in preventing financial distress. The results of the study found that the implementation of good corporate governance can reduce the risk of financial distress in a company because companies with good governance tend to have better financial stability during difficult economic conditions.

***Keyword :** Good Corporate Governance, Financial Distress, Board Directors*

INTRODUCTION

In the ever changing dynamics of the global business environment, financial health is one of the determining factors for business sustainability. Market fluctuations, economic crises, and supply chain disruptions often put pressure on a company's performance, which can lead to financial distress. Financial distress is a condition in which a company experiences a decline in financial performance, making it unable to meet its obligations when they fall due (Tron et al., 2023). This condition will have an impact on the company's sustainability and risks reducing investor confidence. To prevent financial distress, companies need to implement Good Corporate Governance mechanisms that are oriented towards long-term sustainability.

Good Corporate Governance (GCG) is a system that regulates the relationship between company management, the board of directors, shareholders, and other stakeholders by providing a framework and system used to direct the company, set goals, and determine how to achieve them in accordance with principles such as transparency, accountability, responsibility, independence, and fairness, which serve to ensure that company management runs effectively and efficiently (OECD, 2023). The implementation of strong GCG can reduce the risk of companies experiencing financial distress because good governance can create effective internal supervision and control (Casciello, 2021; Shi et al., 2023). As part of the GCG mechanism, the independent board of commissioners plays an important role as the one who maintains objectivity and oversees management policies to ensure they remain in line with the interests of shareholders and other stakeholders. The audit committee has an important function in ensuring the accuracy of financial reports and the effectiveness of internal control systems, thereby minimizing the risk of fraud. The role of the CEO as the executive leader is key in implementing GCG principles in the company's daily operations. The combination of independent commissioners, an audit committee, and a CEO with integrity is a major factor

E-ISSN 3089-1566
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in maintaining the company's financial performance and preventing the risk of financial distress.

According to research conducted by (Ashraf et al., 2022), it was found that corporate governance characteristics play an important role in the possibility of financial distress. This shows that GCG has a strategic role in preventing financial distress through the application of GCG principles that can increase investor confidence and improve managerial discipline. However, (luqman et al., 2018) found that director ownership and audit committees have a negative effect on the likelihood of financial distress. Similar to the findings of (Ud-Din et al., 2020), companies with more independent directors have a lower likelihood of financial distress because independent directors are tasked with effectively controlling and monitoring the overall performance of management.

Meanwhile, the study (Manzaneque et al., 2016) found that the characteristics of ownership and the board in companies exacerbate agency problems and contribute to a worsening financial situation, which can lead to financial distress. The results of this study indicate that Good Corporate Governance mechanisms are not functioning in accordance with established principles, such as managerial ownership dominance and weak board independence, which can hinder oversight functions and reduce objectivity in decision-making, making companies more vulnerable to inefficient management and increasing the risk of financial distress.

The differences in the results of studies conducted by (Ashraf et al., 2022; luqman et al., 2018; Ud-Din et al., 2020) and those conducted by (Manzaneque et al., 2016)show that the effectiveness of GCG in preventing financial distress is still an issue that requires further study. Therefore, this study aims to explore how the application of GCG principles can help prevent financial distress in companies. The results of this study are expected to provide a more comprehensive understanding of the role of GCG in preventing financial distress and serve as a reference for management and regulators in strengthening good corporate governance practices.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Good Corporate Governance

Good Corporate Governance (GCG) is a system that regulates the relationship between company management, the board of directors, shareholders, and other stakeholders by providing a framework and system used to direct the company, set goals, and determine how to achieve them in accordance with principles such as transparency, accountability, responsibility, independence, and fairness, which serve to ensure that company management runs effectively and efficiently (OECD, 2023). The efficient implementation of GCG is believed to maintain the stability of a company's financial performance and reduce the risk of managerial misconduct. The audit committee is an important component that plays a role in supervising management and ensuring financial stability by monitoring strategic actions and handling financial or operational issues (Bravo-Urquiza & Moreno-Ureba, 2021) According to the results of a study by (Ud-Din et al., 2020)

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companies with more independent directors have a lower financial risk. This is because independent directors are tasked with controlling and monitoring all management performance to prevent managerial errors.

Financial Distress

Financial distress denotes a situation where a company faces a considerable decline in its financial performance, leading to the failure to fulfill its financial commitments as they come due (Tron et al., 2023). This scenario presents a significant danger to the company's enduring viability and could jeopardize investor trust. A firm is deemed to be in financial trouble when it encounters insolvency where its financial health has deteriorated significantly, even though bankruptcy has not yet taken place (Tanaka et al., 2025). These results bolster the claim that adopting Good Corporate Governance (GCG) practices can significantly help in averting or reducing the transition of a company from being solvent to becoming insolvent.

Financial distress can result from a combination of internal and external influences. Internal factors consist of poor corporate management systems, unsustainable capital structures, a disconnect between the company's vision and stakeholder interests, insufficient internal controls, and inadequate oversight. On the other hand, external elements include macroeconomic changes, market rivalry, and shifts in regulatory conditions. (Manzaneque et al., 2016) state that a skewed ownership structure and poor board composition can exacerbate internal disputes and agency issues within the organization, consequently raising the risk of financial distress

Agency Theory

Agency theory addresses the conflicts of interest that emerge from the separation of ownership (principals) and management control (agents) within a company (Bravo-Urquiza & Moreno-Ureba, 2021; Gerged et al., 2022). This theory describes a contractual relationship in which the principal appoints the agent to carry out particular tasks or make decisions for them (Gerged et al., 2022). However, because agents typically act according to their own interests, they may engage in behaviors that benefit themselves rather than the company's owners (Hammond et al., 2022). This behavior can manifest in different ways, including the improper use of company resources, inflated executive pay, or choices that focus on immediate gains. Such actions may adversely affect shareholders, especially minority investors, and heighten the risk of financial distress in the company (Bravo-Urquiza & Moreno-Ureba, 2021). Consequently, efficient governance structures are required to oversee and synchronize managerial actions with the organization's objectives and the preferences of its shareholders.

Good Corporate Governance (GCG) systems are crucial for minimizing principal agent conflicts and ensuring corporate stability (Tran, 2025). Robust governance frameworks deter managers and controlling shareholders from acting opportunistically or utilizing company resources for personal gain, thereby safeguarding the interests of all stakeholders (Bravo-Urquiza & Moreno-Ureba, 2021). The successful execution of GCG also lessens information asymmetry and enhances transparency in financial reporting and decision-making processes, which is vital for reducing agency costs (Lee & Tulcanaza-Prieto, 2024). Empirical research additionally shows that GCG can reduce earnings management activities and diminish the probability of financial distress, thereby bolstering the company's long-term sustainability

E-ISSN 3089-1566
Proceeding Accounting, Management, Economics Uniska Volume 2, 2025, pp 154-165

and financial stability (Bravo-Urquiza & Moreno-Ureba, 2021; Idawati & Pranoto, 2024). This theoretical viewpoint highlights that robust corporate governance is essential for protecting shareholder interests and improving the company's capacity to endure financial distress (Bravo-Urquiza & Moreno-Ureba, 2021).

Stewardship Theory

Stewardship theory offers a different perspective than agency theory by proposing that managers are not mainly driven by self-interest, but serve as stewards whose objectives align with those of shareholders (Lim et al., 2023; Yin et al., 2025). Rooted in psychological and sociological viewpoints, this theory posits that managers are dedicated to fostering the enduring success of the organization and its stakeholders, collaborating towards common goals instead of personal gain (Lim et al., 2023). Stewards are described as reliable, collaborative, and inclined to embrace organizational risks, always placing shareholder interests above individual incentives (Xiang et al., 2022). Consequently, stewardship theory proposes that governance frameworks ought to focus on enhancing and facilitating managerial autonomy instead of depending predominantly on control and supervision, since excessive oversight can undermine intrinsic motivation and restrict actions that promote organizational performance (Al Sawalqa, 2021; Torres & Augusto, 2021).

The alignment of managerial and shareholder interests establishes the basis for corporate sustainability, as it encourages a mutual dedication to generating long-term value. In contrast to agency theory, which highlights self-interest and opportunistic actions, stewardship theory posits that managers focus on teamwork and are driven by ethical obligations and a dedication to organizational success (Torres & Augusto, 2021; Yin et al., 2025). This inherent drive and feeling of belonging motivate managers to take actions that increase company value and guarantee sustained longevity (Xiang et al., 2022). Focusing on shared interests and sustainable development, stewardship theory offers a framework where managerial actions inherently bolster corporate resilience and lower the chances of financial hardship (Jonsdottir et al., 2020)

Resource Dependency Theory

Resource Dependency Theory suggests that organizations rely on external resources to operate effectively and ensure their survival (Singh et al., 2022; Waerder et al., 2022). As a result of this dependence, companies must tactically manage their external surroundings to secure essential resources and reduce uncertainty (Singh et al., 2022). In corporate governance, the board of directors plays a vital role by offering expertise and external connections that allow the company to access these resources, thus improving overall organizational effectiveness (Boadi et al., 2023; Kok et al., 2022). An effective and varied board can attract funding and vital resources, boosting the organization's capacity to overcome external obstacles and reducing the likelihood of financial distress (Boadi et al., 2023; García & Herrero, 2021)

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Trade Off Theory

In corporate governance, Trade-Off Theory proposes that sound governance practices enable firms to achieve an ideal equilibrium between debt and equity (Butt, 2019). Effective governance minimizes agency costs associated with debt and enables companies to employ leverage more effectively, thus increasing shareholder value and decreasing the risk of financial distress (Nikhil et al., 2024; Ugur et al., 2022)Consequently, companies with robust governance frameworks can maintain elevated debt levels without incurring significant financial risk, thereby promoting long-term stability and organizational sustainability ((Butt, 2019; Li & Shiu, 2024)

METHODS

A literature review is a crucial research method that entails systematically finding, evaluating, and integrating previous scholarly works to create a clear and comprehensive understanding of a research subject (Snyder, 2019)Its goal is to situate novel research within current understanding, pinpoint deficiencies in theory and methodology, and propose avenues for future inquiry, thereby contributing significantly to scholarly discourse (Chigbu et al., 2023). Numerous types of literature reviews exist like systematic, narrative, integrative, and scoping reviews each having distinct processes and aims. In areas such as management and corporate governance, systematic literature reviews are highly regarded due to their organized, transparent, and reproducible methodology, which minimizes potential bias and enhances the credibility of findings through defined phases of study identification, selection, and thorough assessment (Sauer & Seuring, 2023). This organized approach guarantees that the review goes beyond simply summarizing existing studies, it also evaluates the current body of knowledge critically

Carrying out a literature review involves multiple systematic phases to guarantee the study's reliability and scholarly excellence. Typically, the procedure starts by creating well-defined research questions, then establishing an organized search strategy that incorporates pertinent keywords and choosing suitable academic databases. Researchers subsequently set clear inclusion and exclusion criteria to identify studies pertinent to the subject (Chigbu et al., 2023). Once the literature is gathered, the subsequent step entails assessing the quality of each source, extracting key information, and synthesizing the results through organization, analysis, and interpretation to address the research questions (Sauer & Seuring, 2023). Within studies on Good Corporate Governance and financial distress, numerous researchers utilize systematic literature reviews (SLR) to consolidate empirical results concerning board composition, ownership, and transparency. This method aids in offering a more precise comprehension of how governance mechanisms affect corporate resilience and acts as a solid methodological basis for additional research (Syifa Indah Aurora Salsabila et al., 2024)

RESULTS

Table 1. Results

	Title	Authors	Year	Results
1	Corporate Governance and Financial Distress : Moderating Role of	Ngoc Mai Tran	2025	This study found that board members, board meetings and board diversity contribute to good corporate governance so

	Firm Complexity in an Emerging Economy			that it can improve the company's financial health and can reduce the risk of financial distress.
2	Corporate Governance and Financial Distress : Lessons Learned From an Unconventional Approach	Alberto TRON, Maurisio Dallocchio, Salvatore Ferri, Federico Colantoni	2022	This study found that corporate governance variables, especially those related to the company's directors and top management, play an important role in preventing bankruptcy caused by financial distress.
3	Does Board Committee independence affect financial distress likelihood? A comparison of China with the UK	Sumaira Ashraf, Elisabete G.S.Felix, Zelia Serraqueiro	2021	This study finds that corporate governance plays an important role in the likelihood of financial distress. Although there are differences in the impact between developing and developed markets, this study provides evidence that increased state ownership and institutionalization reduce the likelihood of financial distress for companies.
4	Probability of financial distress and proposed adoption of corporate governance structures : Evidence from Pakistan	Rabia luqman, Masood Ul Hassan, Shanza Tabasum, Maria Shams	2018	This study found a significant negative relationship between blockholder ownership, director ownership, and audit committee ownership with the possibility of financial distress.
5	Early Warning Indicators : An Empirical Investigation in Italian Context adn First Implications For Corporate Governance	Raffaela Casciello	2021	The results of this study show that, Italian LLCs and JSCs in 2019 did not show any particularly worrying signs in terms of exposure to financial distress and bankruptcy risk.
6	Female Directors, Capital Stucture and Financial Distress	C. Jos´ e García, Bego˜ na Herrero	2021	The study found that the potential for financial distress was significantly reduced by gender diversity on the board, as evidenced by greater monitoring by women, lower self-confidence, and risk avoidance by women, which led to a lower likelihood of

E-ISSN 3089-1566
Proceeding Accounting, Management, Economics Uniska Volume 2, 2025, pp 154-165

				financial distress. In addition, the level of the board showed that the likelihood of financial distress was reduced due to greater monitoring.
7	Corporate governance effect on financial distress likelihood: Evidence from Spain	Montserrat Manzaneque, Alba María Priego, Elena Merino	2016	This study found that the distribution of company ownership and corporate governance characteristics are more likely to increase agency problems that contribute to a deteriorating financial situation..
8.	The role of moderating audit quality relationship between corporate characteristics and financial distress in the Indonesian mining sector	Perdana Wahyu Santosa, Martua Eliakim Tambunan, Eva Rohima Kumullah	2020	This study found that audit quality as a moderating variable affects four main variables, namely liquidity, leverage, efficiency, and PBV. It was found that the higher the debt ratio, the higher the possibility of financial distress.
9	Board Structure and Likelihood of Financial Distress: An Emerging Asian Market Perspective	Shahab UD-DIN, Muhammad Yar KHAN, Anam JAVEED, Ha PHAM4	2020	The study found that companies with many independent directors are unlikely to experience financial distress because independent directors are tasked with controlling and monitoring all aspects of management performance.
10	Estimating the Risk of Financial Distress Using a Multi-Layered Governance Criterion: Insights from Middle Eastern and North African Banks	Ali Meftah Gerged Mohamed Marie and Israa Elbendary	2022	The study found a negative relationship between board meetings, CEO duality, and the likelihood of financial distress. The study shows that CEOs who are more involved in fewer investments can reduce the likelihood of their companies experiencing financial distress.

Source: *Author's compilation*

E-ISSN 3089-1566
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DISCUSSION

How effective mechanisms of Good Corporate Governance (GCG) affect the prevention or alleviation of financial distress

Good Corporate Governance (GCG) is a framework that manages the interactions between management, the board of directors, shareholders, and stakeholders to enhance internal control, accountability, and transparency in the organization (Bravo-Urquiza & Moreno-Ureba, 2021)). Governance structures like board composition, audit committees, and ownership setups assist in monitoring managerial activities and diminishing agency conflicts that could result in financial troubles (Indrati & Handayani, 2022). Research indicates that effective GCG practices enhance financial performance and reduce the chances of financial distress. Companies characterized by strong governance often demonstrate increased profitability, lower operational risks, and enhanced resilience to external (Alruwaili et al., 2023). This underscores GCG as an essential factor for corporate stability and sustainability.

The importance of corporate governance structures in enhancing company resilience and sustainability

Robust corporate governance is crucial for enhancing company resilience and enduring stability. According to agency theory, structures like independent boards and efficient audit committees mitigate managerial self-interest and decrease the likelihood of financial trouble (Bravo-Urquiza & Moreno-Ureba, 2021; Gerged et al., 2022)Research also indicates that independent directors and institutional ownership further reduce the likelihood of distress, although results may differ in various contexts (Shi et al., 2023; Tran, 2025). Integrating stewardship theory, emphasizing managers' inherent dedication to organizational objectives, indicates that avoiding financial instability necessitates both efficient oversight and backing for managerial accountability, enhancing the organization's ability to endure external challenges (Torres & Augusto, 2021)

The influence of GCG on financial resilience reveals intricate complexities. Although there is widespread consensus that robust GCG practices strengthen internal controls, increase transparency, and subsequently reduce distress (Idawati, Pranoto, Prabowo, & Muchlis, 2024; Idawati, Pranoto, Prabowo, & Prabowo, 2024), certain studies, including one by Lohmann et al., propose a non-linear association between financial distress and ESG scores, highlighting context-sensitive dynamics (Lohmann et al., 2025). Notwithstanding these subtleties, the dominant agreement highlights that GCG frameworks are essential for corporate resilience by facilitating strategic risk management and promoting a stable operational setting (Gianfrate et al., 2024; Zouaghi et al., 2024). Strong governance frameworks, by aligning interests and guaranteeing accountability, play a crucial role in developing financially robust, flexible, and sustainable companies that can adapt to evolving economic environments

CONCLUSION

The impact of Good Corporate Governance on financial resilience is undoubtedly complex. Strong GCG practices are well-regarded for enhancing internal controls, boosting transparency, and thus reducing financial distress (Ashraf et al., 2019). As outlined by Ashraf et al., and further supported by Bravo-Urquiza & Moreno (Bravo-Urquiza & Moreno-Ureba, 2021) and Gerged et al. (Gerged et al., 2022), these mechanisms play a vital role in mitigating

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managerial opportunism and agency conflicts that may increase a firm's financial vulnerability. Although the consensus emphasizes the anxiety-alleviating effects of GCG, certain studies suggest that context-dependent dynamics may affect these connections.

Despite this, GCG frameworks are crucial for enhancing corporate resilience by supporting strategic risk management and encouraging operational stability (Gerged et al., 2022). The incorporation of viewpoints, such as stewardship theory, indicates that managers who align with organizational goals enhance long-term sustainability (Torres & Augusto, 2021; Yin et al., 2025). This method, in which governance emphasizes the common good and ongoing growth, is essential for creating financially sound, adaptable, and sustainable firms that can adjust to changing economic conditions. Therefore, effective governance that guarantees accountability and aligns interests is crucial for managing the intricacies of financial stability.

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