Institutional Ownership and Financial Distress: The Moderating Effect of Executives with Foreign Experience

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Abstract
Objective –This research aims to analyze the influence of institutional ownership on financial distress and the role of executives with foreign experience as a moderating variable.

Design/Methodology –The object of this research is the consumer cyclical sector companies listed on the Indonesian Stock Exchange during the 2017–2021 period. The data sample was gained through purposive sampling and obtained from 47 companies that met the criteria. Partial Least Squares Structural Equation Modeling (PLS-SEM) using WarpPLS 8 is the analytical technique used in this research.

Results –This study provides evidence that institutional ownership can prevent or reduce financial distress as it functions to monitor company performance. The variable of executives with foreign experience strengthens the influence of institutional ownership on financial distress, which shows the role of executives with foreign experience in reducing the possibility of financial distress.

Research limitations/implications –This study was conducted in the consumer cyclical sector for five years of observation, which can limit the generalizability of its findings. The implications of this study are practical suggestions for the company's management to avoid financial distress and achieve long-term goals through the role of CEO in relation to its overseas background.

Novelty/Originality –In Indonesia, prior research has explored the impact of good corporate governance and the CEO's role in maintaining financial distress conditions. Nevertheless, none has investigated the overseas background aspect, namely the CEO with foreign experience, as one of the moderating factors that influence the GCG aspect of reducing financial distress, which is the originality of this study.

Keywords: Financial distress, institutional ownership, executives with foreign experience, good corporate governance

1. Introduction

The global financial crisis that occurred in 2007–2009 has had a major effect on global economy, which also shows that many companies around the world are facing financial distress (Jia, 2019; Mangena et al., 2020). Regarding this phenomenon, financial distress then became a crucial issue in the financial sector, especially after not only the 2008–2009 financial crisis but also the financial scandals of Enron, World COM, Lehman Brothers, and the American Investment Group (Udin et al., 2017). Financial distress has become such a worrying economic reality for policymakers (Sehgal et al., 2021). After several years had passed, a similar phenomenon shocked the global economy in early 2020 when the COVID-19 pandemic outbreak occurred. In 2020, the Indonesian economy experienced a recession that was triggered by the outbreak of the COVID-19 pandemic (Directorate General of Fiscal Balance, 2021). Global economic uncertainty, related to changes in economic and regulatory environments, has led to crises and recessions. This research

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was conducted in the year of observation when the pre-COVID-19 and the years during COVID-19 crises occurred and suddenly affected all the company sectors around the world, including Indonesia. In contracting or recessionary economic conditions, people's incomes in general have decreased, so the level of people's purchasing power has decreased (CNBC Indonesia, 2022). The cyclical consumer sector (nonprimary consumer goods) is the sector that is affected, considering that its nature is not basic needs or secondary and tertiary needs. People often stop spending on this sector when times are tough. The impact of this crisis can cause companies to be in financial distress.

Financial distress is the condition where companies fail to fulfill their debt obligations when they fall due (Farooq & Noor, 2021). The financially distressed company has difficulty fulfilling its debt obligations, and this effect can increase the likelihood of default (Kushermanto et al., 2023). One of the controls that can be carried out is calculating the possibility of financial distress so that it can be used as a consideration for decision-making on the company's financial condition (Syuhada & Muda, 2020). Several studies on financial distress have been conducted previously by Udin et al. (2017), Scalzer et al. (2019), Balasubramanian et al. (2019), Cardoso et al. (2019), Yazdanfar & Öhman (2020), Mangena et al. (2020), Chamboko & Chamboko (2020), Farooq & Noor (2021), Oware & Appiah (2021), Mariano et al. (2021), Liu et al. (2021), Younas et al. (2021), Yousaf et al. (2021), Hazami-Ammar & Gafsi (2021), Gerged et al. (2022), Goh et al. (2022), Farooq et al. (2022), Oware & Botchway (2022), and Guizani & Abdalkrim (2022). One of the important factors examined in financial distress is the aspect of corporate governance (Guizani & Abdalkrim, 2022). Institutional ownership is one of the corporate governance factors that can be related to the company's financial distress (Udin et al., 2017). Institutional investors become supervisors of company performance, marked by the institution or institutions participating in the decision-making process, because they have extensive expertise and resources to prevent and reduce financial distress (Lin & Fu, 2017).

The research about the influence of institutional ownership on financial distress provides various results. According to research by Widhiadnyana & Ratnadi (2019), Annither et al. (2020), Gerged et al. (2022), and Santoso & Nugrahanti (2022), institutional ownership has a negative effect on financial distress. Research by Balasubramanian et al. (2019), Pranita & Kristanti (2020), and Younas et al. (2021), shows that institutional ownership has a positive influence on financial distress. On the other side, Udin et al. (2017) revealed that institutional ownership has no effect on financial distress. The difference in these results raises the question of whether there are moderating variables that can strengthen or weaken the relationship between these variables (Baron & Kenny, 1986). A study by Liu et al. (2021) shows that executives with foreign experience is the moderator variable. Executives with foreign experience are executives with foreign experience, such as studying or working abroad (Yuan & Wen, 2018). This reflects that executives with foreign experience can reduce the risk of financial distress through more effective management of innovative products (Liu et al., 2021). Therefore, it is interesting to re-examine institutional ownership by linking executive with foreign experience as a moderating variable.

This research aims to analyze the effect of institutional ownership on financial distress as well as provide information on ownership structure that can monitor company performance and prevent and reduce financial distress. Theoretically, this study is useful to provide evidence of the influence of institutional ownership on financial distress by linking executives with foreign experience as a moderating variable. Practically, this research is useful as a means of information for investors and potential investors considering investing in the company. In addition, the benefits for the company are input for the management (agent) in an effort to achieve company goals. The research questions presented in this study are: How does institutional ownership affect financial distress? And how do executives with foreign experience moderate the relationship between institutional ownership and financial distress?

This paper is organized as follows: section 2 presents the literature review and hypothesis development; section 3 describes the methodology; section 4 provides results and discussion, leading to conclusions in section 5.

2. Literature Review and Hypotheses Development

2.1 Literature Review

Agency theory arises from cooperation involving two parties, namely managers (agents) and owners of capital or investors (principals), in carrying out company operations (Annither et al., 2020). This theory is used to explain the impact of the contractual relationship between agent and principal. According to Jensen & Meckling (1976), there is an agency relationship between principals and agents to perform several services on behalf of the principal and delegate authority to agents in making decisions. However, the delegation of company duties and control by principals to agents causes agency conflicts to arise. This is because managers' decision-making tends to be based on personal interests and not on the interests of shareholders (principals).

Another impact of delegating tasks to agents from principals is that it causes information asymmetry, which occurs because agents sometimes do not convey real information or hide information from principals (Heniwati & Essen, 2020; Revina et al., 2014). Managers (agents) as parties authorized to run a business, of course, have an information advantage compared to shareholders (principals). Information asymmetries can be explained in terms of information adverse selection and moral hazards. Adverse selection is a condition where the management (agent) has more information about the company and its future prospects than the shareholders (principals). Moral hazard is a condition in which the principal does not fully know what has been done by the agent, so that there is a potential for the agent to carry out opportunistic behavior (Amaliah, 2015).

2.2 Hypothesis Development

2.2.1 Effect of Institutional Ownership on Financial Distress

The emergence of differences in interests between managers (agents) and shareholders (principals) results in the emergence of agency conflicts (Jensen, 1986). Institutional ownership, as one of the corporate governance mechanisms, refers to shares owned by an institution. The existence of institutional shareholders can reflect a good corporate image and reduce the influence of the interests of company management, such as the opportunistic behavior of managers. Institutional shareholders are believed to have the ability and knowledge, as well as extensive resources, so that they can play a role in planning and determining the most effective strategy and can influence managers' decision-making (Lin & Fu, 2017).

Institutional ownership makes for more supervision from institutional shareholders than from other shareholders (Ashraf et al., 2016). Institutional shareholders have an active role in supervising management activities, the process of improving the company's financial performance, and reducing the possibility of default (Udin et al., 2017). The hope is to minimize information asymmetry and agency conflicts that arise between shareholders and management, marked by greater institutional ownership, which will reduce the possibility of financial distress (Pranita & Kristanti, 2020). If institutional ownership increases, financial distress decreases. This is consistent with the results of the study by Gerged et al. (2022), Santoso & Nugrahanti (2022), Annither et al. (2020), and Widhiadnyana & Ratnadi (2019) which explain that institutional ownership has a negative effect on financial distress. The greater the percentage of institutional ownership owned by the company, the more effective monitoring of management performance, the more efficient use of company assets, and the less likely financial distress (Widhiadnyana & Ratnadi, 2019). Based on the arguments that have been described, the research hypothesis is:

H1. Institutional ownership has a negative effect on financial distress.

2.2.2 Effect of Institutional Ownership Moderated Executives with Foreign Experience on Financial Distress

There is segregation of duties and differences in interests between company owners (principals) and company controls (agents), which causes agency conflicts to arise. In addition, it causes information asymmetry because agents, as parties who run the business, have the potential to hide information from principals, which can lead to agency costs arising due to the opportunistic behavior of agents (Jensen & Meckling, 1976; Heniwati & Essen, 2020; Pranita & Kristanti, 2020). Institutional ownership allows for more oversight of institutional shareholders than other shareholders, aiming to protect shareholder rights and minimize agency costs (Ashraf et al., 2016; Santoso & Nugrahanti, 2022).

Executives with foreign experience refer to executives in the company who have studied or worked abroad (Yuan & Wen, 2018). Executives' education, work, and foreign experience influence their perspective and behavior. Executives with an international outlook are believed to be more professional and innovative in running the company (Gu et al., 2022). Executives with foreign experience have more professional knowledge, experience, and skills, so they are more flexible in leading and maintaining company stability and can assume greater responsibility because they have experience in countries with more complex markets (Masulis et al., 2012). Companies that have executives with overseas experience, whether studying or working, attract more investors (Li et al., 2016; Yuan & Wen, 2018). It is believed that executives (principals) have quality human resources who are more professional and competent in leading and running the company. Better management quality makes it attractive for institutions to own shares in the company.

The greater the shares owned by institutions (institutional ownership), the less likely financial distress will be (Pranita & Kristanti, 2020). The presence of executives with foreign experience can improve corporate governance and reduce the risk of financial distress (Giannetti et al., 2015; Liu et al., 2021). Based on the arguments that have been described, the research hypothesis is:

H2. Executives with foreign experience strengthen the influence of institutional ownership on financial distress.

3. Research Method

3.1 Data Samples

This study is causality research that examines the relationship between institutional ownership and financial distress and the moderating role of executives with foreign experience in the effect of institutional ownership on financial distress. The types of data in this study are secondary and quantitative. The sample in this study was obtained through purposive sampling as follows:

Table 1.
Selection of research samples

Criteria	Amount
The consumer cyclical company listed on the Indonesia Stock Exchange for the 2017–2021 period	89
Companies that do not publish annual reports during the 2017–2021 period	(15)
Companies that do not present the data required in this study	(27)
Number of samples that meet the criteria (i)	47
Years of observations (t)	5
Total observations (i*t)	235
Data outliers	34
Total observations processed	201

Based on Table 1, total data processed in this paper is 201 observations. Global economic uncertainty, related to changes in economic and regulatory environments, has led to crises and recessions. This research was conducted in the year of observation when the pre-COVID-19 and the years during COVID-19 crises occurred and suddenly affected all the company sectors around the world, including the consumer cyclical sector in Indonesia for the year observed. Next, the variable measurement for each variable in this paper is described in the next subsection.

3.2 Variable measurement and technical analysis

The variable measurement for each variable in this paper is described in Table 2 below.

Table 2. Variable Measurement

Variable	Indicator	Reference
Dependent Variable: Financial Distress (ZM)	The Zmijewski's ZM-Score model is used to predict financial distress, as follows: $ZM= -4.336 - 4.513\left(\frac{NI}{TA}\right) + 5.679\left(\frac{TL}{TE}\right) + 0.004\left(\frac{CA}{CL}\right)$ Note: NI = Net Income; TA = Total Assets; TL = Total Liabilities; TE = Total Equity; CA = Current Assets; and CL = Current Liabilities.	Hazami-Ammar & Gafsi (2021) and Farooq et al. (2022).
Independent variable: Institutional Ownership (IO)	$IO= \frac{\text{Number of institutional ownership}}{\text{number of outstanding share}} \text{ x } 100\%$	Gerged et al. (2022).
Moderating variable: Executive with Foreign Experience (EFE)	$EFE= \frac{\text{Number of Executives with Foreign Experience}}{\text{Number of Executives Within the Company}} \text{ x } 100\%$	Liu et al. (2021)
Control variable: Firm Size (FSIZE)	FSIZE = Ln Total Assets	Udin et al. (2017); Younas et al. (2021).
Control variable: CEO duality (CEOD)	Dummy variables. Code = 1; if the CEO and chairman are the same person; code = 0, otherwise	Mariano et al. (2021).
Control variable: Leverage (LEV)	$LEV= \frac{\text{Total Debt}}{\text{Total Capital}}$	Annither et al. (2020)
Control variable: Board size (BSIZE)	BSIZE = Number of directors on the company board	Gerged et al. (2022)
Control variable: Sales growth (SG)	$\text{Sales Growth}= \frac{\text{Sales}_t - \text{Sales}_{t-1}}{\text{Sales}_{t-1}}$	Rahma & Dillak (2021)

This study uses the Partial Least Squares Structural Equation Modeling (PLS-SEM) technique to process and analyze all research data with WarpPLS 8.0 software. PLS-SEM is used as a technical analysis in this study because it can be done even if the data does not meet the normality criteria. In this study, the equation model is described as follows:

Equation 1.

$$FD = \rho 1IO + \rho 2IO * EFE + \rho 3FSIZE + \rho 4CEOD + \rho 5LEV + \rho 6BSIZE + \rho 7SG$$

Notes:

FD = Financial distress;
ρ = Regression coefficient;
IO = Institutional ownership;
IO*EFE = Interaction of institutional ownership and executives with foreign experience;
FSIZE = Firm size;
CEOD = CEO Duality;
Lev = Leverage;
BSIZE = Board Size;
SG = Sales Growth.

4. Results and Discussion

4.1 Results

4.1.1 Descriptive statistics

The descriptive statistics for each variable in this paper are described in Table 3 below:

Table 3. Descriptive statistics

Variable	Mean	Maximum	Minimum	Standard Deviation
Financial Distress (ZM)	-0.277	9.588	-16.803	3.708
Institutional Ownership (IO)	67.685	101.086	6.657	21.638

Based on table 3, it shows that financial distress (ZM) have mean values that are higher than the standard deviation. This shows that the data variation of financial distress in this research data is high or varied. Meanwhile, the institutional ownership has a mean value greater than the standard deviation. This shows that the research data is less varied.

4.1.2 Model Fit

The descriptive fit model criteria for each variable in this paper are described in Table 4 below:

Table 4. Model Fit

Model Fit	Value	Sign.	Rule of Thumb	Notes
Average Path Coefficient	0.141	P =0.004	P < 0.05	Satisfy
Average R-Square	0.143	P = 0.004	P < 0.05	Satisfy
Average Adjusted R-Squared	0.112	P = 0.014	P < 0.05	Satisfy
Average Variance Inflation Factor	1.100		≤ 5	Satisfy
Average Full Collinearity VIF	1.302		≤ 5	Satisfy
Tenenhaus GoF	0.378		Small ≥ 0.1 Medium ≥ 0.25 Large ≥ 0.36	Large

The first step is to evaluate the structural model by evaluating the goodness-of-fit model. Based on the model fit indicator output presented in Table 4, the six indicators used in this research model meet the criteria. The APC, ARS, and AARS indicators have a P value <0.05. The AVIF and AFVIF indicators have values < 3.3. The GoF indicator has a value of 0.378, meaning it is in the large model category because it is > 0.36.

4.1.3 Explanatory Power

The explanatory power for each variable in this paper is described in Table 5 below:

R-Squared = 0.143
Q-Squared = 0.270
Effect size

Table 5. Explanatory Power

Variables	Path Coefficients	Notes	Rule of Thumb
IO	0.019	Very weak	
EFE*IO	0.054	Weak	
FSIZE	0.062	Weak	Weak > 0.02
CEOD	0.024	Weak	Medium > 0.15
LEV	0.041	Weak	Large > 0.35
BSIZE	0.059	Weak	
SG	0.002	Very weak	

The next step is to evaluate the structural model by evaluating the model's ability to explain the dependent variable. Based on table 5, the R-Squared coefficient of determination value is 0.143, which means that 14.3% of the variation in the dependent variable (financial distress) can be explained by the independent variable (institutional ownership), executive with foreign experience moderation with institutional ownership, and the control variables in this model, while the remaining 85.7% can be explained by other variables outside this model. Furthermore, the Q-squared value is 0.270 > 0, which means this research model has predictive relevance. The next indicator in this evaluation is effect size, which aims to explain the individual contribution of each independent variable to the value of the R-squared endogenous variable. The institutional ownership effect size value of 0.019, or 1.9%, means that the absolute value of the individual contribution of the institutional ownership variable to the R-squared financial distress value is considered very weak from a practical perspective. The IO*EFE effect size value is 0.054 or 5.4%, meaning that the absolute value of the individual contribution of the executive with foreign experience moderating variable to the R-Squared financial distress value is considered weak from a practical perspective.

4.1.4 Explanatory Power

The path coefficient and p-value for each variable in this paper are described in Table 6 below:

Table 6. Path Coefficients and P-Values

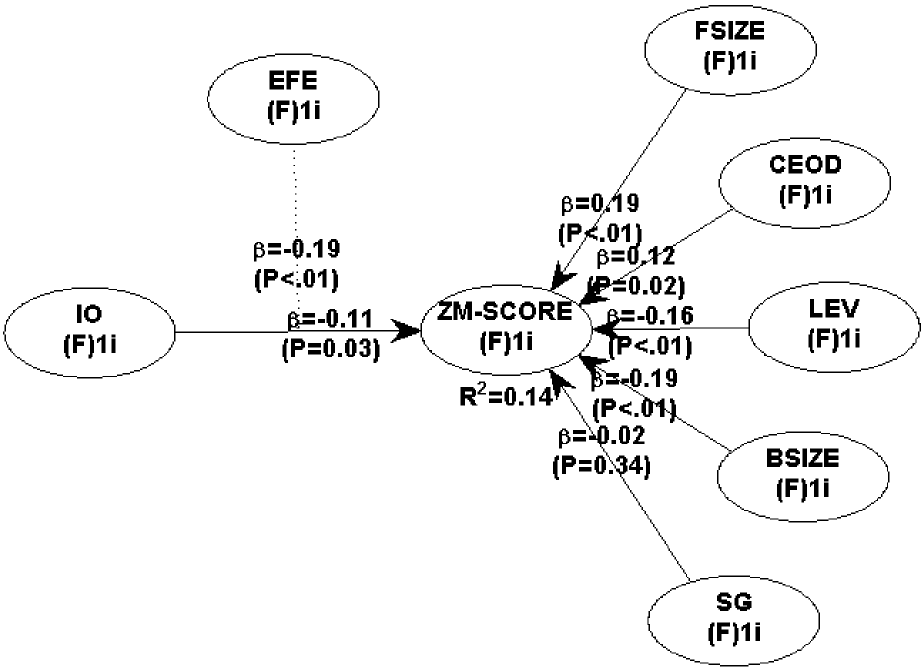
Variables	Path Coefficients	P-Values	Rule of Thumb	Notes
IO	-0.107	0.033	P < 0.05	Accepted
EFE*IO	-0.190	<0.001	P < 0.05	Accepted
FSIZE	0.188	<0.001		
CEOD	0.123	0.018		
LEV	-0.164	0.003		
BSIZE	-0.192	<0.001		
SG	-0.025	0.337		

The next stage is to evaluate the path coefficients and P-value values from the output summarized in Table 6. The path coefficient of the institutional ownership variable (IO) is -0.107 and significant with P = 0.033; the path coefficient of moderating variable, which is the interaction of executives with foreign experience and institutional ownership (EFE*IO), is -0.190 and significant with P = <0.001. This model also includes control variables, namely firm size, CEO duality, leverage, board size, and sales growth.

4.2 Discussion

The research framework to describe our variable is captured in Figure 1 below.

Figure 1.
Path Diagram



The next subsection described the interpretation of Figure 1.

4.2.1 Effect of Institutional Ownership on Financial Distress

Based on Figure 1, the path diagram explains that institutional ownership has a negative and significant effect on financial distress. This can be seen from the path coefficient of institutional ownership of -0.11 with P = 0.03 <0.05, meaning that hypothesis 1 (H1) is accepted. This finding is in line with research that has been conducted by Widhiadnyana & Ratnadi (2019), Annither et al. (2020), Santoso & Nugrahanti (2022), and Gerged et al. (2022), which shows that institutional ownership has a significant negative effect on financial distress. This significant influence can be explained by the fact that institutional ownership has a significant impact on consumer cyclicals companies in Indonesia. One reason is that institutional ownership can suppress and minimize the possibility of financial distress. If institutional ownership increases, financial distress decreases. Another reason is that institutional ownership makes for more supervision from institutional shareholders than other shareholders (Ashraf et al., 2016).

The existence of collaboration involving two parties, namely the agent and the principal, in carrying out company operations results in the emergence of agency problems. The trigger for the emergence of conflicts of interest begins with information asymmetry (Heniwati & Essen, 2020). Agency theory and financial difficulties are interconnected when the handover of company management from the principal to the agent does not go well. The impact of agency problems is that they can cause large losses for the company and even result in financial distress if errors occur in decision-making (Kartika et al., 2020). One of the opportunistic behaviors of agents is manipulating and misusing financial reports, so that financial reports can no longer be a source of information when considering decision-making. As a result, errors arise in decision-making, which can result in losses and even financial difficulties for the company.

Therefore, institutional shareholders are needed, who are considered a pressure group for managers to act in the best interests of shareholders (Udin et al., 2017). Institutional shareholders are believed to have extensive capabilities, knowledge, and resources, so they can play a role in planning, determining, and monitoring the most effective strategies and can influence manager decision-making (Lin & Fu, 2017). The existence of institutional shareholders can reduce the influence of company management interests, such as managers' opportunistic behavior. The existence of institutional ownership can minimize information asymmetry, agency conflicts, and the emergence of agency costs due to agents' opportunistic behavior. Supervision from institutional shareholders can minimize gaps in information about the company between agents and principals, thereby preventing the possibility of opportunistic behavior by agents (Amaliah, 2015). The higher the institutional ownership, the smaller the possibility of financial distress (Pranita & Kristanti, 2020). This is because the higher the percentage of institutional ownership a company has, the more effective the monitoring of management performance, the more efficient the use of company assets, and the smaller the possibility of financial distress (Widhiadnyana & Dwi Ratnadi, 2019).

4.2.2 Effect of Institutional Ownership Moderated Executive with Foreign Experience on Financial Distress

Based on Figure 1, the path diagram explains that executives with foreign experience strengthen the influence of institutional ownership on financial distress. This can be seen from the path coefficient of the moderating variable in Figure 1, namely the interaction of executive with foreign experience and institutional ownership on financial distress, which is -0.19 and significant with P <0.001, meaning hypothesis 2 (H2) is accepted. The greater the shares owned by the institution; the less likely financial distress will occur. The presence of executives with foreign experience strengthens this effect. Executives with foreign experience can improve the quality of human resource management, which makes it attractive for institutions to own shares in companies.

Companies that have executives with overseas experience, whether studying or working, attract more investors (Li et al., 2016; Yuan & Wen, 2018). It is believed that executives (principals) have the quality of human resources who are more professional and competent in leading and running the company (Masulis et al., 2012). The skills, knowledge, and experience possessed by principals who are experienced abroad are believed to reflect better company management, so that they can prevent and respond to agency problems. The greater the percentage of shares owned by institutions (institutional ownership) in the company, the less likely it is that financial distress will occur (Pranita & Kristanti, 2020). The presence of executives with foreign experience can improve corporate governance and reduce the risk of financial distress (Giannetti et al., 2015; Liu et al., 2021).

5. Conclusion

This research aims to analyze the effect of institutional ownership on financial distress as well as provide information on ownership structure that can monitor company performance and prevent and reduce financial distress. Based on the results of statistical tests and analysis in the previous section, it can be concluded that institutional ownership can suppress and minimize the possibility of financial distress. If institutional ownership increases, financial distress will decrease. Executives with foreign experience strengthen the influence of institutional ownership on financial distress. The presence of executives with foreign experience strengthens the negative influence of institutional ownership on financial distress.

Theoretically, this research contributes to the study of agency theory. This study is useful to provide evidence of the influence of institutional ownership on financial distress by linking executives with foreign experience as a moderating variable.

Practically, this research is useful as a means of information for investors and potential investors considering investing in the company. When considering investment decisions, investors may consider the background of top-level executives, particularly their foreign experience, as it may influence the company's ability to deal with financial distress. The role of the CEO in a company is very significant, one of which is making decisions that will be carried out by the company. The CEO must know what strategies to use so that the company can achieve the vision that has been previously set for the short-term and long-term. One of the most important visions in a company is to support the company to avoid financial distress. With the advantages of a CEO with foreign experience, the CEO can have an impact on the company with the decisions that have been made. The benefits for the company are input for the management (agent) in an effort to achieve company goals. Hiring executives with foreign experience is important to enhance control and efficiency in decision-making. In addition, the regulator can enhance the control process and establish the regulation of financial distress in the company.

The limitations of this research are that it only examines institutional ownership variables, only uses the Zmijewski formula to measure financial distress, only observes the consumer cyclical sector, and only has years of observations. Future research can include adding other variables, for example, other corporate governance proxy variables; analyzing various measurements of financial distress, for example, the Altman Z-Score, Springate, and Grover; investigating sample data from other sectors, such as companies in the technology or financial sector; and increasing the number of years of observation to gain more relevant results.

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