

# The Effect of Severity, Asset Retrenchment, Downsizing and Leverage on The Success of Corporate Turnaround with Profitability as a Moderating Variable

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DOI : <https://doi.org/10.61796/icossh.v2i1.62>



Sections Info

## Article history:

Submitted: January 25, 2025

Final Revised: February 10, 2025

Accepted: February 15, 2025

Published: March 10, 2025

## Keywords:

Corporate turnaround

Severity

Asset retrenchment

Downsizing

Leverage

Profitability

## ABSTRACT

**Objective:** This research was conducted with the aim of finding out the influence of severity, asset retrenchment, downsizing, and leverage on the success of corporate turnaround with profitability as a moderating variable in tourism sector companies listed on the Indonesia Stock Exchange for the 2019-2022 period. **Method:** Testing in this research uses the SmartPLS program using the moderated regression analysis method. **Results:** Based on the results of the bootstrapping test, it shows that severity and leverage have an effect on the success of the company's turnaround, while downsizing and asset retrenchment have no effect on the success of the company's turnaround. Based on the results of the bootstrapping test, profitability can moderate the influence of leverage on the success of a company's turnaround, while profitability cannot moderate the influence of severity, asset retrenchment, and downsizing. **Novelty:** The study provides insights into the role of profitability as a moderating variable in the relationship between leverage and corporate turnaround success, highlighting that it does not moderate the influence of severity, asset retrenchment, and downsizing.

## INTRODUCTION

Indonesia's economy shows rapid development, as seen from the number of companies that are able to survive in the fierce market competition. The company's inability comes from many factors, such as internal factors and external factors. The existence of an economic crisis also results in economic instability so that many companies are unable to compete and will be evicted from the market and will experience a decline in performance that can potentially lead to bankruptcy [1]. Financial distress is the stage of declining a company's financial condition before bankruptcy occurs. This condition is usually characterized by delays in debt payments, bills, and declining product quality [2]. Management needs to conduct analysis and make decisions so that the company does not experience financial distress [3]. The ability of a company to succeed in dealing with financial distress is called corporate turnaround [4], [5].

Corporate turnaround is a strategy used with the aim of surviving the company and recovering from a decline in profits [6]. The success of corporate turnaround is not achieved easily, and comes from many factors, such as external factors and internal factors. The strategy for the success of the corporate turnaround includes two stages, namely the strategy to survive the downturn, and the recovery stage [7]. There are several factors that can affect the success of a corporate turnaround, one of which is severity, asset retrenchment, downsizing, and leverage.

Severity is an important factor that can have an impact on corporate turnaround. The higher the severity value, the higher the chance of corporate turnaround success [8]. Based on the research of [1] stated that severity had an effect on the success of corporate turnaround, but research by [6] stated that severity had no effect on the success of corporate turnaround.

Another factor in the success of corporate turnaround is asset retrenchment or called free assets. Asset retrenchment is an asset that is not collateralized by the company so that its existence can equip the company when conducting a corporate turnaround [2]. Research conducted by [8] states that asset retrenchment has an effect on the success of corporate turnaround. Meanwhile, research by [9] states that asset retrenchment has no effect on the success of corporate turnaround.

In addition to asset retrenchment, there is also downsizing which is a cost cut with the aim of improving company performance [1]. Based on research by [1] which states that downsizing affects the success of corporate turnaround, while research by [6] states that downsizing has no effect on the success of corporate turnaround.

Meanwhile, another factor, namely leverage, is called the company's ability to pay off its long-term obligations and debts. High leverage will be followed by potential financial distress [10]. Based on the research of [11] which states that leverage affects the success of corporate turnaround, while the research of [7] states that leverage has no effect on the success of corporate turnaround.

## **Literature Review**

### **Signalling Theory**

According to [12] Signalling theory is information in the form of positive signals or negative signals given to investors regarding the financial condition of a company. The information provided will later help in making an investor's decision to invest. The information provided can be in the form of financial statements, policy information or other information that is deliberately provided by management. Signal theory is relevant because investors need signals in the form of financial statements as a sign of whether the company is in good or bad shape.

### **Agency Theory**

Agency theory according to [5] is the relationship between two individuals who have different interests, namely the principal and the agent. The two parties have a difference between the investor (principal) and the manager (agency). Agency theory is used by companies as a fundamental business practice. Agency theory views a company as a contractual arrangement between its members [13]. The relationship between agency theory and the success of corporate turnaround is that there is a difference of opinion in decision-making from different management and investors with the aim of avoiding financial distress and succeeding in maintaining the existence of the company.

### **Financial Distress**

According to [14], financial distress can occur due to various factors. Factors that can cause companies to experience financial distress are rising costs, excessive expansion, market competition, and also economic conditions. According to [15], financial distress

in a company includes all the initial periods from a decline in performance to the lowest point, until the company can improve its performance again. A deteriorating company performance indicates the possibility of the company experiencing bankruptcy, if the company's performance improves, it shows the company's ability to deal with financial distress.

### **Corporate Turnaround**

Corporate turnaround is the company's ability to deal with financial crises and change direction into a good state. There are 4 conditions when financial performance declines and turnaround cycles, namely, the first stage is when the company is at the peak of financial performance from the previous 2 years, the second stage is financial performance weakening and in conditions of financial distress, the third stage the company is resource efficiency after savings, the fourth stage the company succeeds in turnaround (recovery) or fails to turn around (non recovery) [16].

### **Severity**

According to [17] Severity is a situational factor that can affect a company's chances when it comes to conducting a corporate turnaround by assessing the company's performance on the company's financial ratio. Companies that experience financial pressure must immediately reduce costs and assets in order to survive the financial crisis. [1].

### **Asset retrenchment**

According to [18] Asset retrenchment refers to the reduction of fixed assets for long-term use, such as land, buildings, and equipment, and also in the short term with the aim of reducing financial deterioration conditions. Asset retrenchment can increase the trust of external stakeholders and can improve the company's ability to get support from external parties.

### **Downsizing**

Downsizing is a strategy with a cost-cutting method with the aim of improving the company's performance, increasing the profitability and productivity of a company. Another meaning of downsizing is the reduction of the scale of the company which aims to increase the effectiveness and efficiency of the company by reducing unproductive assets or called retrenchment [1]. Downsizing occurs when a company reduces the company's total assets in the same period. Reduction of assets that do not have power with the aim of increasing the productivity of the company [14].

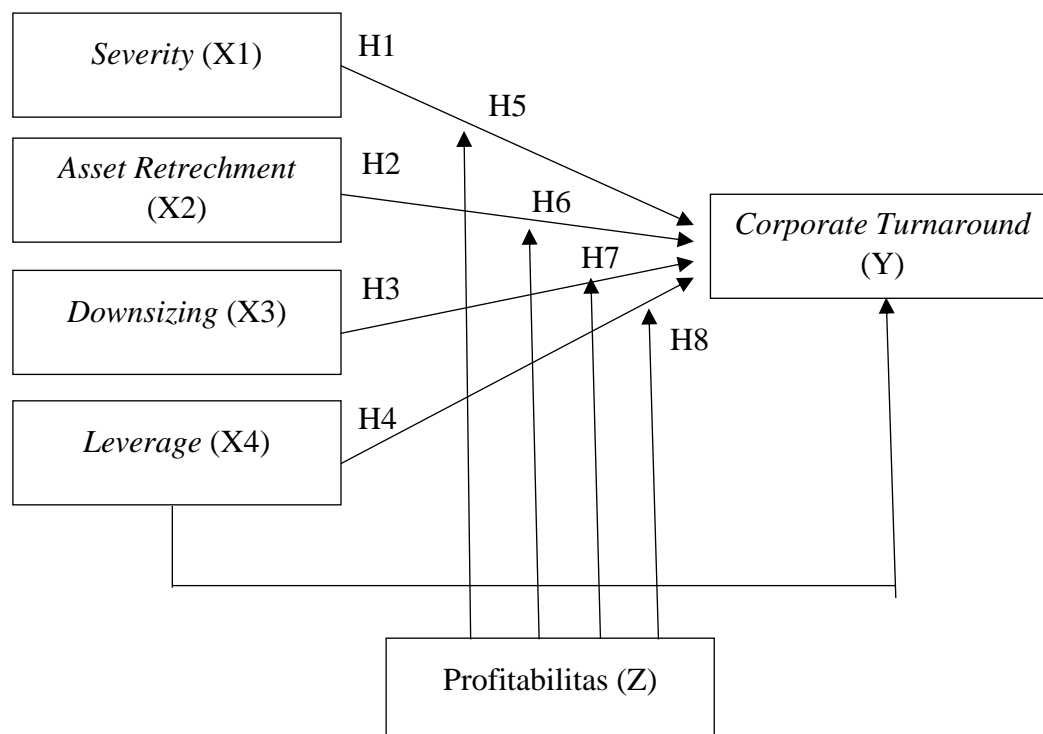
### **Leverage**

Leverage is the ratio of the relationship between a company's debt and capital and assets which is used as an indicator to see how far the company is financed by debt or from outside parties. Companies that have a high leverage value have a high financial risk, but also have a great chance of making high profits [19]. [20] stated that leverage is used to calculate the company's ability to pay its short-term debts as well as its long-term debts. Companies that are financed a lot of debt, there is a risk of difficulties in the future due to debts that are larger than assets.

## Profitabilitas

According to [11] Profitability is how much a company is able to generate a profit level over a certain period. Profitability is used as a dividend payment and is used to attract new investors. The level of profitability shows how effective a company's management is in managing its resources to generate profits. The high level of profitability shows the good operation of the company. The management also needs to balance the value of short-term profitability and also its long-term profitability to maintain the optimization of the company's value.

Based on the results of the study of the theories above, the rationale for this research entitled the influence of severity, asset retrenchment, downsizing and leverage on the success of corporate turnaround with profitability as a moderating variable is presented in Figure 1.



Source: Data processed by researchers, 2024

**Figure 1.** Conceptual framework.

## Hypothesis Development

### The effect of severity on the success of corporate turnaround

Severity describes the decline in company performance which is analyzed through a comparison of Z-Score between two years [1]. The level of severity affects the success of the corporate turnaround; low values indicate a decline in performance and reduce the likelihood of success [17]. Research by [1] and [8] shows that severity has a positive effect on corporate turnaround success, while [6] shows the opposite. Based on this analysis, the following hypothesis can be developed:

H1: Severity affects the success of corporate turnaround.

### **The effect of asset retrenchment on corporate turnaround success**

[9] state that asset reduction is a company step to reduce ineffective resources in order to reduce operating costs. [8] define asset reduction as an effort to save assets and avoid financial difficulties. [8] shows that asset reduction has a positive impact on the success of company turnover, in line with the results of [9]. Meanwhile, [21] found that asset reduction has no effect on the success of company turnover. Based on this analysis, the following hypothesis can be developed:

H2: Asset retrenchment affects the success of corporate turnaround.

### **The effect of downsizing on the success of corporate turnaround**

Downsizing is downsizing by reducing less productive asset retrenchment which aims to increase company efficiency [1]. Downsizing must be done according to its portion, if downsizing is done too massively it will result in reduced company wealth [22]. Research by [1] shows the results that downsizing has an influence on the success of corporate turnaround in line with research by [6]. in contrast to research by [22] which shows that downsizing has no effect on the success of corporate turnaround. Based on this analysis, the following hypothesis can be developed:

H3: Downsizing affects the success of corporate turnaround.

### **The effect of leverage on the success of corporate turnaround**

Leverage is a ratio that measures the proportion of a company's activities that finance debt. High leverage increases the risk of financial difficulties, because companies with large debts find it difficult to fulfill payment obligations, which can hinder the improvement of company performance. Research by [12] and [11] shows that leverage affects the company's turnaround process. However, [23] found that leverage has a negative influence. Based on this analysis, the following hypothesis can be developed:

H4: Leverage affects the success of corporate turnaround.

### **The role of profitability in moderating severity on corporate turnaround success**

Profitability is a ratio that assesses the company's ability to generate profits. Where low values indicate the risk of financial difficulties, which can reduce the chances of a successful corporate turnaround [11]. In this context, profitability also moderates the success factors of corporate turnaround. Severity measures the decline in company performance through Z-Score. A decrease in profitability negatively impacts performance, increases the risk of financial distress, and reduces turnaround opportunities [1]. Based on this analysis, the following hypothesis can be developed:

H5: Profitability moderates the effect of severity on the success of corporate turnaround.

### **The role of profitability in moderating asset retrenchment on corporate turnaround success**

Profitability is a ratio that shows the company's ability to generate profits from its assets, reflecting management's success in maintaining profit stability. In addition, profitability helps moderate the factors that support corporate turnaround [23]. Asset retrenchment is a company's move to reduce assets to avoid financial distress and bankruptcy. Reduction of ineffective assets can increase added value and competitive advantage, thereby optimizing financial performance and increasing the probability of

success. This shows the relationship between profitability and asset retrenchment in corporate turnaround [8]. Based on this analysis, the following hypothesis can be developed:

H6: Profitability moderates the effect of asset retrechment on the success of corporate turnarun

#### **The role of profitability in moderating downsizing on corporate turnaround success**

High profitability indicates that the company is getting away from the risk of financial distress, reflecting the ability to generate optimal profits and healthy financial conditions. Profitability also moderates the success factors of corporate turnaround [12]. Downsizing, as a restructuring strategy to reduce costs and assets, aims to restore sales and increase profitability. The effectiveness of downsizing is directly related to profitability, helping companies avoid financial distress and increasing the chances of turnaround success [6]. Based on this analysis, the following hypothesis can be developed:

H7: Profitability moderates the effect of downsizing on the success of corporate turnaround.

#### **The role of profitability in moderating leverage on corporate turnaround success**

Profitability is a ratio that describes the company's ability to use assets to generate profits. High profitability reflects management's success in maintaining optimal profit stability through asset utilization. In addition, profitability also serves to moderate the factors that contribute to the success of corporate turnaround [23] safend. Leverage is a ratio used to measure the extent to which a company's assets are financed by debt. Leverage also functions as a tool for credit analysis or financial ratio analysis [11]. A low leverage ratio indicates good financial condition and high profitability, thereby increasing the likelihood of a successful corporate turnaround [24]. Based on this analysis, the following hypothesis can be developed:

H8: Profitability moderates the effect of leverage on the success of corporate turnaround.

## **RESEARCH METHOD**

This research is a quantitative research. This study tests existing theories by measuring research variables using numbers and also data analysis with statistical procedures. According to [15] The quantitative method is a method that is carried out by means of analysis using populations and also certain samples that have quantitative/statistical properties. The object used in the study is tourism sector companies listed on the IDX for the 2019-2022 period with a sampling technique using purposive sampling and producing a total sample of 15 companies. The data analysis method uses statistical analysis and also partial lear square analysis.

## RESULTS AND DISCUSSION

### Results

#### Outer Model Testing

##### 1. Validitas kovergen test

###### a. Validitas konvergen test

**Table 1.** Convergent validity test result based on loading factor and AVE.

Variable	Loading Factor	AVE	Evaluation
Severity (X1)	1.00	1.00	Valid
Asset Retrenchment (X2)	1.00	1.00	Valid
Downsizing (X3)	1.00	1.00	Valid
Leverage (X4)	1.00	1.00	Valid
Corporate Turnaround (Y)	1.00	1.00	Valid
Profitabilitas (Z)	1.00	1.00	Valid
X1_Z	3.37	1.00	Valid
X2_Z	3.39	1.00	Valid
X3_Z	3.47	1.00	Valid
X4_Z	3.46	1.00	Valid

The indicator on each variable has been valid as a measure of the latent variable. Based on the AVE value produced, each variable has an AVE value of more than 0.50. So it can be said that all constructs have good convergent validity.

###### b. Validitas diskriminan test

**Table 2.** Discriminant validity test result based on Cross loading values.

	X1	X1_Z	X2	X2_Z	X3	X3_Z	X4	X4_Z	Y	Z
SEV	1	0.721	0.994	0.727	0.981	0.727	0.970	0.726	0.978	0.966
AR	0.994	0.733	1	0.738	0.985	0.738	0.970	0.737	0.975	0.963
DS	0.981	0.749	0.985	0.754	1	0.755	0.987	0.755	0.978	0.973
LV	0.970	0.747	0.970	0.752	0.987	0.754	1	0.753	0.980	0.979
Z-Score	0.978	0.758	0.975	0.764	0.978	0.767	0.980	0.766	1	0.987
Profit	0.966	0.770	0.963	0.776	0.973	0.780	0.979	0.779	0.987	1
X1 * Z	0.721	1	0.733	1.000	0.749	0.998	0.747	0.996	0.758	0.770
X2 * Z	0.727	1.000	0.738	1	0.754	0.998	0.752	0.996	0.764	0.776
X3 * Z	0.727	0.998	0.738	0.998	0.755	1	0.754	0.999	0.767	0.780
X4 * Z	0.726	0.996	0.737	0.996	0.755	0.999	0.753	1	0.766	0.779

It is known that all values of the cross loading variable are greater than the values of other latent cross loading, as well as the variables that are influenced by the moderation variable. Where it is marked with the number one in the green table which shows that each variable has valid test results, with the test value greater than 0,7.

## 2. Reliabilitas Test

### a. Reliabilitas indicator test

**Table 3.** Indicator realibility test result.

Variable	Criteria	Cronbach's Alpha	Evaluation
<i>Severity (X1)</i>		1.00	Reliabel
<i>Asset Retrenchment (X2)</i>		1.00	Reliabel
<i>Downsizing (X3)</i>		1.00	Reliabel
<i>Leverage (X4)</i>		1.00	Reliabel
<i>Corporate Turnaround (Y)</i>	> 0.70	1.00	Reliabel
<i>Profitabilitas (Z)</i>		1.00	Reliabel
X1_Z		1.00	Reliabel
X2_Z		1.00	Reliabel
X3_Z		1.00	Reliabel
X4_Z		1.00	Reliabel

The value of Crombach's alpha on each variable shows a construct value greater than 0.70, thus it can be shown that the research variable has qualified from Cronbach's alpha value, so it can be concluded that the whole variable has a high level of reliability.

### b. Reliability consistency test

**Table 4.** Indicator consistency test result.

Variable	Criteria	Composite Reliability	Evaluation
<i>Severity (X1)</i>		1.00	Reliabel
<i>Asset Retrenchment (X2)</i>		1.00	Reliabel
<i>Downsizing (X3)</i>		1.00	Reliabel
<i>Leverage (X4)</i>		1.00	Reliabel
<i>Corporate Turnaround (Y)</i>	> 0.70	1.00	Reliabel
<i>Profitabilitas (Z)</i>		1.00	Reliabel
X1_Z		1.00	Reliabel
X2_Z		1.00	Reliabel
X3_Z		1.00	Reliabel
X4_Z		1.00	Reliabel

The composite reliability value on each variable has a value of more than 0.70 which indicates that the variable has met the composite reliability. So it can be concluded that each variable has a high level of reliability.

### Inner Model Testing

**Table 5.** Coefficient of determination test result (R-Square).

	R Square	R Square Adjusted
<b>Corporate Turnaround</b>	0.985	0.983

The results of the determination coefficient test showed the value of the R-Square Adjusted which was 0.983. So it can be concluded that the ability of the variables of severity, asset retrenchment, downsizing, leverage, and profitability in explaining the corporate turnaround variable is quite strong, which is 98.3% while the remaining 1.7% is influenced by other variables that are not measured in this study.

### Hypothesis Test

**Table 6.** Hypothesis bootstreping test result.

	Original Sampel (O)	Sampel Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values
X1 -> Y	0.341	0.318	0.190	1.801	0.036
X2 -> Y	0.043	0.057	0.196	0.218	0.414
X3 -> Y	-0.177	-0.184	0.115	1.542	0.062
X4 -> Y	0.274	0.265	0.092	2.981	0.002
Z -> Y	0.499	0.526	0.143	3.483	0.000

The criteria used in the hypothesis test are as follows:

- $H_1$  rejected if the significance figure  $> \alpha = 5\%$  atau  $T_{hitung} < T_{tabel}$
- $H_2$  accepted if the significance figure  $< \alpha = 5\%$  atau  $T_{hitung} > T_{tabel}$

**H1:** The value produced from the parameter coefficient is 0.341, with a T-Statistics value of 1.801 which has a value greater than the T-table value (1.679) and the resulting P-Values value of 0.036 is smaller than the significance value of 0.05. so it can be concluded that H1 is accepted, which means that the severity variable has a significant positive influence on the success of the corporate turnaround.

**H2:** The value generated from the parameter coefficient is 0.043, with a T-Statistics value of 0.218 which has a value smaller than the T-table value (1.679) and the resulting P-Values value of 0.414 is greater than the significance value of 0.05. so it can be concluded that H2 was rejected which means that the asset retrenchment variable does not have a significant influence on the success of the corporate turnaround.

**H3:** The value produced from the parameter coefficient was 0.274, with a T-Statistics value of 1.542 which had a value smaller than the T-table value (1.679) and the resulting P-Values value of 0.062 was greater than the significance value of 0.05. so it can be concluded that H3 was rejected which means that the downsizing variable does not have a significant influence on the success of the corporate turnaround.

**H4:** The value produced from the parameter coefficient is 0.341, with a T-Statistics value of 2.981 which has a value greater than the T-table value (1.679) and the resulting P-Values value of 0.002 is smaller than the significance value of 0.05. so it can be concluded that H4 is accepted, which means that the leverage variable has a significant positive influence on the success of the corporate turnaround.

**Table 7.** Hypothesis bootstreping test result.

	<b>Original Sampel (O)</b>	<b>Sampel Mean (M)</b>	<b>Standard Deviation (STDEV)</b>	<b>T Statistics (  O/STDEV  )</b>	<b>P Values</b>
X1_Z -> Y	-0.117	-0.090	0.257	0.457	0.324
X2_Z -> Y	0.197	0.159	0.323	0.611	0.271
X3_Z -> Y	-0.314	-0.282	0.218	1.439	0.075
X4_Z -> Y	0.243	0.220	0.141	1.726	0.043

**H5:** The resulting parameter coefficient value is -0.117, with a P-value of 0.324 more than a significance value of 0.05. So it can be said that H5 was rejected which means that profitability weakens the influence of severity on the success of corporate turnaround insignificantly.

**H6:** The resulting parameter coefficient value is 0.197, with a P-value of 0.271 more than a significance value of 0.05. So it can be said that H6 was rejected, which means that profitability weakens the influence of asset retrenchment on the success of corporate turnaround insignificantly.

**H7:** The resulting parameter coefficient value is -0.314, with a P-value of 0.075 more than a significance value of 0.05. So it can be said that H7 was rejected which means that profitability weakens the downsizing effect on the success of the corporate turnaround insignificantly.

**H8:** The resulting parameter coefficient value was 0.243, with a P-value of 0.043 less than a significance value of 0.05. So it can be said that H5 is accepted, which means that profitability strengthens the influence of leverage on the success of corporate turnaround significantly.

### *Discussion*

1. Severity affects the success of corporate turnaround. The results of this study are in line with research by [17] and also research by [1] which stated that severity has a positive effect on the sustainability of corporate turnaround. Severity indicates the health of a company. Companies with a high level of severity have a high chance of successful corporate turnaround. The higher the severity value, the better the company's financial performance and increase the Z-Score value. This is because saverity is the first step to analyzing risk in a company, where the smaller the risk found in a company, it can be said that the company has good financial performance in avoiding financial distress.
2. Asset retrenchment has no effect on the success of corporate turnaround. This research is in line with research by [25] and [9] which states that asset retrenchment has no effect on the success of corporate turnaround. Asset retrenchment is carried out by the company with the aim of improving the company's performance. Asset retrenchment is carried out by reducing or selling company assets that are considered less valuable so that they can increase the company's profitability. Asset

- retrenchment that is carried out continuously can cause losses to the company and can also reduce the company's operational activities.
3. Downsizing has no effect on the success of corporate turnaround. The results of this study are in line with research by [14], [25] which stated that downsizing has no effect on the success of corporate turnaround. Downsizing or cutting costs is carried out with the aim of increasing profitability, productivity, and also company performance. An effective downsizing strategy can provide benefits to the company, but if the downsizing strategy is not carried out correctly, it will result in losses to the company and reduce the company's activities.
  4. Leverage affects the success of corporate turnaround. The results of this study are in line with the research of [11] which stated that leverage has a positive effect on the success of corporate turnaround. Leverage proxied by Debt of Equity Ratio (DER) measures the amount of capital funded by debt, or the ratio of a company's total capital to a company's total debt. Companies that have a low leverage value show that the economy of debt-financed companies is also low, so the company is far from a state of financial distress so that leverage can increase the company's probability of successful corporate turnaround.
  5. Profitability does not play a role in moderating the influence of severity on the success of corporate turnaround. Severity measures the financial severity experienced by a company based on the Z-Score value which only includes the liquidity ratio and also the profitability ratio, while many other ratios can be used as an assessment of the financial performance of the company. So that the success rate of a company's corporate turnaround does not depend on the severity value but is based on other factors.
  6. Profitability does not play a role in moderating the influence of asset retrenchment on the success of corporate turnaround. Asset retrenchment is an asset reduction strategy that aims to increase the company's profitability. The level of profitability is indeed important in a company as proof that the company has sufficient assets, but if asset retrenchment is carried out excessively, it will reduce the company's operational activities. So that profitability derived from asset retrenchment cannot increase the company's probability of achieving a successful corporate turnaround.
  7. Profitability does not play a role in moderating the effect of downsizing on the success of corporate turnarounds. The downsizing strategy is a strategy for downsizing the assets owned by the company. Downsizing is carried out to increase the company's profits, market share, and the quality of customer service work. However, in the downsizing strategy, the probability of success of corporate turnaround is not only done by downsizing assets, but also needs to consider optimal resource reduction. So that the downsizing strategy can be used to increase the company's profitability so that the company does not experience financial distress.

Profitability plays a role in moderating the influence of leverage on the success of corporate turnaround. Good management performance will improve the company's

operations, so that the profits generated by the company will be high and meet the targets set by the company. The profits generated by the company can be used to pay for the company's long-term liabilities as well as short-term liabilities (leverage). So that the company will be saved from financial distress and the probability of the company's success in corporate turnaround is higher.

## CONCLUSION

**Fundamental Finding :** Based on the results of the research and discussion, it can be concluded that severity and leverage have an effect on the success of corporate turnaround, while downsizing and asset retrenchment have no effect on the success of corporate turnaround. Profitability can moderate the influence of leverage on the success of corporate turnarounds, while profitability cannot moderate the influence of severity, asset retrenchment, and also downsizing on the success of corporate turnarounds. **Implication :** The findings of this study highlight the significance of severity and leverage in determining corporate turnaround success, suggesting that companies should carefully manage these factors to improve recovery prospects. Additionally, the role of profitability as a moderating variable in leverage indicates that firms with higher profitability may have better leverage management capabilities, influencing turnaround outcomes. **Limitation :** This study was conducted with the aim of finding out how the relationship between independent variables, namely severity, asset retrenchment, downsizing, and leverage with the dependent variable, namely the success of corporate turnaround by using moderation variables, namely profitability. The test in this study uses the SmartPLS program with observations on 15 tourism sector companies listed on the Indonesia Stock Exchange (IDX) for the 2019-2022 period. **Future Research :** It is hoped that this research can be redeveloped by using other objects and using other variables that are suspected to affect the success of corporate turnaround. Additionally, it is hoped that other variables can be used to moderate the research variables.

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