ABSTRACT

This study aims to examine the effect of capital adequacy (CAR), liquidity policy (LDR), and operational efficiency (BOPO) on Financial Distress as measured by the Modified Altman Z''-Score, with credit risk (NPL) serving as an intervening variable in Rural Banks (Bank Perekonomian Rakyat/BPR) in Indonesia during the period 2020–2024. The study is grounded in Agency Theory as the grand theory and Risk Management Theory as the supporting theory to explain the relationships among the research variables.

This research employs a quantitative approach using secondary data obtained from BPR published financial reports issued by the Financial Services Authority (Otoritas Jasa Keuangan/OJK). The sample was selected using purposive sampling, resulting in 1,206 BPRs with a total of 5,975 observations during the study period. Data were analyzed using panel data regression with EViews 13 software. Mediation analysis was conducted to examine the role of credit risk as an intervening variable.

The results indicate that CAR has a positive and significant effect on Financial Distress as measured by the Modified Altman Z''-Score, while LDR has no significant effect. BOPO has a negative and significant effect on Financial Distress. Furthermore, CAR has no significant effect on NPL, whereas LDR and BOPO have positive and significant effects on NPL. NPL significantly affects Financial Distress. The mediation analysis indicates that the mediating role of NPL should be interpreted based on the final mediation test results.

The findings imply that strengthening capital adequacy, improving operational efficiency, and implementing effective credit risk management are essential for maintaining the financial stability of BPRs and reducing the potential for Financial Distress. This study is expected to provide useful insights for BPR management and financial regulators in strengthening risk management implementation and enhancing the resilience of the rural banking industry.

Keywords:* *Capital Adequacy Ratio, Loan to Deposit Ratio, BOPO, Non-Performing Loan, Financial Distress, Modified Altman Z''-Score, Rural Banks.