

Financial Distress Prediction: The Role of CEO Overconfidence and Profitability as Moderating

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Abstract

This study aims to determine the effect of CEO overconfidence on financial distress with profitability as a moderating in oil and gas producer companies that have ESG High Risk and are listed on the London Stock Exchange Group (LSEG) during the period 2018-2022. Using test panel data regression and moderated panel data regression analysis of 225 observations, the result shows that CEO overconfidence with a proxy of overinvestment, has a significant negative effect on financial distress, while the DER and dividend do not affect financial distress. Profitability can strengthen the influence of CEO overconfidence, proxied by DER on financial distress. This finding shows that the CEO's decision to invest with large capital can minimize the risk of financial distress. Profitability as a moderating factor strengthens the effect of DER on financial distress, showing that the profit does not quickly cover the capital issued. This study provides empirical evidence that decisions made by CEO regarding investments do not always negative impact on the company's financial distress.

Article Info

Keywords:
CEO Overconfidence,
Profitability,
Financial Distress

JEL Classification:
G32, G34, M14

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Received: 19-09-2025
Revised: 31-10-2025
Accepted: 10-05-2026
Published: 30-06-2026



1. Introduction

The energy crisis is the toughest challenge faced by countries in the world today. Due to global population growth, rapid industrial development, and rising living standards, the demand for energy has increased dramatically, triggering an increase in electricity and gas prices (Kompas, 2021). The energy crisis is caused by limited non-renewable energy resources, extreme climate change, and unequal energy access around the world (Logayah et al., 2023). This energy crisis is experienced mainly in Europe as the continent comes into winter and there is massive economic growth due to the relaxation of COVID-19 restrictions. This can reduce energy supply as natural gas storage facilities are not as full as before. Even the gas capacity in the European Union is only at 71% (Katadata, 2022).

This crisis must be a serious concern for oil and gas producers, especially companies that have a high level of risk in the implementation of their operations. Oil and gas-producing companies in Europe and America that manage non-renewable energy resources need to look for alternative energy resources, especially renewable energy resources, to survive this energy crisis. If not, oil and gas-producing companies may experience a decrease in revenue and profits due to financial distress. That is a condition where the company faces financial difficulties as a result of management decisions and supporting external factors (Jhonni Sinaga et al., 2024).

Based on Figure 1 shows that the phenomenon that occurred during 2018-2022 in companies in the oil and gas producer sector listed on the London Stock Exchange Group (LSEG) was an increase in the amount of liabilities from 91 million dollars in 2018 to 99 million dollars in 2022. However, this condition is very contrary to the amount of profitability and income of the company. In the study period, the amount of profitability in 2018 amounted to 21,8 million dollars to 1 million dollars in 2022. Total revenue in 2018 amounted to 123,7 million dollars to 5 million dollars in 2022. The decline in profitability and revenue in oil and gas-producing companies listed

on LSEG was triggered by travel restrictions, regional quarantine, and a decrease in industrial and economic activity due to the COVID-19 pandemic (Ekonomi.Bisnis, 2021).

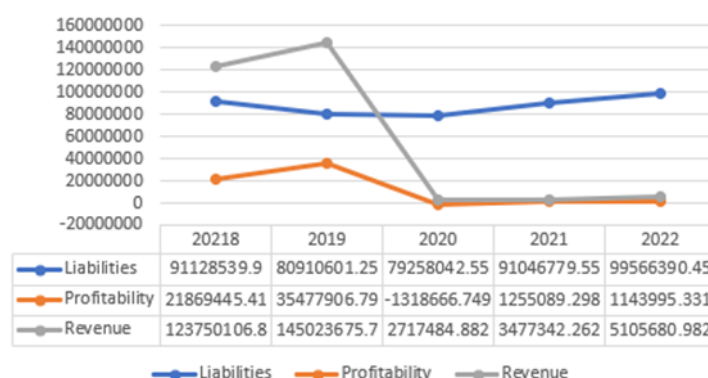


Figure 1. Development Chart of Liabilities, Profitability, and Revenue in Oil and Gas Producing Companies for The Period 2018-2022

The phenomenon of decreasing sales and profitability and increasing the amount of a company's liabilities can have an impact on financial distress (Hastiarto, 2021). An increase in the amount of corporate debt when profitability and revenue decline is carried out by the CEO of a company that has excessive self-confidence (Dehkordi et al., 2021). A CEO who has excessive self-confidence has a positive impact on the company's financial difficulties. In line with the results of research conducted by Ozkan (Ozkan, 2021) which states that companies with CEO overconfidence face a greater risk of failure in an innovative corporate environment. In addition, CEO overconfidence increases the risk of bankruptcy by using less conservative accounting.

According to Ho (P. H. Ho, 2016), in banking companies, CEO overconfidence tends to weaken lending standards and increase leverage. CEO overconfidence generally defaults on loans and experiences a decline in operating performance and stock returns. However, Ho's research (C. R. Ho, 2024) states that CEO overconfidence shows a lower risk of financial distress. In line with research conducted by Heidari (Heidari et al., 2022) which states that managers who have a confident character do not influence financial distress, confident managers have a sense of optimism about the future of the company by reducing the level of accounting conservatism.

Apart from the CEO overconfidence factor, profitability is also able to influence financial distress in companies. In line with Susanti and Samara's research (Susanti & Samara, 2021), Saputri and Santoso (Saputri & Santoso, 2023), Prastyatini (Prastyatini & Novikasari, 2023), Aisyah and Mulyani (Aisyah & Mulyani, 2024), Amah (Amah et al., 2023), Abdelkader and Wahba (Abdelkader & Wahba, 2024), and Hidayat (Hidayat et al., 2024) which states that profitability has a significant negative effect on financial distress. This shows that the lower the level of profitability, the higher the risk of financial distress of a company, and the higher the level of profitability, the lower the risk of financial distress.

However, research conducted by Antoniawati and Purwohandoko (Antoniawati & Purwohandoko, 2022) state that profitability does not affect financial distress, because companies have other funds both internally and externally to cover obligations when profits decline. In line with Asmarani and Purbawati (Asmarani & Purbawati, 2020) research which states that probability is unable to affect financial distress. In research conducted by Kusanti (Kusanti, 2020) which states that profitability does not affect financial distress. This is because the utilization of well-managed company assets can increase revenue so that profitability also increases. In addition, research by Wilujeng and Yulianto (Wilujeng & Yulianto, 2020) states that profitability is unable to moderate the effect of the audit committee on financial distress because high profitability does not necessarily have an effective audit committee in carrying out its duties to reduce the risk of financial distress.

However, there are several limitations in the existing literature. First, empirical studies on the effect of CEO overconfidence on financial distress in the oil and gas producer sector listed on the London Stock Exchange Group (LSEG) are still limited. Second, the majority of previous studies such as Liu et al (2020) in the United States and Ho et al. (2016) in China, focus more on the effect

of CEO overconfidence on financial distress in banking. Third, there are not many studies that use moderated regression analysis with moderating and control variables to examine the influence of CEO overconfidence on financial distress in the oil and gas producer sector listed on the London Stock Exchange Group (LSEG).

According to Slamet and Ramadhan (Slamet & Ramadhan, 2023) CEO overconfidence is the attitude of a CEO who tends to overestimate their abilities and knowledge and make decisions based on personal perspectives regarding investment and debt. The results of the study say that the attitude of CEOs who have overconfidence has a positive effect on the number of assets and company growth, which has the potential to cause financial distress. According to Liu (Liu et al., 2020) CEO overconfidence has a positive influence on high systematic risk than other companies that do not have overconfidence properties. The behavior of CEOs who have overconfident characters can cause negative externalities for the company. This is in line with research conducted by Atitallah and Lotfi (Ben Atitallah Rihab & Ben Jedidia Lotfi, 2016) that overconfident CEOs choose higher debt rather than being rational and underestimating the condition of financial difficulties, which can trigger financial distress.

H1: CEO overconfidence has a positive effect on financial distress

According to Metwally (Metwally et al., 2025) profitability is an indicator of company health and managerial success. The result of this study says that financial distress can be significantly affected by economic growth, economic performance, and profitability. In line with Aisyah and Mulyani's (Aisyah & Mulyani, 2024) research the company has a chance of experiencing financial distress due to low-level profitability. The high level of profitability indicates that the profit obtained from the results of using the company's assets is high, and there is good funding. Research by Powell (Powell et al., 2023) states that profitability is the best indicator to detect financial distress, followed by liquidity and leverage. Research by Sumarni (Sumarni, 2025) says that profitability can strengthen the influence of leverage on financial distress. This means that if the company is unable to increase profits by maximizing company assets, it is at risk of financial distress.

H2: Profitability has a positive effect on strengthening financial distress.

The empirical model developed in this study is as follows:

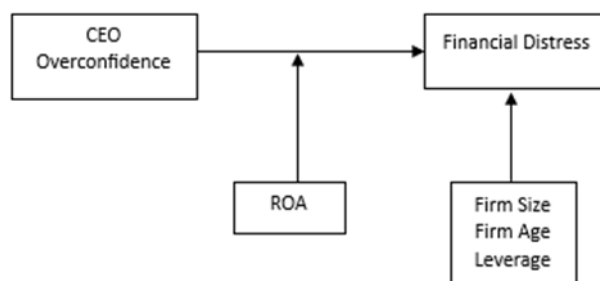


Figure 2. Empirical Model
Source: Development by Researcher

2. Methods

This study uses a quantitative approach to examine the effect of CEO overconfidence on financial distress with profitability as a moderator. The research data uses secondary data in the form of annual financial reports on oil and gas producer companies listed on the London Stock Exchange Group for the period 2018-2022 and has an ESG Risk Rating on the ESG Risk Rating agency, namely Sustainalytic Morningstar. The selection of research objects was made using a purposive sampling method, which resulted in a sample of 45 out of 59 companies. This study uses CEO overconfidence as an independent variable, financial distress as a dependent variable, and profitability as a moderating variable. The control variable in this study consists of firm size, firm age, and leverage. The purpose of using control variables is to increase the accuracy of the relationship between variables. Variable measurements and operational definitions in this study are presented in Table 1.

Table 1. Operational Definition of Variable

Variable	Measurment	Scale	Source
Financial Distress	$Z\text{-Score} = 1,2X1 + 1,4X2 + 3,3X3 + 0,6X4 + 1,0X5$	Unit	(Robiansyah et al., 2022)
CEO Overconfidence	$\frac{\Delta Asset_{it}}{Asset_{it} - 1} = \beta_0 + \beta_1 \frac{\Delta Sales_{it}}{Sales_{it} - 1}$	Dummy	(Sumunar, 2020).
Profitability	$ROA = \frac{EAT}{Total Asset}$	Ratio	(Amah et al., 2023)
Firm Size	Firm Size = LN (Total Assets)	Unit	(Dirman, 2020)
Firm Age	Firm Age = LN (year of establishment-current year)	Unit	(Jia & Li, 2022)
Leverage	$Leverage = \frac{Total Liabilities}{Total Asset}$	Ratio	(Saputri & Santoso, 2023)

Source: Data Processed (2025)

The data analysis techniques used in this study are descriptive statistical tests, multiple linear panel data regression analysis to test hypothesis 1, and moderated panel data regression analysis to test hypothesis 2. The panel data regression model estimation method is carried out using three approaches, namely the common effect method, fixed effect method, and random effect method. To obtain the research results, the empirical model was developed into two equations as follows: $FD_{it} = \beta_0 + \beta_1 Overinvestment_{it} + \beta_2 DER_{it} + \beta_3 Dividend_{it} + \beta_4 FirmSize_{it} + \beta_5 FirmAge_{it} + \beta_6 Leverage_{it} + \varepsilon_{it}$ (1)

Financial distress is a condition of financial difficulty experienced by the company. CEO overconfidence is a characteristic of company leaders who tend to have excessive confidence in their knowledge and abilities. CEO overconfidence is proxied into three things, namely overinvestment, debt-to-equity ratio, and dividend yield. Firm size shows the age of the company from its establishment until the current year. Leverage shows the ratio of debt to company assets. $FD_{it} = \beta_0 + \beta_1 Overinvestment_{it} + \beta_2 DER_{it} + \beta_3 Dividend_{it} + \beta_4 ROA_{it} + \beta_5 Overinvestment_{it} * ROA_{it} + \beta_6 DER_{it} * ROA_{it} + \beta_7 Dividen_{it} * ROA_{it} + \beta_8 FirmSize_{it} + \beta_9 FirmAge_{it} + \beta_{10} Leverage_{it} + \varepsilon_{it}$ (2)

Financial distress is a condition of financial difficulty experienced by the company. CEO overconfidence is a characteristic of company leaders who tend to have excessive confidence in their knowledge and abilities. CEO overconfidence is proxied into three things, namely overinvestment, debt-to-equity ratio, and dividend yield. Overinvestment*ROA represents the interaction between overinvestment and return on assets. DER*ROA represents the interaction between the debt-to-equity ratio and return on assets. Dividend*ROA represents the interaction between dividends and return on assets. Firm size indicates the size of a company. Firm age shows the age of the company from its establishment until the current year. Leverage shows the ratio of debt to company assets.

3. Results and Discussion

Descriptive Statistics Test Result

Table 2. Descriptive Statistics Test Result

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Financial Distress	225	-8.7473	14.0854	0.9696	4.1129
Overinvestment	225	0.0000	1.0000	0.4844	0.5008
DER	225	0.0000	1.0000	0.6000	0.4909
Dividend	225	0.0000	1.0000	0.5955	0.4918
ROA	225	-1.5870	0.5851	0.0489	0.2083
Firm Size	225	8.0307	23.823	13.778	2.9533
Firm Age	225	1.2000	4.9000	3.4106	0.7918
Leverage	225	-0.0067	762.75	14.316	82.150

Source: Data Processed (2025)

Based on Table 2, the financial distress variable has a minimum value is -8.74 or -874% and a maximum value is 14.08 or 1408%. This indicates that some companies are safe from financial distress, while others have experienced severe financial distress. In addition, companies with a minimum financial distress value have healthy financial indicators. Meanwhile, companies with a maximum financial distress value have poor financial indicators and are potentially facing bankruptcy. The proxy for CEO overconfidence has a minimum value of 0.000 and a maximum value of 1.000. This indicates that companies with overinvestment exhibit agency problems, especially when managers pursue expansion without considering efficiency, and there is information asymmetry or high free cash flow. The ROA variable has a minimum value of -1,58, indicating that among the companies in this study, there were companies that did not generate profits and suffered losses from their assets. This was due to very high operating expenses, a drastic decline in revenue, and inefficient asset management, which could cause the company to be in financial distress. Companies with a maximum ROA value show good profitability because they can generate a profit of 58 cents for every 1 rupiah of asset they own. This indicates that the company can manage its assets efficiently, has a controlled cost structure, and optimal operational performance. The Leverage variable has a minimum value of -0.0067, indicating that the equity value of the companies in this study is negative. Meanwhile, the maximum value is 762.75, which indicates the companies are highly dependent on external financing but face high risk if their income is insufficient to cover their liabilities.

Table 3. Pearson Correlation Test

Variable	FD	Overinvest	DER	Dividend	ROA	Firm Size	Firm Age	Leverage
FD	1.00							
Overinvest	-0.12	1.00						
DER	-0.33	-0.04	1.00					
Dividend	0.00	0.01	0.15	1.00				
ROA	-0.08	-0.17	0.00	-0.10	1.00			
Firm Size	0.04	0.05	-0.20	-0.00	-0.06	1.00		
Firm Age	-0.12	0.01	0.14	-0.20	-0.00	-0.11	1.00	
Leverage	0.04	-0.07	0.12	0.13	-0.11	-0.14	-0.01	1.00

Source: Data Processed (2025)

Table 3 shows the results of the Pearson correlation test that explains the relationship between variables. Overinvestment and DER show a significant negative correlation with financial distress, with significant values of $-0.12 < 0.05$ and $-0.33 < 0.05$. This means that there is an inverse relationship between overinvestment and DER to financial distress. This indicates that overinvestment in potentially profitable projects can generate income and cover the capital. In addition, overinvestment in various sectors with dispersed risks can suppress the negative effects of overinvestment that trigger financial distress. The dividend variable has a significant positive correlation with financial distress, it has significant value of $0.00 < 0.05$. This indicates the CEO has an overconfident character not like dividend payments, because they try to save the company's cash reserves to invest in the future, so that increased investment from dividend funds can increase the risk of financial distress. The ROA variable has significant values of $-0.08 < 0.05$. This indicates that ROA is a significant negative with financial distress, and it is an indicator of predicting financial distress. This indicates that although the company can generate profits from its assets, there are factors such as high debt burden, problematic cash flow, decreased demand to ineffective management that can have an impact on financial distress. The firm size variable has a significant value of $0.04 < 0.05$. This shows that the larger size of the company experiences financial pressure caused by high debt burden due to poor management of interest and liabilities, operational complexity or inefficient management in making financial decisions, global economic change due to international political uncertainty, pressure from high fixed costs if revenue decreases and new market competition that has innovations. The firm age has a significant value of $-0.12 < 0.05$. This indicates older the company less likely it is to experience financial distress. This can be caused by good financial stability, company reputation, operational efficiency and the

strength of a stable customer base. The Leverage has a significant value of $0.04 < 0.05$. This indicates that leverage greater impact on the financial distress if the company have existence of a high debt-to-asset burden, dependence on external funding, liquidity risk and decreased trust from investors.

Table. 4 Regression Analysis

Variable	(1) Financial Distress	(2) Financial Distress	(3) Financial Distress
Overinvestment	-0.75 (0.04)		-0.95 (0.00)
DER	0.02 (0.97)		-0.80 (0.10)
Dividend	-2.85 (0.34)		-4.64 (0.05)
Firm Size		-1.17 (0.00)	-1.31 (0.00)
Firm Age		2.25 (0.02)	2.69 (0.00)
Leverage		0.00 (0.05)	0.00 (0.09)

Source: data processed (2025)

Based on the regression analysis in Table 4, Model (1) shows that CEO overconfidence, proxied by overinvestment, has a significant negative relationship to financial distress with a coefficient of -0.75 and a significant level of $0.04 < 0.05$. This means that the higher the level of overinvestment, the lower the financial distress. This shows that the investment made by the company actually reduces the number of financial distresses caused by good financial management by using efficient funding sources, the level of liquidity that helps the company survive and investment diversification that can minimize risk. Model (2) shows that firm size has a significant negative relationship coefficient of -1.17 and a significant level of $0.00 < 0.05$. This means that the higher the size of the company, the lower the financial distress. This shows that the more of company has large total assets, the more it has stability and resistance to financial distress, supported by efficient management. In addition, the firm age variable has a significant positive relationship to financial distress with a coefficient of 2.25 and a significant level of $0.02 < 0.05$. This means that the older the company, the greater the chance of financial distress. Older companies have challenges in facing business competition if they do not quickly adapt to market changes, technology and international scale regulations that can change instantly. Model (3) is a model that combines all variables from the previous model. Overinvestment has a significant negative relationship with financial distress with a coefficient of -0.95 and a significant level of $0.00 < 0.05$. This shows that an increase in overinvestment actually reduces the level of financial distress. In this case, the company can implement efficient and effective use of funding sources, maintain the level of liquidity so that the company can survive even though it invests a large amount and spreads investment risk with various portfolios. Firm size has a significant negative relationship to financial distress with a coefficient of -1.31 and a significant level of $0.00 < 0.05$. That shows that the greater the level of total assets owned by a company, the lower the level of financial distress. This is because the company can develop the value of its investment and assets so that the investment can cover capital and generate profits. The firm age variable has a significant positive relationship with a coefficient of 2.69 and a significant level of $0.00 < 0.05$. This shows that the older the age of a company, the higher the level of financial distress. Companies with old age often have easier access to large debt for expansion or investment if this debt is not managed properly, interest and payment obligations can trigger financial distress.

Table 5. Moderated Regression Analysis

Variable	(4) Financial Distress	(5) Financial Distress
Overinvestment*ROA	2.08 (0.33)	-3.16 (0.09)
DER*ROA	2.44 (0.20)	5.39 (0.00)
Dividend*ROA	-2.30 (0.12)	-2.28 (0.31)
ROA		1.17 (0.59)
Firm Size		-1.15 (0.00)
Firm Age		2.79 (0.00)
Leverage		0.01 (0.00)

Source: Data Processed (2025)

Table 5 explains the relationship between profitability, overinvestment, DER, and dividends on financial distress. Model (4) shows that profitability cannot strengthen the influence of overinvestment, DE, and dividend on financial distress because it has a significantly more than 0.05. This shows that companies can generate profits to cover operational costs, interest, and financial obligations, thereby reducing the risk of financial distress. In addition, companies that have high profitability tend to be more active in CSR activities that can minimize the risk of financial distress. Model (5) shows the relationship of all variables. Profitability strengthens the relationship between DER and financial distress positively and significantly, with a coefficient of 5.39 and a significant level of $0,00 < 0.05$. This means the profit generated does not reflect healthy cash flow. Capital invested in large investments does not generate profits quickly enough to cover the capital spent. However, profitability is not able to strengthen the relationship between overinvestment and financial distress with a coefficient of -3.16 and a significant level of $0,09 > 0.05$. This means that the profit generated is not able to cover financial obligations. Profitability does not have enough impact on dividends and financial distress with a coefficient of -2.28 and a significant level of $0,31 > 0.05$. This means that even though the probability of a company is high, its impact on financial distress is still influenced by other factors such as leverage and liquidity. Meanwhile, firm size, firm age, and leverage as control variables have a significant effect on financial distress with a value of $0.00 < 0.05$. This indicates there are important indicators for predicting financial distress so that companies can reduce their debt levels to prevent technical failure and bankruptcy. In addition, firm size shows a positive impact on profit sustainability, and firm age can have a negative impact if the company is unable to innovate.

Overall, the results of this hypothesis show that CEO overconfidence with proxy overinvestment and DER have a significantly negative impact on financial distress, but the dividend has a significantly positive impact on financial distress in the oil and gas producer companies listed in the London Stock Exchange Group. Profitability can strengthen the CEO's overconfidence only in proxy DER.

4. Conclusion

Based on the results of multiple regression analysis and moderated regression analysis of 225 observations of oil and gas producer sector companies listed on the London Stock Exchange during the period 2018-2022, it can be concluded that the CEO's decision to invest with large capital actually minimizes the risk of financial distress. It has happened because the companies can implement efficient and effective sources of funds, and maintain the level of liquidity, so that the companies can survive despite investing large amounts and spreading investment risk across various portfolios.

Meanwhile, profitability actually strengthens the relationship between CEO overconfidence, proxied by DER on financial distress. This empirical evidence shows that capital invested in large investments does not generate profits quickly enough to cover the capital spent. Overinvestment made by the company must be able to provide a return on profits quickly to avoid financial distress. Future research is expected to increase the sample size to provide broader generalization results and cover other sectors.

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