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Exploring the Drivers of Earnings Management in Non-Cyclical Consumer Firms

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Abstract: The study examines the influence of sales growth, profitability, leverage, external auditor quality, and institutional ownership on earnings management in non-cyclical consumer firms listed on the Indonesia Stock Exchange from 2019 to 2023. Using purposive sampling, 21 companies were selected, resulting in 105 observations analyzed through multiple regression. The results reveal that leverage significantly and negatively affects earnings management, highlighting that companies with higher leverage tend to practice less earnings management due to stricter creditor oversight. Conversely, sales growth, profitability, external auditor quality, and institutional ownership have no significant effect, suggesting these variables are not primary drivers of earnings management within this context. This research underscores the importance of effective financial management and external monitoring in mitigating earnings manipulation practices.

Keywords: Earnings Management, Leverage, Corporate Governance.

INTRODUCTION

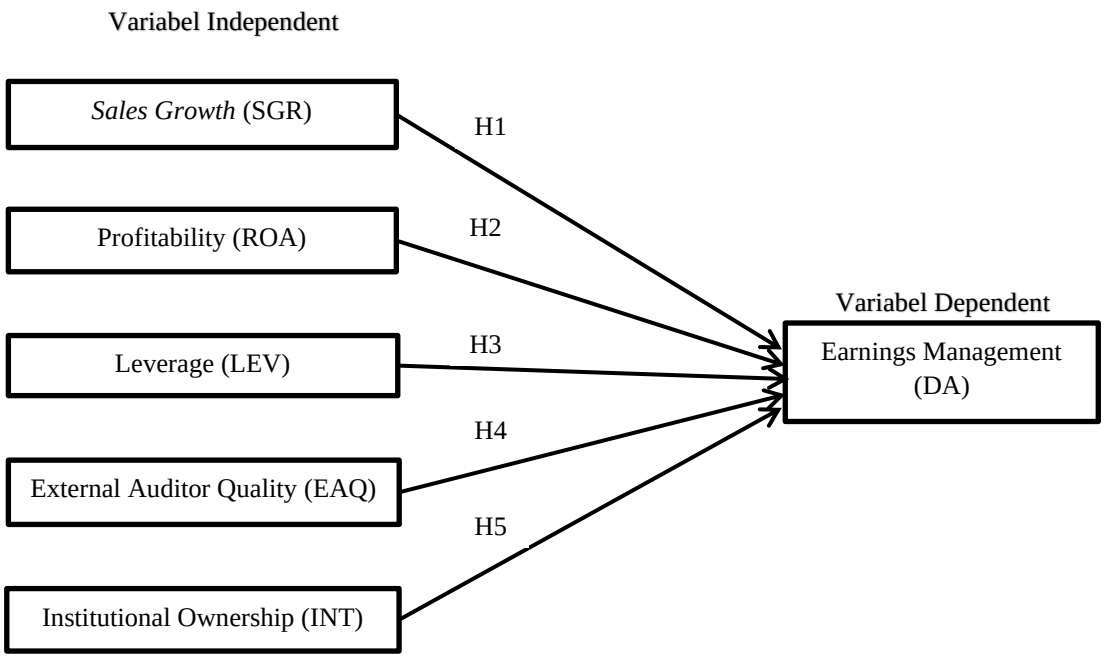
Companies in any sector with large, medium, and small scale prepare financial reports to evaluate the company's performance in a certain period. Financial reports are a crucial element for every company or organization (Dharma et al., 2023).A collection of information provided by the company to investors, which helps bridge the information gap between principals (investors) and agents (managers), so that the higher the quality of accounting information, the lower the information asymmetry between agents and principals and subsequently, allows investors to make better evaluations of the company's performance(Ebaid, 2022). Therefore, financial reports are one of the tools investors use to determine whether to invest in the company. Earnings management practices arise due to an imbalance of interests between shareholders and management, as explained in agency theory (Arya Pradipta, 2019; Firnanti et al., 2019). This misunderstanding can trigger the manipulation of financial reports known as earnings management. Earnings management practices driven by opportunistic behavior can damage investor confidence because the information in the financial statements is considered biased and misleading. If this practice continues to be carried out by the company, it can have

a negative impact on the stability and financial health of the company. The results of the study (Pangesti & Cheisviyanny, 2023; Wijaya et al., 2020), show that sales growth has a positive impact on earnings management. Thus, the higher the level of sales growth of a company, the greater the likelihood of earnings management practices. Significant sales growth creates a good image of the company's performance in the eyes of stakeholders. To strengthen this image, managers may engage in earnings management practices to show that they have succeeded in achieving or even exceeding the company's sales targets. This practice is often carried out to obtain greater incentives or bonuses.

Furthermore, the study (Wijaya et al., 2020) also discussed that profitability has a positive effect on earnings management. More profitable companies tend to have incentives to maximize profits through earnings management practices, such as to obtain bonuses or additional incentives. The two research results above, which want to create a strong corporate image and good performance, are in line with the statement that corporate leverage has a negative effect on earnings management. Companies with high leverage tend to have a greater risk in paying their obligations, so they are less involved in earnings management practices. This is also supported by the tax shield obtained from the use of debt, thereby reducing opportunistic actions. Based on the findings above, an effective corporate governance system is needed to suppress earnings management practices, such as the use of large audit firms (Big 4), which have been shown to significantly suppress earnings management practices (Tran et al., 2023).

This stronger control and supervision mechanism makes it increasingly difficult to manipulate financial data. External audit is an important element in corporate governance because it functions to ensure that financial statements are presented fairly and accurately. Therefore, the quality of external audits plays a significant role in corporate governance, as it is the basis for an effective control system and supports increased efficiency, transparency, and accountability(Abozaid et al., 2020; Nuhu et al., 2023, 2024). Public Accounting Firms (KAP) are known to have greater capital and capabilities in carrying out audits. The assessment of audit quality often depends on the reputation of the KAP, whereas larger KAPs are generally able to produce higher-quality audits. Previous studies have consistently shown that earnings management practices tend to be lower in companies audited by Big 4 firms compared to companies audited by non-Big 4 firms (Almarayeh et al., 2020; Zalata et al., 2020). The ownership structure is one of the mechanisms in corporate governance that aims to limit the potential for opportunistic actions by management. This structure reflects the proportion of share ownership held by certain parties in the company. Significant share ownership by dominant parties can align the interests of shareholders and management, thereby minimizing agency conflicts and reducing information asymmetry. The results of the study(Felicya & Sutrisno, 2020), stated that institutional ownership has a significant negative effect on earnings management. The greater the institutional ownership, the less likely the company is to engage in earnings management. This is because institutional shareholders tend to be more effective in monitoring management.

Based on the background above, the framework is structured as follows:



source: author based on prior research

Figure 1. Conceptual Framework

Thus, several hypotheses for this research were formulated:
H1: Sales growth has a positive effect on earnings management.
H2: Profitability has a positive effect on earnings management.
H3: Leverage has a negative effect on earnings management.
H4: External auditor quality has a negative effect on earnings management.
H5: Institutional ownership has a negative effect on earnings management.

METHOD

This type of research is causal research (Sugiyono, 2022). This study aims to obtain empirical evidence regarding the effect of sales growth, profitability, leverage, external auditor quality, and institutional ownership on earnings management. The subjects in this study were non-cyclical consumer sector manufacturing companies listed on the Indonesia Stock Exchange. This study uses secondary data from the company's financial statements and annual reports in 2018-2023 through the Indonesia Stock Exchange website and the company's official website. The company sample was taken using a purposive sampling technique by determining several criteria such as Non-cyclical consumer sector manufacturing companies that are consistently listed on the Indonesia Stock Exchange (IDX) during 2018-2023, present financial statements in rupiah, and generate net profit during 2019-2023. Based on these criteria, 21 companies were selected as research samples with a data period of 5 years or the number of data to be tested was 105 research data. The analysis method is carried out using Microsoft Excel and SPSS 29 software with multiple regression methods to test the effect of sales growth, profitability, leverage, external auditor quality, and institutional ownership on earnings management empirically. So that the regression equation in this study is formulated as follows:

$$\mathbf{DA = \beta_0 + \beta_1.SGR + \beta_2.ROA - \beta_3.LEV - \beta_4.XAQ - \beta_5.INT + e}$$

Description:

DA : Earnings management
β_0 : Konstanta
β_1 - β_6 : Regression coefficient
SGR : Sales growth

ROA : Profitability
LEV : *Leverage*
XAQ : External Auditor Quality
INT : Institutional Ownership
e : *Error*

In this study, the earnings management variable will be measured using the Modified Jones Model with discretionary accruals (Agustin, E. P. ., & widiatmoko, 2022; Mannuela, C., & Kurniawati, 2024; Nuhu et al., 2024). Sales growth is measured by calculating the percentage change in the company's revenue or sales from one period to the next (Akpm et al., 2020; Pangesti & Cheisviyanny, 2023; Wijaya et al., 2020). Profitability is measured using the Return on Assets (ROA) ratio by dividing net profit after tax by the company's total assets, while leverage is measured using the Debt to Asset (DAR) ratio which is calculated by dividing the company's total debt by its total assets (Agustin, E. P. ., & widiatmoko, 2022; Saputra & Yuliman, 2023; Weygandt et al., 2022). Furthermore, the external auditor quality variable will be measured using a dummy variable based on the size of the Public Accounting Firm (KAP) used by the Company, a value of 1 is given if the company is audited by a Big 4 KAP and a value of 0 if the company is audited by a non-Big 4 KAP (Hasan et al., 2020; Nuhu et al., 2024; Sitanggang et al., 2020). Finally, institutional ownership is measured by calculating the proportion of the number of shares owned by institutions compared to the total outstanding shares of the company (Agustin, E. P. ., & widiatmoko, 2022; Cristofel C., 2021).

RESULTS AND DISCUSSION

105 data were tested using SPSS 29 and 4 outliers were found, so 101 data were tested in the classical assumption test which showed the following results:

Table 1. Classical Assumption Tests

Test Statistic		Result	Conclusion
Residual Normality Test	Kolmogorov Smirnov Test	0,200 > 0,05	Residuals are normal
Heteroscedasticity Test	Glejser Test	Coef. Sig. > 0,05	No heteroscedasticity
Autocorrelation Test	Durbin Watson	1.60383 < **1,897** < (4 - 1.76168)	No autocorrelation
Multicollinearity Test	Tolerance and VIF	Tolerance > 0,05 and VIF < 10,00	No multicollinearity

Source: output SPSS 29

Based on the results in the table above, the data is suitable for the determination coefficient test and shows the following results:

Table 2. Coefficient of Determination

Model	R	R square	Adjusted R Square
1	0,344	0,118	0,072

Source: output SPSS 29

The R-value of 0.344 indicates a weak relationship between the independent variable and the dependent variable because the R value is closer to 0 than to 1. Then with an R square value of 0,118 or only 11,8% the variation in the earnings management variable can be explained by the independent variable and the rest is explained by other factors not used in this study. Adjusted R square is to show the value that has been adjusted for the number of independent variables and only 7,2% of the variation in the management variable can be explained by the model. Furthermore, the F test and t-test are carried out, showing the values:

Table 3. F Test (ANOVA)

Model	F	Sig.
1	2,552	0,033

Source: output SPSS 29

Table 4. t Test (Coefficient)

Model		B	t	Sig.
1	Constant	0,060	2,923	0,004
	Sales Growth	7,818E-11	1,189	0,237
	Profitability	-0,063	-0,608	0,545
	Leverage	-0,085	-2,190	0,031
	External Auditor Quality	-0,025	-1,684	0,095
	Institutional Ownership	-2,219E-11	-0,756	0,452

Source: output SPSS 29

Based on table 3, shows a significance value of 0,033 < 0,05 which means that there is a significant influence simultaneously from all independent variables on earnings management in the regression model or the resulting regression model can be used to predict dependent variables based on independent variables. Based on table 4, with the value of B (Unstandardized Coefficient) the regression equation can be arranged as follows:

$$\mathbf{DA = 0{,}060 + (7{,}818 \times 10^{-11}).SGR - 0{,}063.ROA - 0{,}085.LEV - 0{,}025.XAQ - (2{,}219 \times 10^{-11}).INT + e}$$

Based on the regression equation above, it can be interpreted that if all independent variables are zero, then the value of the earnings management variable is 0,060. Every 1 unit increase in Sales Growth will increase earnings management by 7,818 x 10^{-11}, assuming other variables remain constant. Every 1 unit increase in Profitability will decrease earnings management by 0,063, assuming other variables remain constant. Every 1 unit increase in Leverage will decrease earnings management by 0,085. Every 1 unit increase in External Auditor Quality will decrease earnings management by 0,025 and every 1 unit increase in Institutional Ownership will decrease earnings management by 2,219 x 10^{-11}. Furthermore, to answer the research hypothesis, it can be seen from the significance value in table 4 and concluded:

Table 5. t Test Results and Interpretation

Hypothesis	Sig. (p-value)	Interpretation	Result
H1: Sales growth has a positive effect on earnings management.	0,237	Not significant (0,237 > 0,05)	H1 rejected
H2: Profitability has a positive effect on earnings management.	0,545	Not significant (0,545 > 0,05)	H2 rejected
H3: Leverage has a negative effect on earnings management.	0,031	Significant (0,031 < 0,05)	H3 accepted
H4: External auditor quality has a negative effect on earnings management.	0,095	Not significant (0,095 > 0,05)	H4 rejected
H5: Institutional ownership has a negative effect on earnings management.	0,452	Not significant (0,452 > 0,05)	H5 rejected

Source: output SPSS 29

Based on the table above, leverage has a significant effect and a negative coefficient value (-0,085) indicates that the higher the leverage, the lower the level of earnings management. This result is in line with research (Firnanti et al., 2019; Millenia, Ellysia, 2021; Wijaya et al., 2020) because companies with high leverage tend to be monitored more closely

by creditors. This supervision reduces the opportunity for management to carry out earnings management practices. From a managerial perspective, this finding emphasizes the importance of carefully managing the company's financial structure to ensure transparency of financial statements and maintain investor and creditor confidence. Meanwhile, sales growth, profitability, external auditor quality and institutional ownership show that the results have no effect on earnings management, which also means that these independent variables are not the main drivers of earnings management practices in the context of this study. This can happen because high sales growth is not always directly related to the need for earnings manipulation (Sebastian & Handojo, 2019), because companies with high sales growth may have achieved operational stability and do not feel the need to carry out earnings management to attract the attention of investors or other parties. Similarly, with profitability, both high and low ROA values do not encourage management to engage in earnings management practices. (Pratiwi, D. et al., 2023). The quality of external auditors as measured by big four and non-big four KAP auditors also cannot be used as a factor that can encourage or reduce earnings management practices (Felicya & Sutrisno, 2020). Then institutional ownership does not always have a significant impact on reducing earnings management. This depends on the level of institutional involvement in overseeing the company's operations. In some cases, companies with large institutional ownership may have good governance, so that earnings management practices are not a major concern (Millenia, Ellysia, 2021).

CONCLUSION

This study concludes that leverage has a notably negative effect on earnings management, consistent with previous research suggesting this is due to increased scrutiny from creditors. On the other hand, sales growth, profitability, external auditor quality, and institutional ownership do not emerge as significant determinants of earnings management in this analysis. These results suggest that earnings management in non-cyclical consumer firms may be driven by other factors that were not explored in this study. The findings emphasize the importance of implementing strong financial structures and monitoring systems to enhance transparency and minimize opportunistic actions. Future studies are encouraged to investigate additional variables or contexts to gain a deeper understanding of the factors influencing earnings management.

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