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EARNING MANAGEMENT: THE ROLE OF COMPANY SIZE, LEVERAGE, AND GOOD CORPORATE GOVERNANCE ON GO PUBLIC BANKING

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Abstract
This study investigates the influence of company size, leverage, managerial ownership, and institutional ownership on earning management practices among publicly listed banking firms in Indonesia. The study employs a quantitative approach using panel data regression analysis. The sample comprises 20 banking companies listed on the Indonesia Stock Exchange over the 2017–2023 period, yielding 140 firm-year observations. The model selection is based on the Chow and Hausman tests, with the fixed effect model selected as the best fit. The results reveal that company size, leverage, and managerial ownership have significant negative effects on earning management, indicating that larger companies, higher debt ratios, and greater managerial ownership are associated with less earnings manipulation. Conversely, institutional ownership exhibits a significant positive effect, suggesting that higher institutional ownership increases the likelihood of earning management practices, possibly driven by short-term performance pressures. The findings emphasize the importance of corporate governance mechanisms in curbing earnings management. Regulators, stakeholders, and board members should consider enhancing transparency and aligning ownership structures to mitigate opportunistic financial reporting behavior. This study provides new insights into how firm characteristics and ownership structures affect earnings management behavior in the heavily regulated banking sector of an emerging economy, extending prior agency theory and corporate governance research.

Keywords: Earning Management, Company Size, Leverage, Corporate Governance, Banking Industry

1. Introduction

The submission of financial statements aims to provide information and an overview of a company's finances, this requires that in the process of making the financial statements be made correctly, the preparation is also required to be honest for parties interested in the use of the financial statements. Pacter (2017) explained that currently the world uses the International Financial Reporting Standard (IFRS) in financial reporting. The initiation of IFRS reporting guidance standards began in 2001. The implementation of IFRS in Indonesia began in 2008, where the implementation of IFRS financial reporting in Indonesia is carried out with the convergence of IFRS into PSAK, which is the principles adjusted in the financial accounting standards (SAK) guided by IFRS to improve the function and quality of financial statements.

The emergence of earning management practices is explained in agency theory due to information asymmetry. Information asymmetry is said to be a condition for an imbalance in information acquisition between shareholders and management. Based on this information imbalance, of course, managers have more information than shareholders because managers are the party who manages the company. Shareholders obtaining little information will be able to trigger managers to use their authority within the company to manage reported profits (Zhou & Elder, 2004). The conditions that occur will be able to give rise to a conflict of interest between shareholders (principals) and managers (agents), where each party between the agent and the principal wants to maximize welfare through the information owned by each.

As the banking industry becomes interesting to study further, the practice of earning management faces significant challenges. This is due to the vital role of banking in the country's economy, which makes this financial institution have to comply with various regulations set by Bank Indonesia and the Financial Services Authority. The strict regulations issued by the two institutions make earning management practices in the banking sector even more difficult to implement. The existence of regulators and the strict application of laws issued by the OJK serve to minimize the possibility of fraud in the banking industry.

Although strict regulations have been implemented by Bank Indonesia and OJK on the banking sector in Indonesia, earning management practices still occur. The management cases in banks in Indonesia are the cases of Bank Lippo in 2002 and Bank Century in 2008. Especially in the case of Bank Lippo, there was fraud that occurred in its financial statements. In the published report, Bank Lippo recorded total assets of IDR 24 trillion and net profit of IDR 98 billion, with a capital adequacy ratio (CAR) of 24.77% as of December 27, 2020. However, the report is not in line with the data released by the Jakarta Stock Exchange on the same date, where the total listed assets only reached Rp 22.8 trillion. This difference creates a difference of Rp 1.2 trillion between the two reports. As a result of this manipulation, Bank Lippo was declared to have suffered a loss of IDR 1.3 trillion.

In a company's financial reporting, if there is a condition where the management does not succeed in achieving the profit target determined by the company, then the management will take advantage of the flexibility allowed by accounting standards in compiling the company's financial statements to modify the reported profit. Information asymmetry can be used by managers, thus allowing management to manage profits. Management will be motivated to tend to show good company performance in generating maximum value or profit for the company, thus management will tend to choose and apply accounting methods that are able to provide better information on the company's profits

2. Theoretical Background

2.1 Earning Management

According to Healy and Wahlen (1999), earnings management is the use of accounting discretion by management to achieve specific objectives. A similar view is expressed by Schipper (1989), who defines earnings management as the intentional intervention in external financial reporting. Furthermore, Scott (2015) adds that earnings management is carried out to maximize managerial utility, such as performance-based bonuses or stock prices.

According to Febyani & Devie (2017) Earning management is an intervening factor in predicting the value of a company with independent variables of managerial ownership. Furthermore, fundamental research with Earning management as an intervening variable has been carried out by Zurriah & Sembiring (2020) also explaining that earning

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management is an intervening factor in predicting company value with variables independent of company size and leverage.

Studies from previous research have explained that there are factors that empirically have an impact on earning management, namely the influence of CGPI, leverage, quality auditor, auditor independence, reputation auditor (Insani et al, 2016). Then other factors such as CGPI, firm size and leverage are able to significantly affect earning management (Wira et al, 2019). In addition, other factors such as leverage; abnormal cash flow; abnormal production cost; abnormal discretionary expenses can significantly affect earning management (Zamri et al, 2013). Other factors such as the board of directors, institutional ownership, managerial ownership, independence of commissioners, the size of the audit committee is also able to affect earning management (Nuryana & Surjandari, 2019).

2.2 The Effect of Company Size on Earning management

Moses (1997) suggested that companies with larger firm sizes have a greater incentive to do profit equalization (a form of earning management) compared to small companies, as a political cost. The larger the size of the company, the higher the tendency of the company to practice earning management. The size of the company indicates the amount of information contained in it, so that the size of the company is part of or related to the public's attention with its performance. Large companies that present financial statements that are not in accordance with public expectations tend to cause turmoil that can endanger the company's health. Companies with large sizes tend to do profit alignment such as earning management to avoid unexpected turbulence. Companies with large firm sizes that tend to do earning management will incur increasingly political costs to attract attention from the media and consumers (Yendrawati & Wahyu, 2010). A firm size company has many stakeholders. that various policies of large companies (firm size) will have a greater impact on the public interest compared to small companies. For investors, the company's policies will have implications for the company's future cash flow prospects. For the government, large companies will have an impact on a number of taxes that will be imposed by the government. as well as the effectiveness of government policies in providing protection to public companies (Pambudi & Sumantri, 2014). This is also explained by Siregar & Utama (2008), where it is explained in his research that firm size has a significant positive influence on the earning management of 144 Public Go Companies on the Jakarta Stock Exchange in 1994-2002. Based on the explanation of the previous research above, the researcher proposed the following hypothesis:
H1: The size of the company has a positive effect on earning management.

2.3 The Influence of Leverage on Earning management

Leverage describes the external source of funds used as the company's operational capital and leverage also indicates the company's risk. Leverage is a ratio that shows the extent to which the company is financed by debt. The larger the leverage ratio indicates that the greater the level of dependence on the company's external parties (creditors) and the greater the debt burden (interest costs) that must be paid by the company. The size of the company's debt level (leverage) can affect the actions of earning management. High leverage caused by the lack of careful management or the implementation of inappropriate strategies from the management in managing the company's finances. Therefore, the lack of supervision leads to high leverage, this will increase oppurtunistic actions such as earning management to maintain its performance in the eyes of

shareholders and the public. Lazzem & Jilani's (2017) research explains that there is a significant positive influence of leverage on earning management. This explains that increasing leverage will improve earning management and conversely lowering leverage will lower earning management. Lazzem & Jilani (2017) took a research sample on French companies listed in the CAC from 2006 to 2012. The higher the leverage the company will tend to do earning management. In positive accounting theory, the debtor must maintain a debt-to-equity ratio during the loan agreement period. Therefore, managers of companies that have a large leverage ratio will tend to perform earning management to meet the requirements. Based on the explanation of the previous research above, the researcher proposed the following hypothesis:
H2: Leverage Positive Influence on Earning management

2.4 The Influence of Managerial Ownership on Earning management

Managerial ownership is another type of ownership that plays a crucial role in monitoring a company's profit manipulation activities. In fact, business executives can be managers and shareholders in the companies they manage. Agency conflicts often occur when there is a separation between ownership and control. Jensen and Meckling (1976) argue that, as the amount of equity held by managers increases, they (themselves and shareholders) will be more responsible in using capital. However, when the ownership ratio increases to a certain degree, managers will face the phenomenon of entrenchment. When managers hold a large proportion of shares, they are more influential and have voting power, and they can focus more on personal interests. This is in line with the empirical evidence described in previous research by Warfield, et al (2015) that increased managerial ownership will lead to a significant increase in earning management. Warfield, et al (2015) took a sample of 4,778 firm-year observations at the SEC. The results of Warfield et al's (2015) research showed that if managerial ownership increases, earning management will also experience a significant increase. Likewise, vice versa, if managerial ownership decreases, there will be a significant decrease in earning management. The results of Warfield et al's (2015) research are supported by the research of Kazemian & Sanusi (2015) which also shows that managerial ownership has a significant positive effect on earning management. Based on the explanation of the previous research above, the researcher proposed the following hypothesis:
H3: Managerial ownership has a positive effect on earning management

2.5 The Influence of Institutional Ownership on Earning management

Institutional ownership is the ownership of shares owned by companies/institutions such as insurance companies, banks, investment companies, governments, and other institutional owners. Institutional ownership has the ability to control management through an effective monitoring process thereby reducing earning management. Institutional investors have more time to analyze investments and have access to expensive information compared to individual investors. Therefore, the analysts of institutional investors have the ability to supervise management actions better than individual investors. According to Jensen and Meckling (1976) Institutional Ownership is the main corporate governance mechanism that helps control agency problems (agency conflicts). High Institutional Ownership can be used to reduce agency issues. The existence of institutional ownership such as insurance companies, banks, investment companies and ownership by other institutions will encourage performance management monitoring to be more optimal. The higher the Institutional Ownership, the smaller the

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chance of management manipulating numbers in the form of earning management. The relationship of institutional ownership to earning management can be explained in the research of Schmidt & Fahlenbrach (2017) that institutional ownership has a significant negative effect on the value of the company. Based on the explanation of the previous research above, the researcher proposed the following hypothesis:
H4: Institutional ownership has a negative effect on earning management

3. Methods

3.1 Research Variables

This study uses a quantitative approach that emphasizes numerical data analyzed through statistical methods, specifically panel data regression and moderated regression analysis, to examine the causal relationship between independent variables (company size, leverage, managerial ownership, and institutional ownership) and the dependent variable (company value) of banking firms listed on the Indonesia Stock Exchange. Company size is measured using total assets based on Baker & Wurgler (2002), while leverage is calculated as the ratio of total debt to total assets. Managerial and institutional ownership are measured using the percentage of shares owned by management and institutions, respectively, as referenced in Nia et al. (2017). Company value is measured using the Price to Book Value (PBV) ratio.

3.2 Sample Determination

The population used in this study is 47 banking companies listed on the Indonesia Stock Exchange during the period 2017 to 2023. Non Probability Sampling is a process of sampling that is subjective, in this case the probability of selecting population elements cannot be determined and purposive sampling is a form of sample sampling based on certain criteria (Sugiyono, 2013).

Table 1. Sampling Process

No.	Sample Characteristics	Sum
1	The population is companies engaged in the banking sector listed on the Indonesia Stock Exchange for the period 2018-2023.	47
2.	Companies engaged in the banking sector that are not consecutively listed on the Indonesia Stock Exchange for the period 2018-2023	7
3.	Companies engaged in the banking sector that are no longer listed (delisting) on the Indonesia Stock Exchange for the period 2018-2023	3
4.	Banking companies that do not have complete financial statements for 6 years during the 2018-2023 period	8
5.	Banking companies that are Islamic banks.	3
6.	A local government-owned banking company that goes public.	3
7.	Banking companies that have IPO before 2018 and have never been delisted by the Indonesia Stock Exchange	38
Final Sample Count		20
Year of Observation		7
Number of Observations		140

3.3 Analysis Method

In this researcher, panel data was used. According to Gujarati (2017:195) states that the panel data technique is to combine the types of cross-section and time series data.

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Regression using panel data is called the panel data regression model this study can be formulated as follows:

$$MALAit = \alpha + \beta 1\ SIZEit + \beta 2\ LEVit + \beta 3\ KEPMit + \beta 4\ KEPIit + \varepsilon it;$$

4. Results and Discussion

4.1 Descriptive Statistical

Table 2. Descriptive Statistical Analysis Results

	SIZE	LEV	KEPM	KEPI	MALA
Mean	32.60204	6.087005	0.015150	0.751396	-0.002902
Median	32.81221	5.662120	0.000270	0.820687	-0.000341
Maximum	35.31545	16.07858	0.555500	0.999900	0.211891
Minimum	29.57903	1.559792	0.000000	0.333700	-0.199769
Std. Dev.	1.507494	2.502697	0.068897	0.186454	0.067759
Skewness	-0.206039	1.688651	7.118154	-0.316361	-0.198324
Kurtosis	2.318829	6.422124	55.20847	1.714004	3.911489
Jarque-Bera	3.697176	134.8497	17082.32	11.98238	5.764159
Probability	0.157459	0.000000	0.000000	0.002501	0.056018
Sum	4564.285	852.1807	2.121054	105.1954	-0.406285
Sum Sq. Dev.	315.8830	870.6255	0.659797	4.832349	0.638187
Observations	140	140	140	140	140

The table above provides an overview or description of a data viewed from the mean value, standard deviation, maximum value, and minimum value. The average value of earning management is -0.002902 with a standard deviation of 0.067759. The company size has an average value of 32.60204 with a standard deviation of 1.507494. The leverage has an average value of 6.087005 with a standard deviation of 2.502697. The average value of institutional holdings is 0.751396 with a standard deviation of 0.186454. Managerial holdings have an average value of 0.015150 with a standard deviation of 0.068897.

4.2 Discussion of Research Results

The selection of panel data regression estimation techniques is known to three types of estimation approaches, namely common effect models, fixed effect models and random effect models. Based on the two tests, namely the Chow test and the Hausman test, the right model for the research model for the 2017-2023 period is the fixed effect model, so there is no need to carry out further statistical testing (Lagrange Multiplier Test). The following is the conclusion table of the model selection:

Table 6. Conclusion of Testing the research model for the 2017-2023 period

No	Method	Testing	Result
1	Chow-Test	Common Effect vs Fixed Effect	Fixed Effect
2	Hausman Test	Fixed Effect vs Random Effect	Fixed Effect

Source: data processed

Table 7. Panel Data Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.766085	0.671210	2.631197	0.0097
SIZE	-0.055048	0.020735	-2.654822	0.0090
LEV	-0.009689	0.003849	-2.517102	0.0132
KEPM	-0.040429	0.016201	-2.495436	0.0140

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KEPI	0.113516	0.018324	6.194868	0.0000
R-squared	0.716976	Mean dependent var		0.007871
Adjusted R-squared	0.681549	S.D. dependent var		0.079065
S.E. of regression	0.070569	Sum squared resid		0.577686
F-statistic	2.340568	Durbin-Watson stat		2.239820
Prob(F-statistic)	0.001657			

Based on table 7, the results of the hypothesis test from the panel data regression show that the company size variable partially has a significant negative effect on the earning management of banking companies going public in the 2017-2023 period, with a regression coefficient value of magnitude and probability value (Prob.) 0.0090 is smaller than 0.05. shows that any decrease in the size of banking firms will be able to significantly improve the earning management of banking firms.

The leverage variable partially has a significant negative effect on the earning management of banking companies going public in the 2017-2023 period, this shows that the higher the level of leverage of the company, the less likely it is that the company is involved in earning management. This can happen because high-leverage companies tend to have greater financial liabilities, which encourages them to maintain credibility and avoid the risk of profit manipulation that could affect market or creditors' perceptions of their ability to meet debt obligations.

The variable of managerial ownership partially has a significant negative effect on the earning management of banking companies going public in the period 2017-2023, the higher the level of managerial ownership, the lower the likelihood of the company to engage in earning management practices. This phenomenon is consistent with the basic principle of Agency Theory, which states that when managers own a company's shares, they tend to pay more attention to the long-term interests of the company and shareholders, rather than just seeking short-term profits. Therefore, they will avoid manipulating profits that can harm the company's reputation and value in the long run. In this case, managers who own private shares are more likely to maintain the company's value and improve long-term performance because they will also feel the direct impact of stock price fluctuations.

The variable of institutional ownership partially has a significant positive effect on the earning management of banking companies going public in the 2017-2023 period, this positive influence indicates that the higher the level of institutional ownership in the company, the greater the likelihood of earning management. Institutions, such as pension funds, insurance companies, or other institutional investors, often have short-term goals related to a company's financial performance. They tend to want quick results that can be seen directly in the company's financial statements. Therefore, they may encourage management to conduct earning management to make the company's performance look better in the short term to meet market expectations or to keep the stock price stable.

5. Conclusion

The results of the study show that the size of the company partially has a significant negative effect on the earning management of banking companies going public in the 2017-2023 period Leverage partially has a significant negative effect on the earning management of banking companies going public in the period 2017-2023. Partial managerial ownership has a significant negative effect on the earning management of banking companies going public in the 2017-2023 period. Partial institutional ownership

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has a significant positive effect on the earning management of banking companies going public in the 2017-2023 period

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