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THE EFFECT OF MANAGERIAL OWNERSHIP, INSTITUTIONAL OWNERSHIP, AND OTHER FACTORS ON EARNINGS MANAGEMENT

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Abstract: *The purpose of this research is to obtain empirical evidence regarding the factors that influence earnings management in consumer non-cyclicals and consumer cyclicals companies listed in Indonesia Stock Exchange (IDX). The independent variables used in this research are managerial ownership, institutional ownership, firm size, leverage, profitability, sales growth, board size, and free cash flow. The population of this research are consumer non-cyclicals and consumer cyclicals companies listed in Indonesia Stock Exchange (IDX) with a research period of 2020-2022. The sample used in this research amounted to 66 companies with 198 data obtained from data collection techniques in the form of purposive sampling. The hypothesis testing method used in this research is multiple regression method. The result of this research found that profitability has a positive effect on earnings management. In contrast, institutional ownership and free cash flow have negative effects on earnings management. On the other hand, managerial ownership, firm size, leverage, sales growth, and board size have no effect on earnings management. A company who has higher profits will attract investors because the company will have a higher rate of return. This motivates management to perform earnings management. Companies with a higher percentage of institutional ownership and amount of free cash flow might substantially reduce their earnings management. Having more institutional ownership would reduce the discretionary accounting accrual activities and a higher amount of free cash flow shows that a company has enough money to meet its financial and operational needs.*

Keywords: Board Size, Earnings Management, Free Cash Flow, and Sales Growth

Abstrak: Penelitian ini bertujuan untuk memperoleh bukti empiris mengenai faktor-faktor yang mempengaruhi manajemen laba pada perusahaan *consumer non-cyclicals and consumer cyclicals* yang terdaftar di Bursa Efek Indonesia (BEI). Variabel independen yang digunakan dalam peneilitian ini adalah kepemilikan manajerial, kepemilikan institusional, ukuran perusahaan, *leverage*, profitabilitas, pertumbuhan penjualan, ukuran dewan komisaris, dan arus kas bebas. Populasi penelitian ini adalah perusahaan *consumer non-cyclicals and consumer cyclicals* yang terdaftar di Bursa Efek Indonesia (BEI) dengan periode penelitian 2020-2022. Sampel yang digunakan dalam penelitian ini terdiri dari 66 perusahaan dengan 198 data yang diperoleh dari teknik pengumpulan data berupa *purposive sampling*. Metode pengujian hipotesis yang digunakan dalam penelitian ini adalah metode regresi berganda. Hasil penelitian ini menunjukkan bahwa profitabilitas memiliki pengaruh positif terhadap manajemen laba. Sebaliknya, kepemilikan institusional dan arus kas bebas memiliki pengaruh negatif terhadap manajemen laba. Selain itu, kepemilikan manajerial, ukuran perusahaan, *leverage*, pertumbuhan penjualan, dan ukuran dewan komisaris tidak memiliki pengaruh terhadap manajemen laba. Perusahaan dengan persentase kepemilikan institusional yang lebih tinggi dan jumlah arus kas bebas yang lebih besar akan mengurangi praktik manajemen laba mereka. Kepemilikan institusional yang lebih tinggi akan mengurangi *discretionary accounting* *accrual* dan jumlah arus kas bebas yang lebih tinggi menunjukkan bahwa perusahaan memiliki cukup uang untuk memenuhi kebutuhan keuangan dan operasionalnya.

Kata Kunci: Board Size, Earnings Management, Free Cash Flow, and Sales Growth

INTRODUCTION

Economic and business development has grown rapidly over time. It is getting harder to attract and/or keep several investors to fund business operations because of the tight competition. The amount of profit made is one of the metrics that can be used to assess the performance of the business. Financial reports are used to show management responsibility for the use of resources entrusted them to them as well as provide information about the company's financial position, performance, and cash flow to those who use financial statements as a base for decision-making.

Phenomena that often occur in earnings management are typically brought on by the financial management entity's itself and errors, which are either directly or indirectly influenced by a variety of internal and external causes. Earnings Management is the choice by a manager to implement accounting policies or take other real actions that have an impact on earnings. (Scott 2015, 445). Earnings Management is a type of financial statements manipulation used by managers to communicate with the company's external parties that might weaken the credibility of financial statements (Deviyanti and Sudana 2018).

In this research, researchers referred to research conducted by (Harahap 2021). The purpose of this research is to obtain empirical evidence regarding the effect of managerial ownership, institutional ownership, firm size, leverage, profitability, sales growth, board size, and free cash flow on earnings management. This research is expected to provide benefits to related parties such as, investors, creditors, and future researchers.

Agency Theory

A firm is seen as the result of formal "contracts," in which many organizations contribute in some way to the company in return for a specific "price". In these relationships, management is viewed as the "agent," looking for the assistance of "principals" such as creditors, stockholders, and employees (Hayes *et al.* 2015, 45). In most agency relationships, both the principle and the agent will incur positive monitoring and bonding costs (both financial and non-financial), and there will also be a gap between the agent's decisions and those that would maximize the principal's welfare (Jensen and Meckling 1976).

Earnings Management

Earnings Management is a type of financial statements manipulation used by managers to communicate with the company's external parties that might weaken the credibility of financial statements (Deviyanti and Sudana 2018). Earnings management is the potential use of accrual management to increase company earnings. It also refers to management disclosure, which is a direct management tool used to intervene in the financial reporting process through management income or earnings in order to obtain specific benefits or benefits for both managers and companies that are based on economic factors (Rusdiyanto and Narsa 2020)

Earnings management is performed to achieve several reasons, including to increase compensation, avoid debt covenants, satisfy analyst expectations, and affect stock prices. Managers are able to enhance the numbers by using their judgement and estimation skills by using accrual accounting. There are three common ways to manage earnings (1) Managers increase revenue for the current period. (2) Managers take a big bath by cutting current period income. (3) Managers lower the volatility of earnings by income smoothing (Subramanyam and Wild 2009, 108–9).

Managerial Ownership and Earnings Management

Managerial ownership is known as ownership of shares in a company by management. Earnings management is largely determined by how the company manager's motivation (Harahap 2021). If the manager owns the company's shares, he or she will act in the shareholders' best interests since both of them are shareholders (Ningrum 2021).

Higher levels of ownership would give managers a greater sense of entrenchment and, as a result, more scope for opportunistic behavior, which enhances earnings management (Mayasari *et al.* 2019). On the other hand, managers who are also shareholders will have different motives than managers who are not shareholders. Because managers' share ownership will be one of the factors that influence their decisions about the accounting practices used in the companies they manage, these differences will have an impact on the decisions made by management, including earnings management practices (Darsono 2015). In contrast, managers who also own ownership in the company frequently implement policies to manage earnings from the investor's point of view, such as increasing reported profits to attract more funding and increase the cost of the company's share (Agustia 2013).

H_1: Managerial ownership has influence on earnings management.

Institutional Ownership and Earnings Management

The ownership of a company's shares by other entities or companies is referred to as institutional ownership (such as insurance companies, banks, investment companies, and other institutional ownership) (Harahap 2021). Institutional investors only concentrate to current earnings. Therefore, managers will implement earnings management to achieve these investors' profit goals (Paramitha and Firnanti 2018).

On the other hand, companies with a higher share of institutional ownership may significantly decrease their earnings management. In contrast, an increase in institutional ownership would decrease the discretionary accounting accrual actions (Aygun *et al.* 2014). In contrast, institutional ownership is unable to reduce management in order to increase earnings management. This is because institutional investors act more like temporary owners who are more focused with current earnings rather than sophisticated investors who have the ability and opportunity to monitor and discipline managers to enhance their focus on firm value (Agustia 2013).

H_2: Institutional ownership has influence on earnings management.

Firm Size and Earnings Management

One of the measures used to categorize companies is firm size, which can be large, medium, or small. The total assets, number of sales, average sales, market value of the company's shares, and other factors can all be used to determine a company's size (Tjhai and Saniamisha 2019).

The public pays more attention to large companies so they will be more cautious when making financial reports and the company will report the conditions more accurately (Deviyanti and Sudana 2018). On the other hand, the relationship between company size and earnings management shows that the board of directors' motivation to manage earnings is not related with company size (Mayasari *et al.* 2019). In contrast, due to their reputation, big companies must manage their earnings in order to maintain that reputation (Yuliana and Trisnawati 2015).

H_3: Firm size has influence on earnings management.

Leverage and Earnings Management

Leverage is a measure of the amount of assets of a company that are funded through debt. Investor risk is increased by a high level of leverage (Firnanti *et al.* 2019). A high level of debt will be a clear indicator of a high risk for both parties. A higher leverage ratio prevents investors and creditors from lending money or investing in the company. Management will be going to be motivated to implement earnings management as an outcome of this (Setijaningsih and Merisa 2022).

Companies with high levels of leverage usually manage their earnings because they threaten bankruptcy and are unable to make loan payments on time (Nalarreason *et al.* 2019). On the other hand, high financial leverage means high debt levels for a company, which affects how tightly creditors are supervised. As a result, a company's level of earnings management can be controlled and lowered (Tjhai and Millenia 2021). In contrast, management is not strongly motivated to perform earnings management to prevent future loan agreement violations (Pradipta 2019).

H_4: Leverage has influence on earnings management.

Profitability and Earnings Management

Profitability is a benchmark for company performance in generating profits through the operation of assets owned. The higher the ratio, the better the company's productivity in generating net profit. This can motivate earnings management actions by the company (Harahap 2021).

Company's management typically engages in some form of earnings management activity to attract investors with what looks to be a high rate of return on assets in order for a company's performance to be considered "great" (Firnanti *et al.* 2019). On the other hand, companies that have high profit and accomplish their goals are quite unlikely to manipulate their profit (Djashan and Lawira 2019). In contrast, investors frequently ignore current ROA information, which demotivates management from implementing earnings management for profitability (Pujiati and Arfan 2013).

H_5: Profitability has influence on earnings management.

Sales Growth and Earnings Management

The rate of change in sales from one year to the subsequent one is indicated by the sales growth rate. The growth rate of a company will determine how much it relies on outside funding (Mahapsari and Taman 2013).

If the company has high sales growth, managers may decide to manipulate earnings to increase their bonus (Harahap 2021). On the other hand, companies with high sales growth can easily attract potential investors. This obviously reduces the possibility of earnings management practices (Firnanti *et al.* 2019). In contrast, sales growth is not an indication of a company in implementing earnings management practices (Valensia and Trisnawati 2019).

H_6: Sales growth has influence on earnings management.

Board Size and Earnings Management

Board size is determined by the number of commissioners on a board (Jastin *et al.* 2020). The board of commissioners may have an impact on the willingness of a company to engage in earnings management activities and can be viewed as an internal control instrument (Firnanti *et al.* 2019).

Placement or addition to the independent board of commissioners' composition is allowed only to satisfy the requirements of the law, and the majority shareholders (controllers/founders) tend to have a significant impact on the board's performance (Suheny 2019). On the other hand, the addition of board of commissioners will reduce earnings management practices within the company due to increased supervision (Chandra and Djashan 2019) In contrast, the number of commissioners in a company will not influence management to perform earnings management practices (Firnanti *et al.* 2019).

H_7: Board Size has influence on earnings management.

Free Cash Flow and Earnings Management

Cash is one of the company's current assets that is quite easy to manipulate. The remaining cash that has been distributed to investors and used for additional investment is known as free cash flow. High free cash flow companies will have a higher opportunity to manage earnings (Ramadhani *et al.* 2017).

Companies with significant free cash flow usually don't manage their earnings because without doing so, companies can still raise the price of their shares because investors can see that they have additional funds for paying dividends (Pradipta 2019). As there is no longer a need to attract in new investors, the company's management may no longer be motivated to conduct in earnings management (Firnanti *et al.* 2019).

On the other hand, the higher the free cash flow, the management will tend to earnings management by increasing profit. In contrast, if the company has limited free cash flow, management tends to do earnings management by limiting free cash flow (Jastin *et al.* 2020).

H_8: Free cash flow has influence on earnings management.

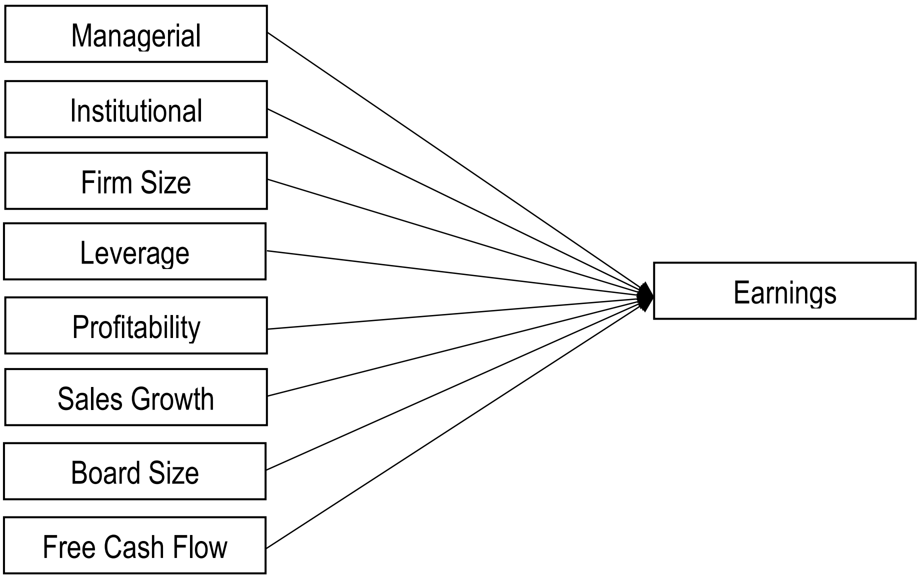

Figure 1. Research Model

Table 1. Sample Selection Procedure

	Criteria Description	Total Companies	Total Data
1	Consumer non-cyclicals and consumer cyclicals that are consistently listed in Indonesia Stock Exchange (IDX) from 2019-2022.	192	576
2	Consumer non-cyclicals and consumer cyclicals that did not consistently publish financial statements as of December 31st from 2019-2022.	(14)	(42)
3	Consumer non-cyclicals and consumer cyclicals that did not consistently use IDR currency in their financial statements from 2019-2022.	(13)	(39)
4	Consumer non-cyclicals and consumer cyclicals companies that did not consistently earn profit from 2020-2022.	(97)	(291)
5	Consumer non-cyclicals and consumer cyclicals that did not consistently have institutional ownership in their financial statements from 2020-2022.	(2)	(6)
	Total sample of companies which are used in this research	**66**	**198**

Source: Processed data obtained from IDX

RESEARCH METHOD

The population used in this research is taken from consumer non-cyclical and consumer cyclical companies listed in Indonesia Stock Exchange (IDX) 2020-2022. This research uses the purposive sampling technique as the sampling method based on the criteria determined by the researcher. The sample used in this research consist of 66 consumer non-cyclical and consumer cyclical companies with the stages of selecting are based on the predetermined criteria that presented in the table 1.

OPERATIONAL DEFINITION AND VARIABLE MEASUREMENT

Earnings management is planned timing of gains, losses, and expenses to smooth out earnings fluctuations (Kieso *et al.* 2017). In this research, earnings management is calculated using the discretionary accrual calculation of the Modified Jones model. The Modified Jones model calculates accrual rates based on the difference between the change in revenue and receivable, along with the level of property, plant, and equipment. The following proxies according to (Dechow *et al.* 1995) in (Saftiana *et al.* 2017):

1. Calculate the total accruals
   Total Accruals (TAC) = Net Income – Cash Flow from Operating
2. Calculate the estimated total accruals
   $$\frac{TAC_t}{A_{t-1}} = \alpha_1\left(\frac{1}{A_{t-1}}\right) + \alpha_2\left[\frac{\Delta REV_t - \Delta REC_t}{A_{t-1}}\right] + \alpha_3\left(\frac{PPE_t}{A_{t-1}}\right) + e$$
3. Calculate the nondiscretionary accruals (NDA)
   $$NDA_t = \alpha_1\left(\frac{1}{A_{t-1}}\right) + \alpha_2\left[\frac{\Delta REV_t - \Delta REC_t}{A_{t-1}}\right] + \alpha_3\left(\frac{PPE_t}{A_{t-1}}\right)$$
4. Calculate discretionary accruals
   $$DA_t = \left(\frac{TAC_t}{A_{t-1}}\right) - NDA_t$$

Where:
TAC_t : total accruals in period t
A_{t-1} : total assets in the end of year t-1
ΔREV_t : change of revenue from the year t-1 to t
ΔREC_t : change of account receivable from year t-1 to t
PPE_t : gross property plant and equipment in year t
e : error
α_1, α_2, α_3 : fitted coefficients

Detection of earnings management is identified through fluctuations in profits. Companies are not engaging in earnings management when the total accrual equals the NDA score, which is zero. A positive discretionary accrual implies that the company engaging in earnings management by increasing income, whereas a negative discretionary accrual indicates that the company engaging in earnings management by decreasing income (Saftiana *et al.* 2017).

Managerial Ownership

Managerial ownership is defined by the amount of a company's shares owned by managers, directors, and commissioners. (Firnanti *et al.* 2019). In this research, Managerial Ownership symbolized as MO and using nominal scale. According to the research carried out by (Firnanti *et al.* 2019), managerial ownership is measured using dummy variable where 1 for companies with managerial ownership while 0 for firms with no managerial ownership.

Institutional Ownership

Institutional Ownership is defined by the percentage of a company's shares held by institutions, such as government (Firnanti *et al.* 2019). In this research, institutional ownership symbolized as IO and using ratio scale. According to the research carried out by (Firnanti *et al.* 2019), institutional ownership is calculated by:

IO = Proportion of share ownership owned by non-management companies

Firm Size

Firm size refers to the process of determining the size of a company. Firm size is crucial for creditors and investors because it will affect the investment risk taken (Harahap 2021). In this research, firm size symbolized as FSIZE and using ratio scale. According to the research carried out by (Firnanti *et al.* 2019), firm size is measured by:

FSIZE = Log Naturals of Total Assets

Leverage

Leverage is a measure of the amount of assets of a company that are funded through debt (Firnanti *et al.* 2019). In this research, leverage symbolized as LEV and using ratio scale. According to the research carried out by (Firnanti *et al.* 2019), leverage is measured by:

LEV = Total Liabilities/Total Assets

Profitability

Profitability refers to the ability of management to generate income by using resources used for operating activities (Harahap 2021). In this research, profitability symbolized as ROA and using ratio scale. According to the research carried out by (Firnanti *et al.* 2019), profitability is measured by:

ROA = Net Income After Tax/Total Assets

Sales Growth

Sales growth is an indicator of changes in sales from year to year (Harahap 2021). In this research, sales growth is symbolized as SG and using ratio scale. According to the research carried out by (Firnanti *et al.* 2019), sales growth is measured by:

SG = Percentage of change in sales

Board Size

Board can be seen as one of the crucial internal monitoring tools that may have an impact on a company's earnings management Aygun(Aygun *et al.* 2014). In this research, board size is symbolized as BSIZE and using ratio scale. According to the research carried out by (Firnanti *et al.* 2019), board size is measured by the number of boards of commissioner.

Free Cash Flow

Free cash flow is the actual cash flow provided to investors after all necessary working capital and investment after the company maintained the operational continuity (Firnanti *et al.* 2019). In this research, free cash flow is symbolized as FCF and using ratio scale. According to the research carried out by (Susanto and Pradipta 2020), free cash flow is measured by:

FCF = (Operating Cash Flow – Investing Cash Flow)/Total Assets

RESEARCH RESULT

The result of descriptive statistics for the data in this research can be seen in Table 2. In the research that has been done, 66 companies with 198 data have met the criteria of this study. The results of the data normality test in this research show that the residual data is normally distributed, so the outlier test is not conducted. The results of the correlation coefficient (R) analysis show very strong and positive relationship between the dependent variable, and the result of the coefficient of determination analysis (Adjusted R Square) shows that 66.8% of the variation in the dependent variable of earnings management can be explained by the independent variables. The results of the F statistical test simultaneously show that the independent variable used have an influence on earnings management. Managerial Ownership is measured by dummy variable. Table 3 provides information about managerial ownership frequency statistic test result.

Table 2. Descriptive Statistics Result

Variables	N	Minimum	Maximum	Mean	Std. Deviation
EM	198	-0.26999	0.81510	4.02239E-17	0.11283
MO	198	0	1	0.75	0.433
IO	198	0.00048	0.99976	0.79591	0.25003

FISZE	198	26.28277	32.82638	29.23904	1.50151
LEV	198	0.00042	0.88815	0.40073	0.19641
ROA	198	0.00011	0.49303	0.08117	0.07316
SG	198	-1	2.65523	0.12047	0.33111
BSIZE	198	2	9	3.91	1.492
FCF	198	-0.21409	0.53602	0.13956	0.13924

Source: Data Output of SPSS 26

Table 3. Managerial Ownership Frequency Table

Description	Frequency	Percentage
Companies with no managerial ownership (0)	49	24.7
Companies with managerial ownership (1)	149	75.3
Total	198	100

Source: Data Output of SPSS 26

Table 4. t-Test Result

Variables	B	Sig.	Decision	Conclusion
(Constant)	0.032	0.752		
MO	0.004	0.736	H_1 not supported	No Influence
IO	-0.048	0.020	H_2 supported	Has Influence
FSIZE	0.000	0.912	H_3 not supported	No Influence
LEV	-0.010	0.718	H_4 not supported	No Influence
ROA	1.008	0.000	H_5 supported	Has Influence
SG	-0.023	0.114	H_6 not supported	No Influence
BSIZE	0.002	0.679	H_7 not supported	No Influence
FCF	-0.650	0.000	H_8 supported	Has Influence

Source: Data Output of SPSS 26

Based on the results of individual parameter statistical test or t test in the table 4, the regression equation obtained in this research are as follows:

EM = 0.032 + 0.004 MO – 0.048 IO + 0.000 FSIZE – 0.010 LEV + 1.008 ROA – 0.023 SG + 0.002 BSIZE – 0.650 FCF + ε

The results show that the value of constant is 0.032. It means that if the value of all independent variables (managerial ownership, institutional ownership, firm size, leverage, profitability, sales growth, board size, and free cash flow) is 0, the value of dependent variables (EM) will be 0.032.

The Influence of Managerial Ownership on Earnings Management.

Managerial Ownership (MO) has a significance value of 0.736, which is above 0.05. Therefore, H_1 is not supported. It means that managerial ownership has no influence on earnings management.

The Influence of Institutional Ownership on Earnings Management.

Institutional Ownership (IO) has a significance value of 0.020, which is below 0.05. Therefore, H_2 is supported. The coefficient of institutional ownership is -0.048 which can be interpreted institutional ownership has negative influence on earnings management. Companies with a higher percentage of institutional ownership might substantially reduce their earnings management. Having more institutional ownership would reduce the discretionary accounting accrual activities (Aygun *et al.* 2014).

The Influence of Firm Size on Earnings Management.

Firm Size (FSIZE) has a significance value of 0.912, which is above 0.05. Therefore, H_3 is not supported. It means that firm size has no influence on earnings management.

The Influence of Leverage on Earnings Management.

Leverage (LEV) has a significance value of 0.718, which is above 0.05. Therefore, H_4 is not supported. It means that leverage has no influence on earnings management.

The Influence of Profitability on Earnings Management.

Profitability (ROA) has a significance value of 0.000, which is below 0.05. Therefore, H_5 is supported. The coefficient of profitability is 1.008 which can be interpreted profitability has positive influence on earnings management. The profits of a company that are shown in its financial statement are crucial for both existing and potential investors. Higher profits will attract investors because the company will have a higher rate of return. The higher this ratio indicates efficient use of assets to obtain net profit. This motivates management to perform earnings management (Harahap 2021).

The Influence of Sales Growth on Earnings Management.

Sales Growth (SG) has a significance value of 0.114, which is above 0.05. Therefore, H_6 is not supported. It means that sales growth has no influence on earnings management.

The Influence of Board Size on Earnings Management.

Board Size (BSIZE) has a significance value of 0.679, which is above 0.05. Therefore, H_7 is not supported. It means that board size has no influence on earnings management.

The Influence of Free Cash Flow on Earnings Management.

Free Cash Flow (FCF) has a significance value of 0.000 which is above 0.05. Therefore, H_8 is supported. The coefficient of free cash flow is -0.650, which can be interpreted as free cash flow has negative influence on earnings management. High amount of free cash flow shows that a company has enough money to meet its financial and operational needs. Therefore, the company might not have a reason to perform earnings management because there is no need to attract more investors (Firnanti *et al.* 2019).

CLOSING

The result of this research found that profitability has a positive effect on earnings management. In contrast, institutional ownership and free cash flow have negative effects on earnings management. On the other hand, managerial ownership, firm size, leverage, sales growth, and board size have no effect on earnings management.

Some limitations that emerged in this research and need to be considered for future research are 1) The research object period taken is relatively short, starting from 2020 to 2022, means it may not accurately describe the company's actual conditions over the long run. 2) The research objects are limited to consumer non-cyclicals and consumer cyclical companies. 3) In the heteroscedasticity test, one independent variable, profitability, does not meet the requirements.

Based on the description of the limitations above, the following describes several recommendations that might help future research related to earnings management 1) Subsequent research can extend the period of research object, so the research can describe the company's actual conditions over the long run. 2) Subsequent research can expand the research object by using other industries. 3) Subsequent research can perform data transformation on the independent variables in this research that has heteroscedasticity problem.

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