

# THE INFLUENCE OF PROFITABILITY, LEVERAGE, PUBLIC SHARE OWNERSHIP AND INSTITUTIONAL OWNERSHIP TO EARNINGS MANAGEMENT (Case study at consumer goods industry sector listed on the BEI during the period 2013-2015)

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## ABSTRACT

*Based on agency theory, earnings management occurs because of differences in economic interests between managers as agents and owners of companies as principals, where each party seeks to achieve the desired level of prosperity. Many factors affect both internal and external earnings management. This study aims to determine the effect of profitability, leverage, public share ownership (PSO) and institutional ownership (INS) to earnings management (earning management). The sample in this research is the consumer goods industry sector listed on the BEI during the period 2013-2015. By using purposive sampling method, there are 42 companies that meet the criteria. Methods of data collection is done through documentation study and literature study. Data analysis techniques using descriptive statistical analysis, classical assumption test, and multiple linear regression analysis. The result of the research gives the conclusion that partial profitability, leverage, public share ownership and institutional ownership have no effect to earnings management. While simultaneously all independent variables have no effect on earnings management.*

**Keywords:** Profitability; Leverage; Public Ownership; Institutional Ownership;

## INTRODUCTION

Earnings management is a frequent agency problem in the business environment. Profit management behavior undertaken by management, originated from the agency conflict is a conflict of interest between the owner or shareholders as principal and manager as an agent. The owner has an interest in earning an ever-increasing profit so as to achieve maximum stock returns. Agencies interested in getting large contract compensation to achieve prosperity. Thus there are two different interests within the enterprise, in which each party seeks to achieve the desired level of prosperity. This will encourage agents to make earnings management.

One of the motivations that can trigger the emergence of earnings management is the motivation by utilizing Initial Public Offering (IPO) activities as a condition of information asymmetry in order to obtain a high

initial stock price (Scott, 2009). Companies that make earnings management before IPO is PT. Katarina Utama (RINA).

Before the IPO, PT Katarina Utama allegedly beautify the financial statements of 2008 and 2009. In the 2008 financial statement document the value of the company's assets seen rose almost 10-fold to Rp 76 billion in 2008 from Rp 7.9 billion in 2007. The company's equity was up 16 fold from Rp 4.49 billion to Rp 64.3. In the 2009 audit financial report, PT. Katarina listed receivables from PT. Media Intertel Graha (MIG) of Rp 8.606 billion and revenue from MIG amounting to Rp 6.773 billion. PT Katarina Utama Tbk made asset bubbles by including a number of fictitious projects worth Rp 29.6 billion. In 2010, the number of assets seen shrank drastically from Rp 105.1 billion in 2009, to Rp 26.8 billion. The equity dropped to Rp 20.43 billion from Rp 97.96 billion. The revenue only recorded Rp 3.7 billion, which was Rp 29.9 billion. The company also suffered a loss of Rp 77 billion from the previous period which earned Rp 55 billion (Source: Detik.com).

From this phenomenon, it can be concluded that PT Katarina Utama Tbk has made earnings management before IPO to beautify its financial statements is increasing the amount of income and assets, in order to attract investors who will buy shares of PT Katarina Utama. However, in 2010 PT Katarina Utama Tbk suffered losses of up to Rp 77 billion. In this case, the profit management technique used is to shift the period of cost or income with the pattern of income maximization which aims to increase profits when filing an IPO.

Profit management is inseparable from several factors that influence it. One of the factors affecting earnings management is profitability. Profitability shows the company's ability to generate profits. Fahmi (2011) said that profitability ratio is a ratio that measures the overall effectiveness that shows the company's ability to gain profit in relation to sales or investment. In research Bestivano (2013) states that profitability does not affect the earnings management, in contrast to research conducted by Wibisana and Ratnaningsih (2014) states that the level of profitability affects earnings management action.

Another factor affecting earnings management other than profitability is leverage. The ratio of leverage shows the comparison of funds borrowed from creditors compared to the funds provided by the owner. Leverage is measured by the ratio of total debt to total equity. In research of Agnes Utari Widyaningdyah (2001) concluded that leverage have significant effect to earnings management while result of research conducted by Subhan (2011) stated that leverage result negatively to earnings management.

The next factor is public share ownership. Public shareholding is the number of shares offered to the public during Initial Public Offering (IPO) by management to offer investment to the public (Rahman et al, 2014).

Azlina (2010) states that there is no influence between public stock and earnings management. But not in accordance with research conducted Rahman et al. (2014) who found that public shareholdings have a significant effect on earnings management.

Institutional ownership is the percentage of voting rights owned by the institution (Beiner et al, 2003). Parties such as investment companies, banks, insurance institutions and other institutions. According to Boediono (2005) the percentage of certain shares owned by an institution can affect the process of preparing financial statements that do not rule out the possibility of manipulation according to the interests of the management. Wahyuningsih (2009) states that institutional ownership has no effect on earnings management but contradicts the results of Indra Kusumawardhani (2012) study, which states that institutional ownership affects earnings management.

This study uses the consumer goods industry sector because this company has seasonal fluctuations in terms of sales. The company will move very strong sales during the holidays, christmas, and new year and will cause a turnover soaring in sales. But outside holiday, christmas and new year sales are few in economy this is often called seasonal cycles. If a company experienced a seasonal cycle, then the existing profit in the financial statements will experience fluctuating also that will impact on decision-making by interested parties such as investors. Therefore, to overcome this the management to do engineering financial statements or earnings management actions so that profits generated company remains stable.

Consumer goods industry sector consists of 5 sub-sectors, namely food and beverage sub sector, cigarette sub sector, pharmaceutical sub sector, cosmetic sub sector and household goods, and household appliance sub sector Based on the description of the background of the above problem, it is necessary to do research with the title: "Analysis of the effect of profitability, leverage, public share ownership, and institutional ownership of earnings management in the consumer goods industry sector.

## **LITERATUR REVIEW**

### **Profit Management**

Scott (2009) says that earnings management is an act of managers to choose accounting policies or actions that affect earnings to achieve certain goals in reporting earnings. However, earnings management differs from fraud because earnings management does not violate financial reporting standards. The management only utilizes the authority it possesses in choosing the accounting methods permitted by the standard. Earnings management is measured by discretionary accruals calculated using the Friedlan (1994) approach in Gumanti (2001,). Discretionary accruals are a comparison of total accruals in a tested period that are

standardized to sales in the test period and total accruals in the standardized period of base against sales during the base period. Systematically, the total accruals themselves constitute the difference between the operating net income and the cash flow from operating activities.

### **Factors Affecting Profit Management**

Watts and Zimmerman (1986) in Belkaoui (2006) explain that there are 3 factors related to manager behavior in choosing accounting policies. These three factors are called three positive accounting theory hypotheses.

- 1) Bonus Plan Hypothesis
- 2) Debt Covenant Hypothesis
- 3) Political Cost Hypothesis

### **Profit Management Pattern**

Scott (2003) says that the pattern of earnings management can be done in the following ways:

#### **1. Taking a Bath**

This pattern occurs at the time of re-organization including the appointment of a new CEO by reporting large losses. This pattern is done by the manager to maximize the compensation or bonus he receives in the next year due to the fact that bonuses this year are unacceptable.

#### **2. Income-minimization**

This is similar to taking a bath done when the company has a high profit rate so that if the profit in the next period is expected to fall drastically can be overcome by taking profit period earlier. In addition, income minimization is also intended for tax purposes (minimizing corporate tax liability).

#### **3. Income maximization**

Performed when profit decreased. Actions on income maximization aim to report high net income in order to get a bigger bonus. This pattern is also done by companies that do breach of debt agreement. With income maximization, then the company can create a good corporate performance that can increase the value of the company.

#### **4. Income Smoothing**

Firms make earnings management by way of leveling the reported earnings that can reduce the fluctuations in profits that are too large because investors generally prefer a relatively stable profit.

### **Relationship Profitability with Profit Management**

In relation to earnings management profitability can affect manager behavior to make earnings management. Because if the profitability obtained by the company is low, generally managers will take the action of earnings management for its performance in the eyes of the owner looks good. This is closely related to the business manager to show the best performance of the company he leads. Herni and Susanto (2008) explained that companies with low profitability tend to make income smoothing. Income smoothing is one form of earnings management. Managers tend to do this activity because with low profits or even a loss, will worsen the performance of managers in the eyes of the owner and will worsen the company's image in the public eye. So based on the above description can be formulated hypothesis as follows:

**H1: Profitability affects earnings management.**

### **Relationships Leverage with Earnings Management**

Widyaningdyah (2001) said that companies that have high leverage ratio due to the large amount of debt owned compared to the total assets of the company, allegedly earnings management because the company is threatened default that can not meet debt payment obligations at a predetermined time. The greater the debt the manager seeks to improve the company's financial performance. If the financial performance of the company does not succeed in accordance with the planned target then it can encourage managers to act opportunistic that is by reporting company earnings higher than they should. Thus, the higher the debt ratio of a company, the closer the company to the constraints in the debt agreement. Ssehingga based on the above description can be formulated hypothesis as follows:

**H2: Leverage affects earnings management**

### **Relationship Public Shares Ownership (PSO) and Earnings Management**

Public share ownership is the percentage of shares offered to the public when the IPO (Initial Public Offering) conducted by the management to offer investment to the public (Rahman, et al 2014). By conducting an IPO, it shows that there will be private information that managers should share with the public. The percentage of shares offered to the public affects the amount of information that will be shared to the public. The higher the percentage of shares offered to the public, the greater the amount of information that must be shared manager to the public (Rahman, et al 2014). Managers are obliged to provide internal information periodically as a form of accountability to public investors that can reduce the intensity of earnings management because of the supervision of the public investor.

So based on the above description can be formulated hypothesis as follows:

### **H3: Public share ownership affects earnings management**

#### **Relationship Institutional Ownership (INS) with Earnings Management**

Company supervision by an institutional investor can encourage managers to focus more attention on the company's performance so that it will reduce self-serving behavior and financial reports generated by the management will be more integrity. Veronica, et al (2005) research states that high institutional ownership can minimize earnings management, but it depends on a significant amount of ownership, so that it will be able to monitor the impacted management of reducing the manager's motivation to earn earnings management. Based on the above explanation, it can be concluded that the greater the share owned by the institutional shareholders will minimize the actions of managers to make earnings management. So that can be formulated hypothesis as follows:

### **H4: Institutional ownership affects earnings management.**

## **RESEARCH METHODS**

### **Research Variables**

Individual variables in this research are profitability, leverage, public share ownership, and institutional ownership. Dependent variable (variable dependent variable) is variable which become main concern in an observation. The dependent variable in this study is earnings management.

### **Profit Management**

Earnings management is the actions of managers to increase or decrease reported earnings from a unit that is the responsibility of the manager without relating it to the increase or decrease in long-term economic profitability Atmini (2007). The earnings management in this study is proxied by the discretionary accruals calculated using the Friedlan (1994) approach in Gumanti (2001). Discretionary accruals are the difference between the accruals value in a tested period that is standardized to the sale during the test period and the total accruals in the base period standardized by sales in the base period or earlier. Systematically, total accruals are the difference between net operating income and cash flow operating cash flow, in calculating total accrual using the following formula:

$$TA = NOI - CFO$$

Notes:

TA = Total Accruals; NOI = Net Operating Income;

CFO = Cash Flow Operating

Then we will measure the value of discretionary accruals by using the equation:

$$DAC_{pt} = \frac{T_{Apt}}{SALE_{pt}} - \frac{T_{Apd}}{SALE_{pd}}$$

Notes:

$DAC_{pt}$  = Discretionary Accrual period t;  $T_{Apt}$  = Total Accruals period t

$SALE_{pt}$  = Sales period t;  $T_{Apd}$  = Total accruals of base period or previous

$SALE_{pd}$  = Sales base or previous period

### **Profitability**

Profitability is a ratio that measures the overall effectiveness shown by the level of profit gained in relation to sales or investment, Fahmi (2011). The profitability ratios in this study are measured using the Gross Profit Margin (Gross Profit Margin). The reason is that GPM is a ratio that measures the efficiency of cost control or production costs, indicating a company's ability to produce efficiently (Sawir 2009). Profit margin is calculated by the formula:

$$\text{Gross Profit Margin (GPM)} = \text{Sales} - \text{Cost of Goods Sold}$$

### **Leverage**

Leverage is a ratio that measures how far a company finances its business by comparing its own funds that have been deposited with the loan amount of its creditors, Madli (2014). In this research leverage ratio is measured by debt to equity ratio (DER). Debt to equity ratio is one of leverage ratio obtained through total debt divided by own capital.

$$DER = \text{Total Debt} / \text{Own Capital} \times 100\%$$

### **Public Share Ownership**

Public share ownership is the proportion of share ownership owned by public/ public to company's shares, Puspitasari (2009). Public shareholding is measured by comparing the number of shares outstanding by the total shares outstanding.

$$PSO = \frac{\text{The number of shares outstanding}}{\text{Total shares outstanding}} \times 100\%$$

### **Institutional Ownership**

Institutional ownership is the voting right of the institution (Beiner et al, 2003). Institutional ownership is measured by the percentage of share ownership by the institution to total outstanding shares.

INS = Share ownership by the institution / total outstanding shares x 100%

### **Population and Sample**

In this study the population used as research objects are all manufacturing companies of the consumer goods industry sector listed on the Stock Exchange for the period 2013-2015. The sample of this research is obtained by purposive sampling method. The criteria determined are as follows:

1. Companies registered as consumer goods industry sector listed in BEI period 2013-2015.
2. Companies that issue financial statements as of December 31 for the period 2013-2015.
3. Companies that have complete financial statements in accordance with the data required in the research variables.
4. Companies use their own positive capital.

Based on these criteria, then the eligible companies in this study are 42 companies from the period 2013-2015.

### **Data analysis**

In this research, data analysis technique used is multiple regression analysis with pooling data method that is by data merging method. Multiple regression analysis can explain the influence of independent variables with dependent variable. Pooling data or panel data is done by summing companies that have met the criteria during the observation period. The classical assumption test in this study includes normality test, multicollinearity, heteroskedasticity, and autocorrelation.

In data processing the researcher uses a tool in the form of statistical software statistics known as SPSS data analysis technique used is multiple linear regression with data merging method. The databinding method is a model obtained by combining or collecting all data. Multiple linear analysis can explain the influence of the dependent variable (Y) with the independent variable (X). Multiple linear regression equation can be formulated as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Notes:

Y : Earnings Management; X<sub>1</sub> : Profitability; X<sub>2</sub> : Leverage

X<sub>3</sub> : Public Shares Ownership (PSO);

X<sub>4</sub> : Institutional ownership (INS);  $\alpha$ : Konstanta;

$\beta_1 - \beta_4$ : Koefisien regresi;  $\varepsilon$  : Error

## **RESULTS AND DISCUSSION**

Based on descriptive statistical analysis, it can be known that Profitability has average value (mean) of 635.88 with the lowest value (min) of 545 and the highest value (max) of 766 and with standard deviation of 63.987.



Leverage has a mean value of 76.93 with the lowest value (min) of 19 and the highest value (max) of 303 and with a standard deviation of 63.733. PSO has a mean value of 20.24 with the lowest value (min) of 2 and the highest value (max) of 50 and with a standard deviation of 13.047. KI has a mean value of 61.38 with the lowest value (min) of 1 and the highest value (max) of 61.38 and with a standard deviation of 30.871. Public shareholding has an average value of -3.90 with a minimum value of (min) of -84 and a maximum value (max) of 23 and with a standard deviation of 17.490.

### Classic Assumption Test

Based on the results of data processing, it can be seen that the probability level of Kolmogorov Smirnov test value is 1.307 and the significance at 0.06. This means that data is normally distributed because the value of  $p = 0.06 > 0.05$ . The data in this study did not occur multicollinearity or there is no strong correlation between independent variables, it can be seen from the tolerance value for all variables  $> 0.10$  and  $VIF < 10$ .

The Glejser test results show that the probability for all independent variables of significance level is  $> 0.05$ . So it can be concluded that the regression model does not contain heteroscedasticity. Durbin-watson (DW) test results show that Dw is located between dU and 4-Du, it can be concluded that in this study there is no autocorrelation symptoms.

### Hypothesis Testing

**Table 1**  
**Partial Hypothesis Test (t test)**

Model	Coefficients <sup>a</sup>						conclusion
	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	α	
	B	Std. Error	Beta				
(Constant)	-,171	,286		-,599	,553		
Profitability	,041	,048	,148	,836	,408	0,05	rejected
Leverage	-,029	,045	-,105	-,636	,529	0,05	rejected
PSO	-,365	,297	-,273	-1,230	,226	0,05	rejected
INS	-,045	,138	-,066	-,325	,747	0,05	rejected

a. Dependent Variable: Earning Management

Source: output SPSS 19, 2017

From the result of statistical test t in table 1 above it can be seen that profitability has probability significance equal to 0,408, leverage variable have probability significance equal to 0,529, variable of PSO have probability significance equal to 0,226, and variable of INS have probability significance equal to 0,747. Based on the above analysis, it can be seen that the variable profitability, leverage, public share ownership (PSO) and institutional ownership (INS) or all variables have no significant effect on earnings management because it has probability above 0.05.

### **The Effect of Profitability on Earnings Management**

Testing the influence of profitability to earnings management in this study indicates that profitability has no effect on earnings management. This is evidenced by the level of significance of  $0.408 > 0.05$ , while the  $t_{\text{count}} 0.836 < t_{\text{tabel}} 1.687$ , it can be concluded H1 rejected. This study proves that profitability can not affect the level of the size of earnings management by management. Profitability has no effect on earnings management can be due to the profitability values in this study can be said either the average value of profitability of 6.36. The results of this study reinforce the results of research conducted by and Bestivano (2013) which states that profitability has no effect on earnings management. However, contrary to the results of research Wibisana and Ratnaningsih (2014) which states that profitability affects earnings management.

### **The Effect of Leverage on Earnings Management**

From the leverage data on the manufacturing company, it can be seen that the average leverage of the company is 70%, meaning that for Rp 1 the capital itself is financed by Rp 0.7 debt or from the company's total equity, 70% is financed by debt. Situations like this are said to be safe because the company still has the capital as a treasure for the company that can be used to pay the debt or liabilities of the company and 30% of the total capital more has become a property/rights for the company. The result of leverage influence test to earnings management in this research concludes that leverage has no effect to earnings management. This is evidenced by the level of significance of  $0.529 > 0.05$ , while  $t_{\text{count}} -0.636 < t_{\text{tabel}} 1.687$ , it can be concluded H2 rejected. If it is linked to leverage data with statistical descriptive data with SPSS program, it can be concluded that the average company has a safe leverage in the sense that the company is able to repay the debt used to finance the company's capital, the manager is neither interested nor motivated to do earnings management. This is because the company is in a good state or safe and able to pay the debt used to finance the company's capital. The results of this study are consistent with the results of research conducted by Jao and Pagulung (2011) which shows that leverage has no effect on earnings management. However, contrary to research conducted by

Widyaningdyah (2001) which states leverage have a positive effect on the earnings management.

### **The Effect of Public Stock Ownership on Earnings Management**

The result of examination of influence of public share ownership to earnings management in this research concludes that public share ownership has no effect to earnings management which means public share ownership can not give influence to earnings management action. This is evidenced by the level of significance of  $0.226 > 0.05$ , while  $t_{count} - 1.230 < t_{table} 1.687$ , it can be concluded H3 rejected. The results of this study support the results of research conducted by Azlina (2010) which states that there is no influence between public stock and earnings management. However, contrary to the results of research conducted by Rahman et al. (2014) who found that public shareholdings have a significant effect on earnings management.

### **The Effect of Institutional Ownership on Earnings Management**

The result of examination of the influence of institutional ownership to earnings management in this study concludes that institutional ownership has no effect on earnings management which means institutional ownership can not give effect to earnings management action and they do not have sufficient strength to provide effective control function to management. This is evidenced by the level of significance of  $0.747 > 0.05$ , while  $t_{count} -0.325 < t_{tabel} 1.687$ , it can be concluded H4 rejected. The tendency of institutional investors to focus more on current earnings is thought to be the cause of the impartiality of institutional ownership of earnings management. Because institutional investors focus more on current earnings, managers are forced to take action that can increase short-term earnings, for example by manipulating earnings. This study supports the results of research conducted by Wahyuningsih (2009) which states that institutional ownership has no effect on earnings management. However, contrary to research conducted by Kusumawardhani (2012) which states that institutional ownership affects earnings management.

## **CONCLUSION AND SUGGESTION**

### **Conclusion**

1. Profitability does not affect the earnings management in the consumer goods industry sector in Indonesia.
2. Leverage does not affect the earnings management in the consumer goods industry sector in Indonesia.
3. Public share ownership (PSO) has no effect on earnings management in the consumer goods industry sector in Indonesia.
4. Institutional ownership (INS) has no effect on earnings management in the consumer goods industry sector in Indonesia.

5. Profitability, leverage, Public share ownership (PSO) and institutional ownership (INS) simultaneously have no effect on earnings management in the consumer goods industry sector in Indonesia.

### **Suggestion**

Suggestions in this research are:

1. Researchers are further advised to consider the different models that will be used in determining the discretionary accrual so that it can see the existence of earnings management with different viewpoints.
2. Researchers are further advised to use different sector companies and longer observation periods so that it will provide larger sample quantities and the possibility of obtaining different conditions.

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