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The Roles of Profitability Moderating Corporate Governance on Earnings Quality

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Abstrak

Penelitian ini bertujuan untuk menganalisis Pengaruh mekanisme Corporate Governance terhadap Kualitas Laba dengan Rentabilitas sebagai Variabel Moderating. Populasi dalam penelitian ini adalah perusahaan perbankanyang terdaftar di Bursa Efek Indoensia tahun 2012-2015 berjumlah 42 perusahaan yang dihasilkan selama 4 tahun dan setelah dipilih dengan kriteria maka didapatkan 20 perusahaan. Metode pemilihan sampel yang digunakan adalah purposive sampling dan terpilih 80 unit analisis sebagai sanpel. Teknik analisis data menggunakan analisis MRA. Hasil penelitian menunjukkan bahwa komisaris independen berpengaruh positif terhadap kualitas laba, kepemilikan institusional berpengaruh positif terhadap kualitas laba. Selain itu, rentabilitastidak mampu memoderasi hubungan komisaris independen dan kepemilikan institusional terhadap kualitas laba.

Abstract

The objective of this research is to analyze the influence of corporate governance mechanisms to earnings quality with profitability as a moderating variable. The population of this research was banking companies listed on the Indonesia Stock Exchange between 2012 to 2015 amounted 42 companies generated over 4 years and after selected by the criteria then obtained 20 companies. The sample selection used purposive sampling method and obtained 80 samples. Data analysis technique used Moderated Regression Analysis (MRA). The results of this research indicated that Independent Commissioner had a positive effect on the earnings quality and institutional ownership had a positive effect on the earnings quality. In addition, the profitability was not able to moderate the relationship of Independent Commissioner and institutional ownership to earnings quality.

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INTRODUCTION

The growing world of business in this modern era cause tighter existing business competition. Tighter business competition requires company to be able to manage corporate finance well. One of the efforts to measure corporate financial quality is by analyzing earnings quality. Information of earnings quality can be used as a basis in estimating or predicting future earnings of the company. Besides being a decision-making basis, earnings quality can be a benchmark for corporate achievement, as it can be used in prediction of cash flows and earnings in the future. In general, earnings quality is also used by companies to measure the performance of the company's management over a certain period. This becomes the concern of stakeholders in assessing the performance of the company. The owner of the company expects management to improve the performance of the company, then the management looking for strategies to achieve these targets. For that, there are times when the management presents profits that are not in accordance with actual fact related to the economic conditions of the company, so that the profits are doubtful in providing information to support decision-making. Such earnings information does not indicate actual information about the performance of management may mislead the user. If this kind of earning information is used by investor to establish corporate market value, then the information cannot explain actual market value. The same thing is expressed by Schipper and Vincent (2003) in Sutopo (2009) that earning quality especially and financial statements quality generally are important for those who use financial statements for the purposes of contracting and investment decision making.

Many researches have been done in relation to the variables assessed to affect the Quality of Earning. Researches related to earnings quality include capital structure, financial ratios, earning management and others. One of which is closely related to the quality of earning today is good corporate governance mechanism. Good corporate governance is definitively a system that regulates and controls companies to create value added for all stakeholders. There are two points emphasized in this concept, firstly, the importance of shareholder rights to obtain timely and accurate information and, secondly, the company's obligation to disclose accurately, timely and transparently on all of the information of corporate performance, ownership, and stakeholders. From this issue, there has been a lot of research positioning Earning Quality as a dependent variable and raises various independent variables of Corporate Governance with proxy of Board of Independent Commissioners and Institutional Ownership. The existence of research gap above provides an opportunity for researchers to propose a hypothesis by presenting Profitability as moderating. Profitability is an assessment that describes the ability of banks to generate profits through bank operations relatively over a certain period. The assessment of earnings factors includes assessments of earnings performance, earnings sources, and sustainability earnings bank. Supervision actions include asking bank to improve the ability to generate profits such as through increased efficiency and business volume while maintaining the precautionary principle. The explanation of the phenomenon, research gap, and support from previous studies mentioned above become the background of the research submission. By considering the factors affecting Earnings Quality, the authors are interested to examine "the Influence of Corporate Governance mechanism on Earning Quality with Profitability as a Moderating Variable".

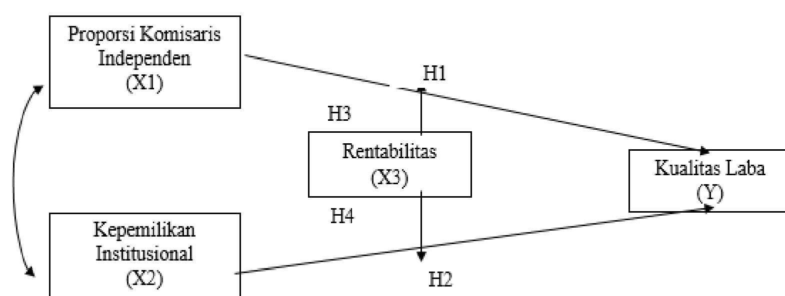

Figure 1. Thinking Framework

If it is based on agency theory, Independent Commissioner has a positive influence on earnings quality. Agency Theory discusses the relationship between management and shareholders, where the principal is a shareholder and agent is management (Belkaoui, 2006). Agency theory can show the difference of interest between the principal and the agent, so the agent reports a poor profit. Therefore, company presents an independent commissioner to oversee the level of earnings quality existing in the company. Because independent commissioner has a positive effect on earnings quality, which means more and more Independent Commissioners, more the Quality of earnings earned by the company. Febiani's research (2012) concludes that independent commissioner has a significant effect on the coefficient of Earnings Response Coefficient (ERC), where the possibility of fraudulent financial reporting will decrease with the monitoring process of financial reporting so that limits the level of earnings management within the company. It shows that the existence of independent commissioners within a company can affect the quality of corporate earnings.

Agency theory can also be used in predicting the relationship between institutional ownership on earnings quality. In general, this theory assumes that the principal is neutral to risk while the agent is resisting business and risk. If the Principal (owner) gives authority to the agent (management), then the institutional investor is to oversee whether the agency (management) commits fraud or not so the higher the supervision of the institutional owners the higher the quality of earnings obtained by the company. The view of agency theory that there is a separation between the agent and the principal that results in potential conflict may affect the reported earnings quality reported. Corporate governance mechanism has the ability in relation to produce a financial statement that contains information on earnings. Institutional ownership may suppress management's tendency to utilize discretionary in financial statement to provide reported earnings quality.

The research conducted by Boediono (2005) suggests that institutional ownership has the ability to reduce the incentives of managers who are self-interested through intensive levels of supervision. Institutional ownership may suppress the tendency of management to utilize discretionary in financial statement to provide reported earnings quality. This study finds evidence that institutional ownership has a positive effect on earnings quality. This means that the higher the institutional ownership, the higher the profit will be. Signalling theory states that a good qualified company will deliberately give a signal to the market, thus the market is expected to differentiate the company with good and bad quality. In order to the signal is good then it should be captured by the market and perceived good and not easily imitated by companies that have bad quality.

Companies that publish audited financial statements will provide information to the market and the market is expected to respond to information as a good or bad signal. Signals given by the market to the public will affect the stock market, especially the stock price of the company. If the signal of the company informs good news on the market, it can increase the share price otherwise, if

the signal of the company informs bad news then the corporate stock price will decrease. With the higher stock prices obtained by companies will affect the higher profits earned company. High market reaction will result in higher earning response coefficient (ERC), ERC is proxied as earnings quality. The company feels the need to oversee ERC by granting authority to independent commissioners to produce higher quality. The signal given to the market is still not enough to increase the corporate profit, therefore the company tries to increase the sales volume to increase the corporate profit. Increased sales volume and cost efficiency of the company can be seen from the profitability of the company, the higher the level of profitability then the higher the corporate profit. With the higher of corporate profit leads to higher market reaction of the company with higher stock returns and market returns of the company. This enhances the company's ERC with high supervision by independent commissioners.

Signalling theory explains why companies are motivated to provide financial statement information to external parties. Signal theory indicates the existence of information asymmetry between the management of the company and the parties concerned with the information. To that end, managers need to provide information needed by interested parties through the issuance of financial statements. Signal theory suggests about how a company should signal to users of financial statements. This signal is information about what has been done by the management to realize the desire of the owner. Signals may be promotions or other information which states that the company is better than other companies.

Managers provide information through financial statements that they implement a conservative accounting policy that generates higher profits because this principle prevents companies from exaggerating earnings and helps users of financial statements presenting earnings and assets that are not overstate. Information received by the investor first translated as a good signal (good news) or bad signal (bad news). The level of earnings reported by companies through the income statement can be translated into good signals as well as bad signals. If the profit reported by the firm increases then the information can be categorized as a good signal because it indicates good corporate condition. Conversely, if the reported profit decreases then the company is in bad condition so it is considered a bad signal. Given a good signal, it will increase market reaction and improve earning response coefficient (ERC).

ERC is proxied to know the quality of corporate earnings viewed from abnormal return and earnings per share of the company. The higher the market reaction, the higher the ERC or the earnings quality gained. High market response leads investor to monitor the quality of corporate earnings, with high monitoring from investor (institutional ownership) is expected to make the quality of earnings higher. Given the supervision by institutional ownership, the company owner seeks to increase the volume of corporate profits for more investors (institutional ownership) to become part of institutional ownership within the company. Therefore, the owner will increase the volume of earnings by increasing the sales volume and profit efficiency, this can easily be assessed from the profitability of the company. It can be concluded that the higher the profitability and the higher the supervision by the institutional ownership, the higher the quality of profit earned by the company.

METHODS

The type of data used was secondary data taken from annual financial statements of banking companies in the form of average value from 2012-2015. Secondary data collected were obtained from Stock Exchange Corner of Semarang State University and Indonesia Stock Exchange website (www.idx.co.id) .The object in this research was all banking companies listed in Indonesia Stock Exchange during period 2012-2015. Taking object in this research was done by purposive sampling,

namely sample determination technique with certain consideration with the aim to get representative sample according to criterion specified.

Dependent variable was a variable that was influenced by independent variable, this variable was bound. In this study, the dependent variable used is the Quality of Earnings, namely the assessment of the extent to which a corporate earnings could be obtained repeatedly, could be controlled, and the bank's worth (eligible to apply for credit / loan at the bank), among other factors. This study used market adjusted model. The stages to calculate ERC was according to Andreas (2012) in Marisatusholekha and Edy (2015). The board of commissioners describes the peak of the control system on the company. The role of supervision by the board of commissioners was expected to minimize agency conflict arising between the board of directors and shareholders. A study by Boediono (2005) that examined the effect of corporate governance mechanisms on earnings quality using path analysis found evidence that board of independent commissioners had a positive effect on earnings quality. Measurement of the Composition of Independent Commissioners used the percentage of the total number of board of independent commissioners against the total number of commissioners present in the composition of the board of commissioners in the sample companies. (Doddy and Marihot, 2007; in Singgih, 2013). Institutional ownership was a shareholding by governments, financial institutions, legal institutions, foreign institutions, trust funds and other institutions by the end of the year (Shien, et.al. 2006) in Sabrina (2010). According to Wening (2007) in Sabrina (2010), institutional ownership was one of the factors that could affect corporate performance. The existence of ownership by institutional investors would encourage more optimal supervision of management performance, since share ownership represented a source of power that could be used to support or otherwise to the performance of management. The measurement of institutional ownership was done by percentage of shares owned by institutional investors (Boediono, 2005).

Moderating variable was a variable that strengthened or weakened the relationship between one variable and another variable. The moderating variable used herein was profitability. The profitability practiced would affect the corporate earnings, and would have an impact on decision-making by those who need it. Earnings that appeared on the financial statements (income statement) would look bigger. The moderating variable in this research was profitability. Net Interest Margin (NIM) was used to measure the performance of bank management in distributing credit, considering that the bank's operating income was highly dependent on the difference between interest rate from the loan distributed and saving interest rate received (net interest income). NIM was the ratio of net interest income to average earning assets. Net interest income was derived from interest income minus interest expense. Earning assets calculated were earning assets that generated interest. Profitability was proxyed by Net Interest Margin (NIM). The formula for calculating the total of NIM value was as follows (Dendawijaya, 2009; in Sutardisa 2013).

RESULTS AND DISCUSSIONS

Table 1. The Result of t Statistical Test

Variable	Unstandardized Coefficients		T	Sig.	Explanation
	B	Std. Error			
Constants	-.268	.323	-.831	.409	
Zscore(KI)	.410	.189	2.167	.033	Significant
Zscore(KPI)	.386	.172	2.248	.027	Significant
KINIM	.194	.225	.861	.392	Insignificant
KPINIM	.113	.188	.598	.551	Insignificant

The table above showed the effect of variables of independent commissioners, institutional ownership, profitability moderated independent commissioner, and profitability moderated institutional ownership to earning quality variable individually. The decision of this hypothesis testing used a significance level of α as big as 5% or 0.05. If p value (sig) <α 0.05 then the hypothesis was accepted and if p value (sig)> α 0.05 then the hypothesis was rejected. Based on the results, it was obtained the following results:

Partial test of independent commissioner to earnings quality produced p_value equal to 0.033, smaller than the value of significance level at 5% (= 0.05), so that h_1 proposed in this study was accepted. Independent commissioner positively affected on earnings quality with coefficient value of 0.410, meaning that each addition of an independent commissioner of 1% would improve the quality of earnings by 41%. Partial testing of institutional ownership on earnings quality produced p_value of 0.027, less than the significance level of 5% (= 0.05), so h_2 proposed in this study was accepted. Institutional ownership positively affected earnings quality with coefficient value of 0.386, meaning that each change of institutional ownership of 1% would improve earnings quality as big as 38.6%. Partial testing of profitability moderated independent commissioners to the quality of earnings produced p_value of 0.392, greater than the significance level of 5% (= 0.05), so h_3 proposed in this study was rejected. This finding meant that profitability did not moderate the independent commissioner to earnings quality. Partial testing of profitability moderated institutional ownership to earnings quality resulting in p_value of 0.551, greater than the significance level of 5% (= 0.05), so h4 proposed in this study was rejected. This finding meant that profitability did not moderate institutional ownership on earnings quality.

CONCLUSIONS

Based on the results of data analysis and discussion, it can be concluded that the independent commissioner and institutional ownership have a positive and significant effect on earnings quality. Meanwhile, profitability is not able to moderate corporate governance (independent commissioner and institutional ownership) on earnings quality. Constructive suggestions for this research will be submitted by the authors as follows. For further research, it is necessary to examine using other financial ratios as moderating variables, such as liquidity and activity. For further research it is expected to replace banking companies, with other companies whose numbers more, because in order to compare it with the results of earnings quality in banking companies. For further research, it is necessary to add to corporate governance proxy, such as audit committee and managerial ownership.

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