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Study of Firm Value: Four Factors of Good Corporate Governance Listed on the IDX LQ-45 Index on Earnings Management

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ABSTRACT: *This study aims to analyze the effect of good corporate governance consisting of institutional ownership, managerial ownership, independent commissioners, and audit quality on firm value with earnings management as an intervening variable. This research was conducted on companies listed in the LQ-45 Index on the Indonesia Stock Exchange in the period 2015-2017. The sample used in this study was purposive sampling so that 30 companies were selected according to the criteria. The data analysis used is path analysis. The results of this study indicate that institutional ownership and audit quality have a significant effect on earnings management, managerial ownership, and independent commissioners affect firm value, and only institutional ownership and audit quality have a significant effect on firm value through earnings management.*
KEYWORDS: *good corporate governance, firm value, earnings management.*

I. INTRODUCTION

A capital market is an attractive place for those who want to invest. The capital market has its charm, namely investors can observe every price movement in real-time. Products that are traded are also various, one of which is stocks. The place that facilitates the sale and purchase of shares in Indonesia is known as the Indonesia Stock Exchange (BEI). The Indonesia Stock Exchange (IDX) will trade shares of companies that have gone public. Several companies that have gone public are usually joined in indexes that by following under the company. The combination of companies in an index is a consideration for investors to make decisions about which company to invest their capital in.

Many investors are usually attracted by the LQ-45 index. The LQ-45 index is in the spotlight of many investors because it displays the stock prices of the top 45 companies. With such a rating, companies will be competing to be the best to be included in the LQ-45 index list. As a result of this, there are often conditions where companies are left on the list due to the inability of the listed companies to maintain their ranking. Thus, a new and superior company will replace its position. It is not wrong if many investors are eyeing the shares owned by companies listed in the LQ-45 index.

The phenomenon that has occurred recently is that not all stocks with high returns can be collected immediately. This is because, in line with the increase in prices, the valuation of stocks in the LQ-45 index is already considered expensive for short and medium term investors. For investors who have short-term goals, BBRI with a price of IDR 3,370 is still safe to buy. On the other hand, some Q-45 stocks have continued to fall. For example, PGAS, PTPP, and WSKT. The decline in PGAS shares was due to pressure from financial reports and operating cash flow, such as WSKT and PTPP. Investors will be safer if they hold back from buying shares in this sector (quoted from https://invest.kontan.co.id/news, 2019). Another phenomenon states several BUMN stocks have become the top losers of LQ-45, including BBTN which fell 0.79% to IDR 3,780, and BBNI fell 0.77% to IDR 9,625.

The existence of an increase and decrease in companies listed in the LQ-45 index is something that needs to be questioned. This is because, in liquidity, these companies no longer need to be doubted. In answering this problem, it is returned to the criteria for companies that can be listed on the Indonesia Stock Exchange (IDX), whether they have met the criteria in the fields of good corporate governance, accounting and finance, and their capital structure.

The presentation of financial reports from companies that have gone public is important because it can provide information for users for decision making, company management, providing legal certainty, and tax collection. Whether or not the company's financial condition will appear in the audited financial statements, both internal and external auditors. Good financial reports are also supported by easy access and transparency of information. The more complete the presentation of a company's information, the more it helps users in making decisions in their fields.

Quality financial reports will be a sign that a company tends to have high corporate value. This can be seen in the price of shares being traded. Companies that have good corporate values are believed by many investors to have a high share value compared to companies that are vice versa. In addition to stock value, investors also use financial statement information to see the profit or loss of the company they are targeting. The need to see profit or loss aims to ensure the correctness of the company in reporting its profit or loss.

In profit and loss reporting, there is a term known as earnings management where stakeholders in the company can arrange their financial condition in such a way to make it look good. Usually, management will play the revenue and costs until they reach the desired point. Practices that occur in the field, many companies take earnings management actions so that there are often conflicts of interest between interested parties to maximizevpersonal interests [3].

Agents tend to perform by following per under what they want to show [21]. Many agents take advantage of the opportunity to carry out earnings management in their companies to influence the final results of various decisions, including the motivation of bonuses so that their performance is better or minimizing the income tax burden that must be paid by the company so that the net profit is large [19].

Research conducted by [25] reveals that overall earnings management and tax avoidance show a negative effect on firm value. Earnings management is a dominant factor in influencing firm value. Another opinion that is the same comes from research conducted by [22] which states that earnings management is not a beneficial action for the company in the long term. The company will present information that is not by following per under reality, so it is necessary to have good corporate governance.

Contrary to research [25] and [22], [20] show that there is a significant positive effect between earnings management and firm value. These results mean that the higher the level of earnings management, the more firm value will be for the sample companies. The motivation for each company in carrying out earnings management is different, but they have the same goal, namely to improve the company's performance in public. The impact will increase the value of the company as well.

The existence of earnings management actions to increase firm value with various motivations must indeed be balanced with good corporate governance. This term is known as Good Corporate Governance (GCG). Apart from being a form of supervision of companies, Good Corporate Governance (GCG) must also be applied to companies wishing to register themselves to be listed on the Indonesia Stock Exchange (IDX). If the company has met these requirements, it is expected to be able to increase the value of the company. Therefore, many studies have begun to examine the relationship between Good Corporate Governance (GCG) and firm value to add references and insights on the importance of both.

Based on research conducted by [17], the results show that corporate governance is positively related to firm value. This is because companies that implement better corporate governance tend to have higher corporate value. The high corporate value will enhance the company's image in front of the public and open up business and investment opportunities in the future.

Other research conducted by [11] also provides the same results that corporate governance with audit quality indicators has a positive effect on firm value as represented by Tobins 'Q. Financial reports are important because they can influence investors' decisions. to assess a company, so it is necessary to conduct an audit of the financial statements for companies that have gone public. This research is strengthened by research [5] which states that audits carried out by big four auditors will improve company image and firm value. The firm value will have an impact on the survival of the company, especially those listed on the Indonesia Stock Exchange (IDX). The companies listed in the LQ-45 Index are no exception. These companies must guard their corporate image with care.

Companies that are listed on the LQ-45 Index have always been the trust companies of investors, so it is important to maintain their positions. Compared to other companies, companies listed in the LQ-45 Index

tend to have a higher firm value. This can occur because it is supported by corporate control through good corporate governance. Therefore, this research aims to know whether the companies listed in the LQ-45 Index also take earnings management actions. If you take these actions, can the actions of earnings management be minimized with Good Corporate Governance (GCG)

II. LITERATURE REVIEW

2.1. Firm Value

Firm value is the main thing a company in the eyes of investors. The decision made by an investor also comes from the value of the company. Firm value is defined as a market value because the firm value can provide maximum prosperity for shareholders if the company's share price increases [4].

Management takes steps to create investment opportunities for the sake of business continuity, company owners, and owners of capital. Investors usually measure the value of the company with financial ratios. In this study, Tobin's Q was used to measure firm value.

2.2. Earnings Management

Companies cannot carry out their business activities without a profit. It is not uncommon for companies to do everything to enhance their profits. One of them is earnings management which is expected to give a certain impression on the stakeholders [8]. There are various ways to measure the level of management, but this study uses the Modified Jones model because it can provide better results than other models [6].

2.3. Good Corporate Governance

Based on the [12] in the establishment of a company, the company should lead to transparency, efficiency, and by following per under applicable legal regulations as well as a clear division between obligations and responsibilities within the company. A system that monitors this is known as Good Corporate Governance [16]. According to Effendi [7], an assessment of good corporate governance can be seen from institutional ownership, managerial ownership, independent commissioners, and audit quality.

2.4. Agency Theory

The main principle of agency theory is the existence of a working relationship between the party giving the authority and the recipient. It can be termed the relationship between principal and agent in the form of a cooperation contract (Elqorni dalam [13]).

2.5. Conceptual Framework

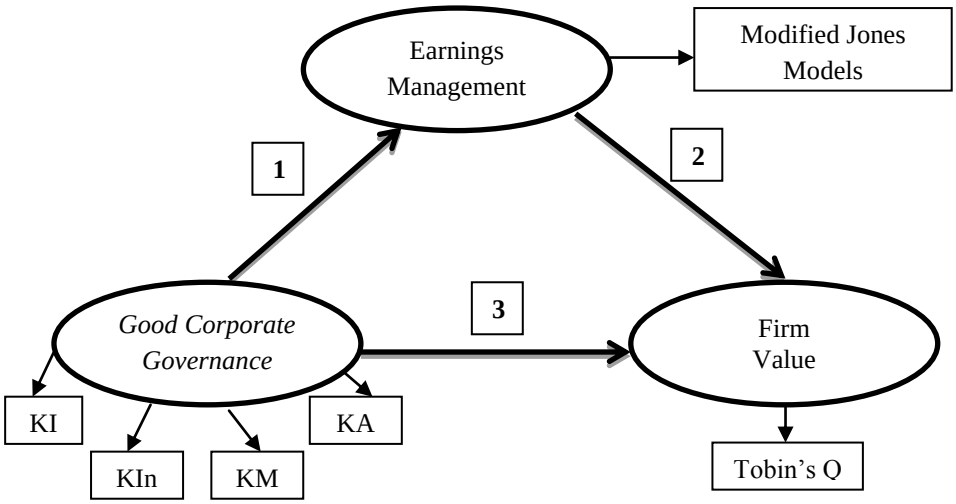

Figure 1: Conceptual Framework

2.6. Hypothesis

The hypothesis tested in this study is:

H1: Institutional Ownership (KIns), Managerial Ownership (KM), Independent Commissioners (KI), and Audit Quality (KA) has a significant effect on Earnings Management in companies listed in the LQ-45 Index on the Indonesia Stock Exchange

H2: Institutional Ownership (KIns), Managerial Ownership (KM), Independent Commissioners (KI), and Audit Quality (KA) has a significant effect on Firm Value in companies listed in the LQ-45 Index on the Indonesia Stock Exchange.

H3: Earnings Management has a significant effect on Firm Value in companies listed in the LQ-45 Index on the Indonesia Stock Exchange

H4: Institutional Ownership (KIns), Managerial Ownership (KM), Independent Commissioners (KI), and Audit Quality (KA) has a significant effect on Firm Value through Earnings Management in companies listed in the LQ-45 Index on the Indonesia Stock Exchange.

III. RESEARCH METHOD

The research method used is quantitative method. The sample of companies in this study were 30 companies that fit the criteria of a total population of 45 companies listed in the LQ-45 Index on the IDX in the 2015-2017 period. The technique used is nonprobability sampling with purposive sampling category. The data analysis used is path analysis with earnings management as an intervening variable.

3.1 Variable Research

3.1.1 Dependent Variable

3.1.1.1 Firm Value

Firm Value in this study can be measured in a way:

$$Q = \frac{(EMV+D)}{(EBV+D)} \quad (1)$$

3.1.2 Independent Variable

3.1.2.1 Good Corporate Governance

The measurement of Good Corporate Governance uses the indicators of Independent Commissioners (KI), Institutional Ownership (Kins), Managerial Ownership (KM), and Audit Quality (KA). The four indicators can be measured in a way:

$$Independent\ Commisioners\ (KI) = \frac{jumlah\ komisaris\ independen}{jumlah\ total\ dewan\ komisaris}\ x\ 100\% \quad (2)$$

$$Institutional\ Ownership\ (KIns) = \frac{jumlah\ saham\ institusional}{saham\ beredar}\ x\ 100\% \quad (3)$$

$$Managerial\ Ownership\ (KM) = \frac{jumlah\ saham\ yang\ dimiliki\ oleh\ manajerial}{jumlah\ saham\ beredar}\ x\ 100\% \quad (4)$$

Whereas for Audit Quality (KA), a dummy variable is used where the company will be given the number 1 if as a client of the big four auditors and given the number 0 if it is not a client of the big four auditors.

3.1.3 Intervening Variable

3.1.3.1 Earnings Management

Earnings management in this study is measured by adopting a Modified Jones Model. The steps can be shown as follows:

First, calculate the Total Accruals (TAC) with the formula:

TAC = NIit – CFOit (5)

Second, Total Accruals (TA) are estimated using the Ordinary Least Square as follows:

$$\frac{TA_{it}}{A_{it-1}} = \beta_1\left(\frac{1}{A_{it-1}}\right) + \beta_2\left(\frac{\Delta Rev_{it}}{A_{it-1}}\right) + \beta_3\left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon$$

Third, with a regression coefficient like the formula above, Nondiscretionary Accruals (NDA) is determined by the following formula:

$$NDA_{it} = \beta_1\left(\frac{1}{A_{it-1}}\right) + \beta_2\left(\frac{\Delta Rev_{it}}{A_{it-1}} - \frac{\Delta Rec_{it}}{A_{it-1}}\right) + \beta_3\left(\frac{PPE_{it}}{A_{it-1}}\right)$$

Fourth, Discretionary Accruals (DA) as a measure of earnings management are determined by the following formula:

$$DA_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it}$$

Note:

DAit : discretionary accruals company *i* in year t
NDAit : nondiscretionary accruals company *i* in year t
TAit : Total accruals company *i* in year t
NIit : Net profit company *i* in year t
CFOit : cash flows from operating activities company *i* in year t
Ait – 1 : total asset company *i* in year t
ΔREVit : revenue of company *i* in year t minus the revenue of company *i* in year t-1
PPEit : property, plant, and equipment of company *i* in year t
ΔRecit : accounts receivable of a company *i* in year t minus the revenue of company *i* in year t-1
e : error

3.2 Analysis Technique

The data analysis technique in this study was path analysis using SPSS 17.0 software. Hypothesis testing used the t-test with an error tolerance of 0.10 or 10% with the consideration that this value can still be tolerated in research in the social and financial fields. If p≥0.1 then the hypothesis is rejected (no effect), if p≤0.1 the hypothesis is accepted (influential). The regression analysis model is formed as follows:

$$Y = \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon_1$$

Note:
β1 : constant
β2, β3 : regression coefficient
X1 : Good Corporate Governance
X2 : Earnings Management
X3 : Firm Value
Ɛ1 : error

IV. RESULT AND DISCUSSION

Table 1. Calculation of the Value of Direct and Indirect Effects

Variable	Direct Effects
Institutional Ownership → Earnings Management	-0,259
Managerial Ownership → Earnings Management	0,025
Independent Commissioner → Earnings Management	-0,094
Audit Quality → Earnings Management	-0,284
Institutional Ownership → Firm Value	-0,011
Managerial Ownership → Firm Value	-0,212
Independent Commissioner → Firm Value	-0,299
Audit Quality → Firm Value	0,079
Earnings Management → Firm Value	0,199

Source: Processed Data, 2019

Variable	Direct Effects	Indirect Effects	Total Effects
Institutional Ownership → Earnings Management → Firm Value	-0,011 (0,917)	-0,0515	-0,0625
Managerial Ownership → Earnings Management → Firm Value	-0,212 (0,038)	0,00498	-0,207
Independent Commissioner → Earnings Management → Firm Value	-0,299 (0,004)	-0,0187	-0,3177
Audit Quality → Earnings Management → Firm Value	0,079 (0,452)	-0,0565	-0,0225

Source: Processed Data, 2019

Based on Figure 2, it can be seen that the independent variables which are purely intervening variables are institutional ownership and audit quality variables. This is because the significance value for the institutional ownership variable is 0.013 with the dependent variable being earnings management. Meanwhile, the audit quality variable shows a significance value of 0.006. Both have a significant negative effect on firm

value through earnings management. At the same time, it becomes pure intervening because it has a significant indirect effect. In other words, the earnings management variable can be an intervening variable to determine the effect of institutional ownership and audit quality on firm value. In Figure 2, it can be determined that the effect of the first error is 0.9066 for the error value of institutional ownership, managerial ownership, independent commissioners, and audit quality on earnings management. The second error value is 0.8977 for the error of institutional ownership, managerial ownership, independent commissioners, and audit quality on firm value through earnings management. Apart from being able to determine the error value, from Figure 1 it can be determined that the total coefficient of determination (Rm^2) is 0.3376 or 33.76%. This means that the diversity of data that can be explained by the model is 33.76% and the rest is explained by other variables that are not included in the model.

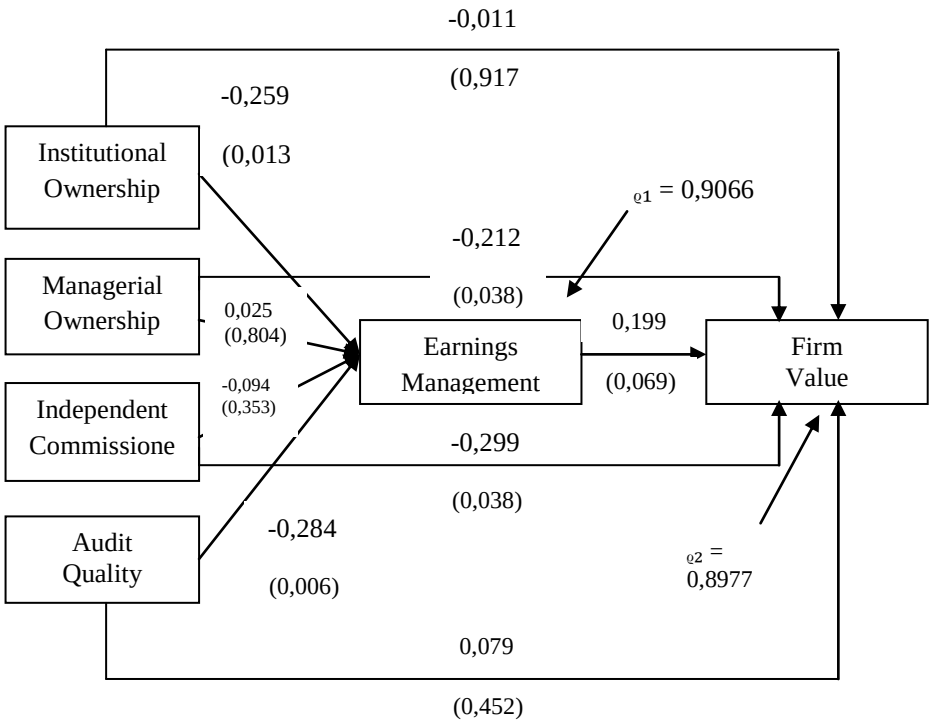

Figure 2: The results of Path Analysis
Source: The results of data analysis using SPSS 17.0

Through the analysis of the research results show that the influence between institutional ownership, managerial ownership, independent commissioners, and audit quality with earnings management does not all produce a significant effect because the higher percentage of institutional ownership will affect voting rights in every decision taken by the company and suppress earnings management actions so that there is no company financial reporting that is far from the truth. The financial statements that have been produced will then be audited as a condition for listing on the IDX. the selection of Big Four Public Accounting Firms supports the emphasis on earnings management actions. Thus, investors will respond well to firm value due to the suppression of earnings by institutional owners and the KAP they use. This research model is consistent with the research [10] and [1].

Managerial ownership and independent commissioners do not affect on earnings management because every manager who owns shares in a company will tend to take personal advantage in managing company earnings. So that an independent commissioner who is appointed based on kinship is not an outsider who is the supervisor of the company, it will be difficult to minimize earnings management actions. The difficulty in controlling earnings management actions is also due to the limited implementation of duties and supervision by the majority shareholder, as a result of which it is unable to encourage the optimal implementation of Good Corporate Governance to limit earnings management practices. The results of this study are consistent with [26]. Overall the results of this study are consistent with [10], [1], and [9], inconsistent with research [18] and [23].

Next, institutional ownership, managerial ownership, independent commissioners, and audit quality on firm value do not all have a significant effect. This is because managerial ownership in a company will conflict with its duties as management in the company. The smaller the number of managerial ownership

percentages, the less are oriented towards returning shares of ownership. Managers will focus more on improving the management of the company, even though they own part of the company's shares. From the independent commissioner's point of view, it will give a negative meaning to firm value if there is a tendency to interfere in shareholder wealth by taking sides with the independent commissioner to interested parties, including investors. Later, investors will be able to see who is the independent commissioner in it, whether they can be invited to compromise or not.

Institutional ownership and audit quality, on the other hand, both do not have a significant effect on firm value because they do not directly evaluate a company, only its share price. Thus, little or a large number of institutional ownership, the quality or not the KAP audited report used does not have a significant effect on firm value. Prospective investors will respond to firm value by seeing how auditors work in reducing earnings and how much institutional ownership has an influence on influencing earnings management actions. If it is proven that it will suppress earnings management actions and generate good firm value for investors, investors will also respond well to the company. So, investors do not directly focus on the value of the company, but see who the auditors are and how much institutional ownership to order reduce earnings management actions. This discussion is not consistent with [15], but consistent with the research [5], [17] and [11].

The next influence between earnings management on firm value shows that there is an influence between the two. This is because profit will be the main point of investors, in this case, if a company can to even out its profits with earnings management actions it will influence investors' decisions. The higher the earnings management action taken, the better the firm value is due to the profit strategy. In contrast to companies that have low earnings management measures, the reflected firm value will approach the actual condition. If investors know this, there can be a loss of investor confidence in a company. This is not in line with research from [25] but line with [22], [2], and [20]..

The last effect, namely institutional ownership, managerial ownership, independent commissioners, and audit quality on firm value through earnings management, shows that not all of them have a significant effect. Only institutional ownership and audit quality have an influence on firm value through earnings management. This is because the higher the level of institutional ownership and the integrity of the audit quality will be able to suppress the occurrence of earnings management in companies listed in the LQ-45 index on the Indonesia Stock Exchange. With an emphasis on earnings management measures, the company does not carry out much manipulation of its reports. It can be said that the company will be more real in reporting the condition of the company. This will increase investor confidence in making decisions about a company that they are interested in. Meanwhile, managerial ownership and independent commissioners have a direct influence on firm value, not through earnings management, because there are still lines of thought between managerial shareholders, independent commissioners, and investors. The three of them are still oriented towards returning their investment. The smaller the number of managerial ownership percentages, the more management will be focused on the running of the company, not just seeing how much returns it gets. If the percentage is bigger, what is feared is that there is almost no difference between investors and management in terms of return on stock returns.

Investors tend to respond to firm value by seeing how the manager's performance is in managing the company until the stock price is formed regardless of whether the manager does earnings management or not. Investors consider that the profits presented in the financial statements are used as material to conclude the determination of share prices or firm value. Besides, the relationship with independent commissioners does not affect firm value through earnings management because investors see more directly who is the independent commissioner in the company. Whether or not the commissioner can be invited to compromise. Thus, investors tend to ignore things other than independent commissioners that affect firm value, including earnings management actions. This is the renewal of previous studies, where earnings management acts as an intervening to determine the effect of institutional ownership, managerial ownership, independent commissioners, and audit quality on firm value.

V. CONCLUSION

Based on the research conducted, it can be concluded that institutional ownership and audit quality have an influence on earnings management in companies listed in the LQ-45 index on the Indonesia Stock Exchange. Meanwhile, managerial ownership and independent commissioners have no effect on earnings management in companies listed in the LQ-45 index on the Indonesia Stock Exchange. Managerial ownership and independent commissioners have a direct effect on firm value in companies listed in the LQ-45 index on the Indonesia Stock Exchange. Meanwhile, institutional ownership and audit quality have no effect on firm value at companies listed in the LQ-45 index on the Indonesia Stock Exchange. Earnings management affects the firm value of companies listed in the LQ-45 index on the Indonesia Stock Exchange. This can happen because the company thinks that

the benchmark of a company is derived from profit. Profits presented in the financial statements will influence decision making for an investor.

Therefore, some companies tend to make decisions to carry out earnings management by leveling their company profits so that investors will give a good assessment of the company. If the company performs high earnings management actions, the reflected firm value is the value of the company which is the result of engineering or manipulation and vice versa. Finally, only institutional ownership and audit quality affect firm value through earnings management in companies listed in the LQ-45 index on the Indonesia Stock Exchange, so it can be said that earnings management is a pure intervening variable of institutional ownership and audit quality on firm value. Meanwhile, managerial ownership and independent commissioners do not affect firm value through earnings management in companies listed in the LQ-45 index on the Indonesia Stock Exchange.

VI. RECOMMENDATIONS

The first suggestion that researchers can give to interested parties is that the research results found by researchers can be used as sample companies to make policies, especially those related to earnings management and Good Corporate Governance. Researchers hope that the information obtained from the results of this study can help improve financial management in sample companies. Second, for science, the findings in this study need to be tested more deeply and further so that they can develop into a strong theory, especially in the field of financial management. Third, for other researchers to be able to explore more deeply because this research model still gave a small contribution of 33.76%. So, there are still opportunities for future researchers to develop research models that are still based on the correct principles. The hope is that if the testing is done more often and the results are consistent, then the concept being tested can be used as a theory in the field of financial management in particular.

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