

## CORPORATE GOVERNANCE MECHANISMS, PROFITABILITY, AND LEVERAGE AS DRIVERS OF EARNINGS MANAGEMENT

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### ABSTRACT

*This study examines whether managerial ownership, institutional ownership, profitability, and leverage are associated with earnings management among consumer goods companies listed on the Indonesia Stock Exchange during the 2020–2024 period. A quantitative approach was employed, utilizing purposive sampling to include only firms with complete data. The analysis was conducted using multiple linear regression. The results indicate that both managerial and institutional ownership exhibit a positive and statistically significant relationship with earnings management practices. In contrast, performance measures (profitability) and capital structure (leverage) show no significant effect. These findings suggest that ownership structure alone may be insufficient to restrain opportunistic financial reporting behavior, while profitability and debt levels do not appear to be the primary drivers of earnings management within this sample.*

### INTRODUCTION

In an increasingly competitive business environment, the intensity of inter-industry competition has risen significantly and become largely unavoidable. This situation requires every organization to continuously develop and sustain its competitive advantage within its respective industry. The effective and efficient optimization of an organization's resources is a critical aspect of operational activities, as it contributes to

strengthening market position and achieving superior performance (Astari & Suryanawa, 2017). One of the primary indicators used to assess an organization's performance is profit information presented in published financial statements (Yovianti & Dermawan, 2020).

Financial statements serve as a communication medium for both internal parties, particularly management, and external stakeholders such as investors, creditors, and government institutions. These reports provide information about an entity's financial position, operating results, and cash flows, which form the basis for stakeholders to make informed business decisions. Moreover, financial statements reflect the company's accountability as an agent to the owners, who act as principals in managing the entrusted resources (Astari & Suryanawa, 2017).

According to the Statement of Financial Accounting Concepts (SFAC) No. 1, profit is regarded as a key indicator of management effectiveness in fulfilling its operational responsibilities. Profit information helps entity owners and other stakeholders evaluate the entity's ability to generate earnings in future periods. An increase in profit from one year to the next signals improved entity performance and greater efficiency in utilizing available resources (Astari & Suryanawa, 2017). Given its strategic role in decision-making, profit becomes a central focus for management, whose performance is often assessed based on this metric. Therefore, management is responsible for presenting profit information honestly and in a manner that accurately reflects the entity's actual condition (Asyati & Farida, 2020).

## LITERATURE REVIEW

### Agency Theory

Agency theory was first introduced by Jensen and Meckling in 1976. This theory is based on fundamental assumptions about human behavior, namely that individuals tend to be self-interested, possess limited rationality in anticipating future conditions, and exhibit risk-averse behavior. An agency relationship arises when the entity's owner (the principal) delegates authority to a manager (the agent) to perform certain tasks on the owner's behalf, granting decision-making authority along with the responsibility to act in the principal's best interests.

### Earnings Management

Earnings management refers to managerial actions involving the selection of accounting policies or specific operational decisions that influence the reported level of earnings, with the objective of producing financial statements that align with desired outcomes (Scott, 2015). In general, earnings management can be understood as efforts to control or adjust profit levels to serve the interests of particular parties—primarily management—driven by various motives and objectives underlying such practices (Fahmi, 2014).

### Good Corporate Governance

The Forum for Corporate Governance in Indonesia (FCGI) defines corporate governance as a set of principles and mechanisms that regulate interactions among investors or shareholders, management, and other stakeholders, both internal and

external, encompassing the distribution of rights, responsibilities, and obligations among these parties. Conceptually, corporate governance represents a system of control and direction designed to ensure that organizational activities are conducted in accordance with predetermined objectives.

### **Managerial Ownership**

Managerial ownership refers to the proportion of company shares held by members of management who are directly involved in strategic decision-making processes within the entity (Effendi, 2016:16). The management in question includes members of the board of commissioners and the board of directors responsible for overseeing and managing the entity. Consequently, management holds a dual role as both managers and shareholders, thereby actively participating in strategic decisions undertaken by the entity.

### **Institutional Ownership**

Institutional ownership refers to the proportion of an entity's shares owned by institutions or institutional investors, such as insurance companies, banks, investment firms, and other organizations (Sartono, 2010:13). Institutional ownership provides substantial monitoring power over management through effective control mechanisms, whereby the size of shareholdings may influence the financial reporting process of the entity.

Furthermore, institutional ownership reflects conditions in which institutions—whether government-owned or private, domestic or foreign—hold equity stakes in an entity (Asyati & Farida, 2020). Given that institutional investors generally have significant interests in their investments, they tend to conduct rigorous and professional monitoring of entity performance. Such oversight contributes to enhancing the effectiveness of managerial control and reducing the potential for fraudulent practices within the entity.

### **Profitability**

Profitability ratios are measurement tools used to assess an entity's ability to generate profits from its operational activities (Hery, 2016:192). In addition to evaluating profit-generating capacity, these ratios are also employed to compare profit performance across periods and to assess profit growth trends over time, whether increasing or declining (Hery, 2016:193).

Moreover, profitability ratios—also known as return ratios—aim to measure the level of returns or gains earned by an entity from its sales and assets (Sujarweni, 2019:114). Accordingly, these ratios reflect the extent to which an entity is capable of generating profits from its business activities, whether viewed in terms of sales, total assets, or equity.

### **Leverage**

Leverage ratios are measurement tools used to evaluate the extent to which an entity's asset financing relies on debt (Hery, 2016:162). In other words, these ratios describe the proportion of debt borne by the entity in financing its assets.

Additionally, leverage ratios function to assess an entity's ability to meet both short-

term and long-term obligations, as well as to evaluate the effectiveness of resource utilization, including capital, assets, and receivables (Sujarweni, 2019:111). Furthermore, these ratios play a role in identifying the entity's total liabilities position, assessing the extent to which assets are financed through debt, and measuring the overall impact of debt usage on the entity's capital structure (Hery, 2016:164).

### **Conceptual Definitions**

This section explains the conceptual definitions of the variables used in this study, as follows:

#### **Earnings Management Variable (Y)**

Earnings management is the choice made by managers regarding accounting policies or real actions that affect earnings in order to achieve certain earnings reporting objectives (Scott, 2015:445).

It can also be defined as an accounting practice in which the flexibility in the preparation of financial statements is utilized by managers who seek to meet earnings targets, with the aim of creating a certain impression or influencing the decision-making of stakeholders who rely on financial statements (Hery, 2016:50).

#### **Managerial Ownership Variable (X1)**

Managerial ownership is the number of shares owned by the company's management who actively participate in the decision-making process of a company (Effendi, 2016:16). In this case, the company's management who hold shares include the board of commissioners and the board of directors.

Managerial ownership is the proportion of share ownership held by managers, who therefore also act as shareholders and directly experience the benefits of the policies taken, while also bearing the consequences if losses arise from inappropriate decision-making (Hanafi & Halim, 2014:75).

#### **Institutional Ownership Variable (X2)**

Institutional ownership is share ownership held by institutional investors or organizations such as insurance companies, banks, investment companies, and other institutional owners (Sartono, 2010:13). The presence of institutional share ownership is considered to have the ability to control management actions, and the percentage of ownership may influence the financial reporting process.

Institutional ownership is a condition in which institutions hold shares in a company. The institutions referred to here may include government institutions, private institutions, domestic institutions, and foreign institutions (Asyati & Farida, 2020). Since these institutions have significant interests in the investments they make, they tend to monitor the development of their investments professionally, resulting in a very high level of control over management actions.

#### **Profitability Variable (X3)**

Profitability ratios are ratios used to measure a company's ability to generate profits from its business operational activities (Hery, 2016:192). In addition to measuring the

company's ability to generate profit, this ratio can also be used to assess the company's profit position in previous and current years, as well as to evaluate the development of profit over time, whether it has increased or decreased (Hery, 2016:193).

The profitability ratio used in this study is return on assets, which is a ratio that shows how much assets contribute to generating net income. In other words, this ratio measures how much net profit is generated from every rupiah invested in total assets (Hery, 2016:193).

### Leverage Variable (X4)

Leverage ratios are ratios used to measure the extent to which a company's assets are financed by debt (Hery, 2016:162). In addition to assessing the company's ability to meet all of its obligations, this ratio is also used to determine the company's total liabilities position, to evaluate how much of the company's assets are financed by debt, and to assess the extent to which debt affects the financing of the company's assets (Hery, 2016:164).

The leverage ratio used in this study is the debt to asset ratio, also known as the debt ratio, which is a ratio used to measure the comparison between total debt and total assets. In other words, this ratio measures the extent to which the company's assets are financed by debt or how much the company's debt affects the financing of its assets (Hery, 2016:166).

## RESEARCH METHOD

This study employs a quantitative approach using an associative research design with a causal orientation, which examines relationships that reflect cause-and-effect influences among the variables under investigation (Sugiyono, 2019:66).

### Measurement Scale of Operational Variables

Dependent Variable	Proxy	Scale
Earnings Management (Dwijayanti & Suryanawa, 2017)	$DAit = (TACit / Ait-1) - NDAit$	Ratio
Independent Variable	Proxy	Scale
Managerial Ownership (Purnama, 2017)	$KM = \text{Number of shares owned by management} / \text{Total outstanding shares}$	Ratio
Institutional Ownership (Yovianti & Dermawan, 2020)	$KI = \text{Number of shares owned by institutional investors} / \text{Total outstanding shares}$	Ratio
Profitability (Asward & Lina, 2015)	$ROA = \text{Net Income After Tax (EAT)} / \text{Total Assets}$	Ratio
Leverage (Yovianti & Dermawan, 2020)	$DAR = \text{Total Debt} / \text{Total Assets}$	Ratio

### Population

The population is defined as the entire set of objects or subjects possessing specific

characteristics and a predetermined size established by the researcher for examination and as the basis for drawing conclusions (Sugiyono, 2019:126). In this study, the population comprises all entities operating in the consumer goods sector and listed on the Indonesia Stock Exchange (IDX) during the period from 2020 to 2024, totaling 53 entities.

### **Sample and Sampling Technique**

This study applies purposive sampling, a sampling method in which samples are selected based on specific criteria determined by the researcher (Sugiyono, 2019:133). The sampling criteria employed in this study are as follows:

1. Consumer goods sector entities that were consistently listed on the Indonesia Stock Exchange (IDX) throughout the period 2020–2024.
2. Consumer goods sector entities that consecutively published annual reports from 2020 to 2024.
3. Consumer goods sector entities with complete data on managerial ownership and institutional ownership for the period 2020–2024.
4. Consumer goods sector entities that reported net income as of December 31 for each year during the period 2020–2024.

### **Data and Data Collection Methods**

#### **Quantitative Data**

Quantitative data are data in the form of numbers or numerical figures that can be collected and interpreted relatively more easily (Sunyoto, 2016:21). The quantitative data used in this study are the annual reports of consumer goods companies listed on the Indonesia Stock Exchange (IDX) from 2020 to 2024.

#### **Secondary Data**

Secondary data are data obtained from records available in the company and from other sources, namely library research by studying books related to the object of the research (Sunyoto, 2016:21). The secondary data used in this study are the annual reports of consumer goods companies listed on the Indonesia Stock Exchange (IDX) from 2020 to 2024, obtained from the official IDX website, as well as literature such as books and journals relevant to this research.

#### **Data Collection Methods**

The data collection method used in this study is the non-participant observation method, in which the researcher is not involved and acts only as an independent observer (Sugiyono, 2019:204). In this case, the data were collected through non-participant observation in the form of annual reports of consumer goods companies listed on the Indonesia Stock Exchange (IDX), which were obtained from the official IDX website.

#### **Multiple Linear Regression Analysis**

Regression analysis is used to examine the extent to which the independent variable(s) (X) influence the dependent variable (Y). When the analysis involves more than one independent variable ( $X_1, X_2, X_3, \dots, X_n$ ), the technique applied is referred to as multiple linear regression analysis (Sunyoto, 2016:47). In this study, multiple linear regression analysis is employed to test the effects of managerial ownership, institutional

ownership, profitability, and leverage on earnings management, using the following regression model:

$$Y = a - \beta_1 X_1 - \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

Where:

- Y = Earnings management
- a = Constant
- $\beta_1, \beta_2, \beta_3, \beta_4$  = Regression coefficients
- $X_1$  = Managerial ownership
- $X_2$  = Institutional ownership
- $X_3$  = Profitability
- $X_4$  = Leverage
- e = Error term

## RESEARCH RESULTS AND DISCUSSION

### Multiple Linear Regression Analysis

**Table 1. Results of Multiple Linear Regression Analysis**

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-35.591	14.438		-2.465	.017
	KM	.056	.018	.481	3.058	.004
	KI	.034	.015	.404	2.221	.031
	ROA	.022	.049	.079	.457	.650
	DAR	.018	.015	.170	1.168	.248

a. Dependent Variable: DA

Source: Processed data from SPSS (2025)

Based on Table 1 above, the following multiple linear regression equation is obtained:

$$DA = -35,591 + 0,056 KM + 0,034 KI + 0,022 ROA + 0,018 DAR + e$$

Based on the regression equation, the estimated coefficients of each independent variable can be interpreted as follows:

**Constant (a) = -35.591**

The constant value of -35.591 indicates that when all independent variables managerial ownership (KM), institutional ownership (KI), profitability (ROA), and leverage (DAR) are equal to zero, the dependent variable, earnings management (DA), for consumer goods sector entities listed on the Indonesia Stock Exchange (IDX) is

-35.591.

**Regression Coefficient ( $\beta_1$ ) = 0.056**

The regression coefficient for managerial ownership (KM) of 0.056 indicates that an increase in KM by 0.1 leads to an increase in earnings management (DA) by 0.056, assuming that institutional ownership (KI), profitability (ROA), and leverage (DAR) remain constant.

**Regression Coefficient ( $\beta_2$ ) = 0.034**

The regression coefficient for institutional ownership (KI) of 0.034 implies that a 0.1 increase in KI increases earnings management (DA) by 0.034, assuming that KM, ROA, and DAR remain unchanged

**Regression Coefficient ( $\beta_3$ ) = 0.022**

The regression coefficient for profitability (ROA) of 0.022 indicates that an increase in ROA by 0.1 results in an increase in earnings management (DA) by 0.022, assuming that KM, KI, and DAR remain constant.

**Regression Coefficient ( $\beta_4$ ) = 0.018**

The regression coefficient for leverage (DAR) of 0.018 suggests that an increase in DAR by 0.1 leads to an increase in earnings management (DA) by 0.018, assuming that KM, KI, and ROA remain constant.

**Coefficient of Determination Test (Adjusted R<sup>2</sup>)**

**Table 2. Results of the Coefficient of Determination Test (Adjusted R<sup>2</sup>)**

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.472 <sup>a</sup>	.223	.161	12.39567

a. Predictors: (Constant), DAR, KM, ROA, KI

Source: Processed data from SPSS (2025)

Based on Table 2, the adjusted coefficient of determination (adjusted R<sup>2</sup>) is 0.161, or 16.1%. This result indicates that managerial ownership (KM), institutional ownership (KI), profitability (ROA), and leverage (DAR) jointly explain 16.1% of the variation in earnings management (DA). The remaining 83.9% is explained by other variables not included in this research model.

**t-Test (Partial Significance Test)**

The t-test is used to determine whether each independent variable has a partial effect on the dependent variable. The test is conducted by comparing the calculated t-value with the critical t-value. If the calculated t-value is less than the critical t-value or if the significance value exceeds  $\alpha$  (0.05), the independent variable is considered to have no significant effect on the dependent variable. Conversely, if the calculated t-value exceeds the critical t-value or if the significance value is less than  $\alpha$  (0.05), the independent variable is deemed to have a significant effect.

The critical t-value is obtained using the formula  $t_{\alpha; df(n-k)}$ , resulting in  $t_{0.05; df(55-4)} = t_{0.05; df(51)} = 1.67528$ , which is rounded to 1.675. The results of the t-test are presented in Table 3.

**Table 3. Results of the t-Test Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-35.591	14.438		-2.465	.017
	KM	.056	.018	.481	3.058	.004
	KI	.034	.015	.404	2.221	.031
	ROA	.022	.049	.079	.457	.650
	DAR	.018	.015	.170	1.168	.248

a. Dependent Variable: DA

Source: Processed data from SPSS (2025)

## Discussion

### 1. The Effect of Managerial Ownership on Earnings Management

The statistical test results indicate that managerial ownership (KM) has a calculated t-value of 3.058, which exceeds the critical t-value of 1.675, with a significance level of  $0.004 < \alpha (0.05)$ . This finding indicates that managerial ownership has a positive and significant effect on earnings management practices in consumer goods sector entities listed on the Indonesia Stock Exchange (IDX). This result is consistent with previous studies by Asward and Lina (2015), Anggani and Nazar (2015), and Larastomo et al. (2016), which also found a positive and significant relationship between managerial ownership and earnings management. However, this finding contradicts the results of Dwijayanti and Suryanawa (2017) and Purnama (2017), which reported a negative and significant effect, as well as Firnanti (2017), who found no significant effect.

This finding suggests that a higher proportion of shares owned by managers increases their incentive to engage in earnings management practices. This condition arises from managers' personal interests in maximizing returns from the shares they own. Consequently, managers may be motivated to manipulate earnings, either upward or downward, to achieve personal benefits. Furthermore, high levels of managerial ownership may lead to an entrenchment effect, where managers gain greater control over the entity due to superior access to internal information. As a result, external shareholders face difficulties in constraining opportunistic managerial behavior (Asward & Lina, 2015). Therefore, this study indicates that managerial ownership has not yet functioned effectively as a corporate governance mechanism in reducing earnings management practices.

Economically, the positive effect of managerial ownership on earnings management indicates that the greater the proportion of shares owned by managers, the stronger their incentive to influence reported earnings in order to obtain personal benefits from their ownership. The implication is that managerial ownership in consumer goods companies listed on the Indonesia Stock Exchange has not yet been effective as a good

corporate governance mechanism to reduce earnings management. Therefore, companies need to strengthen both internal and external monitoring systems in order to maintain the quality of financial reporting.

## 2. The Effect of Institutional Ownership on Earnings Management

The statistical results show that institutional ownership (KI) has a calculated t-value of 2.221, which is greater than the critical t-value of 1.675, with a significance level of  $0.031 < \alpha$  (0.05). This finding indicates that institutional ownership has a positive and significant effect on earnings management practices in consumer goods sector entities listed on the Indonesia Stock Exchange (IDX). This result is consistent with studies conducted by Wahyuwidi and Lusmeida (2020), Asward and Lina (2015), and Pramithasari and Yasa (2016), which also reported a positive and significant relationship. However, this finding differs from those of Dwijayanti and Suryanawa (2017) and Astari and Suryanawa (2017), which found a negative and significant effect, and is inconsistent with Purnama (2017), who found no significant effect.

This result suggests that a higher proportion of shares held by institutional investors is associated with a greater tendency toward earnings management. This may occur because managers face pressure from large institutional investors to meet specific earnings targets, thereby encouraging financial statement manipulation to fulfill such expectations. In addition, institutional investors often prioritize short-term returns and may place less emphasis on comprehensive managerial performance evaluation. This condition provides opportunities for managers to engage in earnings management to present more favorable short-term performance (Asward & Lina, 2015). Accordingly, institutional ownership has not yet operated optimally as an effective corporate governance mechanism in constraining earnings management practices.

Economically, the positive effect of institutional ownership on earnings management indicates that the greater the proportion of shares held by institutional investors, the greater the pressure on management to report earnings in line with shareholders' expectations. The implication is that institutional ownership in consumer goods companies listed on the Indonesia Stock Exchange has not yet been effective as a good corporate governance mechanism to reduce earnings management. Therefore, stronger internal and external monitoring is needed to maintain earnings quality and the credibility of financial reporting.

## 3. The Effect of Profitability on Earnings Management

The statistical test results indicate that profitability (ROA) has a calculated t-value of 0.457, which is lower than the critical t-value of 1.675, with a significance level of  $0.650 > \alpha$  (0.05). This result indicates that profitability does not have a significant effect on earnings management practices in consumer goods sector entities listed on the Indonesia Stock Exchange (IDX). This finding is consistent with prior studies by Agustia and Suryani (2018), Fandriani and Tunjung (2019), and Almalita (2017), which also concluded that profitability does not significantly influence earnings management. However, this result does not support the findings of Astari and Suryanawa (2017) and Purnama (2017), who reported a positive and significant effect, nor Yovianti and Dermawan (2020), who found a negative and significant relationship.

The insignificance of profitability suggests that entities with either high or low profitability levels exhibit similar tendencies toward earnings management. This may be due to limited investor attention to return on assets (ROA) information disclosed in financial statements, reducing managerial incentives to manipulate earnings through profitability indicators. Thus, the level of profitability does not appear to be a determining factor in earnings management practices (Agustia & Suryani, 2018).

Economically, the insignificant effect of profitability on earnings management indicates that a company's ability to generate profit from its assets has not been a major driving factor for management to manipulate reported earnings. The implication is that profitability in consumer goods companies listed on the Indonesia Stock Exchange cannot be used as a primary indicator for detecting earnings management practices. Therefore, the analysis should be directed toward other factors that have a greater influence on the quality of financial reporting.

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

The statistical analysis shows that leverage (DAR) has a calculated t-value of 1.168, which is lower than the critical t-value of 1.675, with a significance level of  $0.248 > \alpha$  (0.05). This result indicates that leverage does not have a significant effect on earnings management practices in consumer goods sector entities listed on the Indonesia Stock Exchange (IDX). This finding is consistent with studies by Asyati and Farida (2020), Purnama (2017), and Yovianti and Dermawan (2020), all of which reported no significant relationship between leverage and earnings management. However, this result contradicts Firnanti (2017) and Astari and Suryanawa (2017), who found a positive and significant effect, as well as Mahiswari and Nugroho (2014), who reported a negative and significant relationship.

The insignificant effect of leverage suggests that both high and low leverage levels do not influence an entity's tendency to engage in earnings management. This may be due to the fact that most entities in the sample are not heavily dependent on debt financing, so changes in debt levels do not significantly affect managerial decisions regarding reported earnings (Purnama, 2017). Moreover, entities with high leverage are generally subject to stricter monitoring by creditors, prompting managers to act more cautiously and align decisions with creditors' interests, thereby limiting opportunities for earnings manipulation (Asyati & Farida, 2020).

Economically, the insignificant effect of leverage on earnings management indicates that a company's level of dependence on debt has not been a major driving factor for management to manipulate reported earnings. The implication is that leverage in consumer goods companies listed on the Indonesia Stock Exchange cannot be used as a primary indicator for detecting earnings management practices. Therefore, other factors that have a greater influence on the quality of financial reporting need to be considered.

#### **Conclusion**

1. Managerial ownership has a positive and significant effect on earnings management practices in consumer goods sector entities listed on the Indonesia Stock Exchange. This finding indicates that a higher proportion of shares owned by managers increases their tendency to engage in earnings management.

2. Institutional ownership also has a positive and significant effect on earnings management practices. This result suggests that an increase in institutional shareholdings is associated with greater earnings management activity within the entity.
3. Profitability does not have a significant effect on earnings management practices. Accordingly, whether an entity exhibits high or low profitability does not influence the likelihood of earnings management.
4. Leverage likewise does not show a significant effect on earnings management practices. This indicates that changes in leverage levels, whether increases or decreases, do not affect an entity's tendency to engage in earnings management.

### Suggestions

Based on the conclusions above, the following suggestions may be considered as input or recommendations:

1. For managerial ownership in consumer goods companies listed on the Indonesia Stock Exchange (IDX), it is suggested that the proportion of shares owned by company managers should be limited. In this way, excessive share ownership can be avoided, which may help minimize opportunistic behavior by managers arising from the returns on their share ownership, particularly through earnings management practices.
2. For institutional ownership in consumer goods companies listed on the Indonesia Stock Exchange (IDX), it is recommended that institutional investors strengthen their supervision of managers' performance in managing the company. With stricter monitoring, managers may be encouraged to focus more on improving company performance, and earnings management practices can be minimized.

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