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THE INFLUENCE OF PROFITABILITY AND FINANCIAL LEVERAGE ON EARNINGS MANAGEMENT AND ITS IMPACT ON THE VALUE OF MANUFACTURING COMPANIES IN THE INDONESIAN STOCK EXCHANGE (Case Study of the Automotive Sub-Sector Period 2018-2022)

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ABSTRACT

The practice of income smoothing still occurs in the Indonesian economy. There are several cases of income smoothing that have occurred, including at PT. Kimia Farma Tbk, PT and Lippo Tbk where these companies have published different financial reports. The purpose of this research is to determine the direct effect of profitability on income smoothing, financial leverage on income smoothing, profitability on company value, financial leverage on company value, the indirect effect of profitability on company value through income smoothing, financial leverage on company value through income smoothing and Income smoothing has a direct effect on company value. This research uses a mixed method. The population used in this research is automotive sub-sector manufacturing companies listed on the Indonesia Stock Exchange for the 2018-2022 period. The sampling method is to use a purposive sampling technique so that the samples obtained are 50 samples. The research results show that there is no direct influence of profitability on income smoothing, there is no direct influence of financial leverage on profit smoothing, there is a direct influence of profitability on firm value, there is no direct influence of financial leverage on firm value, there is no indirect influence income smoothing between profitability and company value, there is no indirect effect of income smoothing between financial leverage on company value and there is no direct effect of income smoothing on company value.

KEYWORDS *profitability, financial leverage, income smoothing, company value*

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INTRODUCTION

Earnings management means manipulating profits according to someone's desires, usually the company's management (Fahmi, 2017). In cases where management cannot achieve their profit targets, they can use the flexibility provided by accounting standards when preparing financial statements to adjust reported earnings to match the actual situation. The Thosiba accounting scandal in 2019 marked the beginning of recent earnings management cases. The scandal started when Thosiba itself began investigating accounting practices in its energy division. Over seven years, the company inflated Thosiba's operating profit by ¥151.8 billion, or about US$1.22 billion, according to an independent committee. Following the accounting scandal that shook the company, many have resigned from their positions. Thosiba's stock has dropped around 20% since the accounting scandal was revealed (Mariana, Lia, Soepriyanto, 2021). Additionally, another case that occurred in 2022 was the accounting reporting scandal of mining companies in Indonesia. This scandal emerged in several media reports, including PT Bumi Resources manipulating financial statements to support project development, PT Rivel engaging in fraud for personal gain, PT Perusahaan Gas Negara being implicated in fund misappropriation, and PT Timah intentionally creating financial reports that do not reflect reality to generate profits.

There are several factors influencing management's earnings management practices; these include profitability, business groups, stock prices, company value, accounting policies regarding earnings, and operational leverage. Researchers only focused on three factors: profitability, financial leverage, and company value. Profitability indicates how well a company can generate profits over a certain period. A company's ability to use its assets productively can be measured by comparing the company's asset amount with the earnings obtained during that period (Munawir, 1995). According to Brigham and Houston (2018), profitability is used to indicate how much profit a business generates. Higher profitability levels indicate better management performance in managing the business, while companies with lower profitability levels are more likely to engage in earnings management compared to companies with higher profitability levels because lower profitability levels indicate poorer management performance.

Another factor influencing earnings management practices is financial leverage, which is defined as a company's use of assets. Increasing leverage indicates that the funds provided by owners to finance company investments are decreasing, or the level of debt used by the company is increasing. Debt ratios can be used to evaluate how effectively a business uses borrowed money. In other words, this ratio is used to compare the sources of capital derived from debt with equity. The higher a company's debt ratio, the greater its debt, thus increasing the risk borne by the equity owners.

Several researchers have conducted studies investigating the factors influencing earnings management methods among them. Because each researcher uses different variables, the findings of each researcher differ. Research conducted by Nur and Suyatmin (2021) found that profitability affects earnings management practices, but this finding contradicts the study by (Yulvinda, 2022), which found that profitability does not affect earnings management practices. Furthermore, Dewi et al. (2020) found that leverage influences earnings management practices, but this contradicts the research conducted by Devina et al. (2021) stating that leverage does not affect earnings management practices.

Previous research results are not consistent, so further research is needed. Additionally, there is an important fact that earnings management practices will affect the company's value. When a company has a low value, investors view it negatively, so they will not want to buy its stock. If a company has a poor assessment in the eyes of investors, then the company will not have many opportunities to obtain additional capital from new investors or from increasing the volume and price of shares already issued in the capital market (Riswandi & Yuniarti, 2020). This indicates that there is a relationship between earnings management and company value.

RESEARCH METHOD

This research uses mixed method. This study used the population of automotive subsector manufacturing companies listed on the Indonesia Stock Exchange from 2018 to 2022. To collect samples, researchers used purposive sampling techniques. The samples collected numbered fifty. Smart PLS SEM software is used to statistically analyze data using structural equation models (SEM).

RESULT AND DISCUSSION

Data Analysis

In this study there were 4 latent variables and 4 manifest variables. The independent latent variable of this study consists of two variables, namely: Profitability (X1) 1 manifest variable and Financial leverage (X2) 1 manifest variable. While the dependent latent variable in this study consists of one variable, namely Company Value (Y2) 1 manifest variable and intervening latent variable, namely Profit Flattening (Z) 1 manifest variable. Using the Partial Least Square estimation method, a full model path diagram of the effect of profitability and financial leverage on profit smoothing and its impact on company value is obtained as shown below:

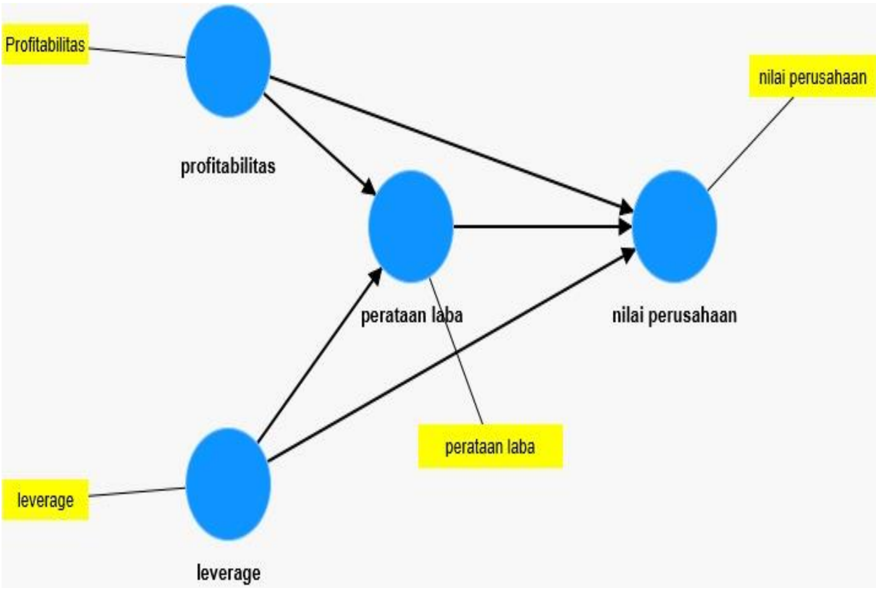

Figure 1 Research Model

The calculation output results of the entire path diagram model using SmartPLS are as follows:

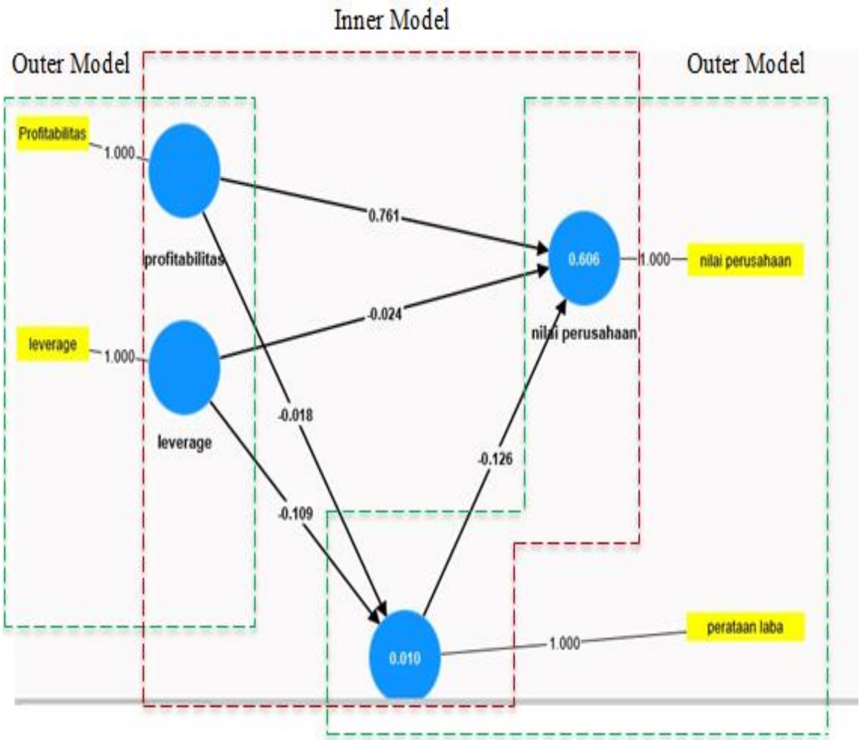

Figure 2 Complete Path Diagram Model

Furthermore, to determine the specification of the relationship between latent variables and manifest variables, these tests include convergent validity, discriminant validity and composite reliability and Cronbach Alpha, along with the tests:

Table 1. Variable Loading Factor

	Leverage	nilai perusahaan	perataan laba	Profitabilitas
Profitabilitas				1.000
Leverage	1.000			
nilai perusahaan		1.000		
perataan laba			1.000	

Source: Smart PLS output result version 4, 2024

Table 1 above presents information about the Loading Factor values for each variable. The Loading Factor value for profitability, financial leverage, company value, and profit smoothing is more than 0.7, which indicates that the manifest variable has the highest correlation with the construct variable. All other variables are also valid or valid. In addition to looking at the outside load, you can also test convergent validity by looking at the Extracted Average Variance (AVE) value. An AVE value above 0.5 indicates that an indicator has good convergent validity. The value of the external load can still be tolerated up to 0.5, and if the value is below 0.4, the analysis can be discarded (Ghozali, 2018). The calculation of the AVE value discarded from the analysis shows that the AVE value obtained may be below 0.4, so the analysis can be discarded.

Table 2. Variable Correlation Value

	Profitability	**leverage**	**profit smoothing**	**Company Value**
Profitability	1,000	0.000	0.000	0.000
Leverage	-0.510	1,000	0.000	0.000
Profit Smoothing	0.037	-0.100	1,000	0.000
Company Value	0.768	-0.399	-0.095	1,000

Source: Smart PLS output result version 4, 2024

Based on the table above, we can see the root of AVE leverage (-0.100) < the correlation of profitability (0.037), besides the root of AVE flattening of profit < from the correlation of leverage and profitability, the discriminant validity requirement of Criterion is not determined.

According to Ghozali (2018), the reliability composition component is used to evaluate the reliability value of indicators on a variable. A composite reliability value greater than 0.7 indicates that the variable satisfies the composite reliability. The results of smart PLS analysis show that the reliability values of composites and Cronbach Alpha for construction validity and reliability are not displayed. Therefore, if the reliability values of the composite and Cronbach Alpha are below 0.4, those variables may be excluded from the analysis.

Based on the results of the outer model measurement model, it can be concluded that the Convergent Validity analysis shows that the shelter factor value test is met, while the AVE value is not met; Discriminant Validity analysis shows that the value of discrimination validity is not met; and combined reliability and Cronbach Alpha analysis showed that the reliability value and construct validity were not met. PLS-SEM is a test that does not require normal, valid, and credible distributed data, and has the ability to test predictive relationships between variables to determine if there is a relationship or influence between those variables, according to Hair et al. (2013). In addition, PLS-SEM has the ability to perform parameter estimation without having to meet Godness of Fit (GoF) criteria. The value of the coefficient of determination (R2) is a parameter of the precision of the prediction model.

Table 3. Research Results

	Original sample (O)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values	Kesimpulan
Profitabilitas -> perataan laba	-0.018	0.084	0.216	0.414	Tidak terdapat pengaruh secara langsung profitabilitas terhadap perataan laba
leverage -> perataan laba	-0.109	0.105	1.038	0.150	Tidak terdapat pengaruh secara langsung *finansial leverage* terhadap perataan laba
Profitabilitas -> nilai perusahaan	0.761	0.110	6.927	0.000	Terdapat pengaruh secara langsung profitabilitas terhadap nilai perusahaan
leverage -> nilai perusahaan	-0.024	0.082	0.290	0.386	Tidak terdapat pengaruh secara langsung *finansial leverage* terhadap nilai perusahaan
perataan laba -> nilai perusahaan	-0.126	0.099	1.272	0.102	Tidak terdapat pengaruh secara langsung perataan laba terhadap nilai perusahaan
Profitabilitas -> perataan laba -> nilai perusahaan	0.002	0.012	0.191	0.424	Tidak terdapat pengaruh tidak langsung perataan laba antara profitabilitas terhadap nilai perusahaan
leverage -> perataan laba -> nilai perusahaan	0.014	0.017	0.798	0.213	Tidak terdapat pengaruh tidak langsung perataan laba antara *financial leverage* terhadap nilai perusahaan

Source: Smart PLS output result version 4, 2024

Discussion

The Effect of Profitability on Profit Smoothing

Profitability shows how well a company can make a profit in a certain period of time. A low level of profitability will not do a flattening of profits, but a high level of profitability will. If the company has high profitability, large investors may encourage managers to do profit leveling. This is because the probability of smoothing profits is greater if the company has high profitability. According to Intan (2023), a high probability indicates good company performance, while a low probability indicates poor performance. Because investors prefer stability and fluctuating increases in earnings, managers avoid ups and downs in performance appraisals. Therefore, companies that have the ability to generate high profits are more likely to do profit smoothing than companies that have the ability to generate low profits.

The Effect of Financial Leverage on Profit Smoothing

In this study, the company's financial leverage will not encourage the company to carry out profit leveling practices, so it cannot attract the attention of creditors. Finacial leverage means that the company uses borrowed capital in addition to its capital, and the company has to pay interest as a fixed expense. Thus, the greater the debt of the company, the greater the risk that investors face. Investors will feel uncomfortable if they have larger debts. In agency theory, the difference in interest between a company's management and investors determines whether or not the company will engage in profit-leveling practices. To do so, the company will use debt to maintain its capital position as best as possible.

The Effect of Profitability on Company Value

In this study, Return on Assets is used to measure profitability. This is done by comparing profit after tax with total assets. In addition, this negative trend indicates that the profitability of the enterprise is negatively correlated with the value obtained. The company does not have high enough profitability to improve its performance, which means that its value decreases. Companies that can increase their profitability annually will attract investors. Because the return obtained is low, investors will trust businesses that are able to generate large profits. The manager of the company will use this situation to obtain a source of capital in the form of shares. According to Salwa Azahra's (2022) research, individual profitability has a positive impact on company value.

The Effect of Financial Leverage on Company Value

By using foreign capital or debt to finance its operations and bear fixed expenses in an effort to increase earnings per share, companies use financial leverage to obtain borrowed capital from outside (Alfiani, 2023). Favorable financial leverage conditions can increase profits for shareholders and increase a company's share price in the market, as described in this explanation. However, when financial leverage is not in the company's favor, investors become concerned because the company's high debt levels raise concerns because there is a possibility that the company may not be able to pay off its debts and result in bankruptcy, which is seen by investors as a risk that threatens its investment.

The effect of profitability on company value through profit smoothing

Nonetheless, investors may consider profit leveling practices and profitability as important factors when making investment decisions. It's not just high or low levels of profitability that are a major concern for potential investors; The level of money turnover shown in the company's cash flow statement is one of the other indicators that potential investors should pay attention to. This is because companies with a high level of profitability may experience financial problems due to the low rate of money turnover caused by large transactions. In addition, most manufacturing companies listed on the IDX, both large and small, have implemented good corporate governance, which makes reporting financial conditions more accurate and reduces the possibility of profit leveling practices.

The effect of financial leverage on company value through profit smoothing

Optimizing the use of debt can increase the value of the company, according to Jansen (Devina. 2021). This is because optimal use of debt can help companies achieve their goals and increase their stock price, which in turn increases the value of the company. This is achieved by minimizing the possibility of managers to do things that do not benefit shareholders. The use of debt capital has advantages and disadvantages. If the business climate is good, the use of debt capital will be beneficial, because the benefits of using debt will outweigh the interest costs. However, in an unstable business environment, the benefits of using debt can be less than the costs incurred (SIANTURI, 2023).

Management often uses profit smoothing to cover debt ratio information and stabilize profits (Widyowati &; Rani, 2019). However, when investors invest in companies, this is not one of the things they pay attention to. The use of liquidity ratios using the current ratio is assessed from the company's ability to pay short-term debt. On the other hand, investors pay the most attention to the company's estimated future profits.

The Effect of Profit Smoothing on Company Value

Profit leveling jeopardizes the value of the company. This shows that investors look at more than financial statements when choosing to buy a company's stock. Despite the fact that high profit leveling measures carried out by management will reduce the value of the company in the future.

CONCLUSION

Based on the findings and discussions, this study concludes as follows: (1) This research indicates that there is no direct influence of profitability on earnings management. This occurs because the company's profits from sales are mainly used to pay off debts rather than increasing its capital, so management is not motivated to engage in earnings management. (2) This study shows that there is no direct influence of financial leverage on earnings management. This could be due to the relatively low financial leverage in the automotive sub-sector companies during the period 2018-2022, coupled with tighter scrutiny by creditors, which minimizes the opportunities for companies to engage in earnings management. (3) This research demonstrates a direct influence of profitability on company value. This is because the automotive sub-sector companies during the period 2018-2022 successfully maximize profitability each year, attracting many investors and signaling positive investor interest in the company. (4) This study indicates that there is no direct influence of financial leverage on company value. This may be due to the low level of debt in the automotive sub-sector companies during the period 2018-2022, which does not raise concerns for investors as a risk that could threaten their investments. (5) This research shows no indirect influence of earnings management between profitability and company value. This is because the level of profitability of companies is not a primary indicator considered by potential investors. Additionally, most manufacturing companies listed on the Indonesian Stock Exchange, regardless of their size, already implement good corporate governance, resulting in more accurate financial reporting and reducing the opportunity for earnings management practices. (6) This study indicates no indirect influence of earnings management between financial leverage and company value. This is because earnings management is often used by management to stabilize profits and cover up debt ratio information, which is not a major aspect considered by investors when investing in companies. (7) This research indicates no direct influence of earnings management on company value. This may occur because investors consider not only fundamental factors through financial statements in the decision-making process of purchasing company stocks. Although high levels of earnings management by management may decrease the company's value in the future.

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