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The Influence of External Financing, Book-Tax Differences, and Product Diversification on Profit Management Moderated by Managerial Ability

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ABSTRACT

This study aims to examine the influence of external financing, book-tax differences, and product diversification on earnings management, with managerial ability as a moderating variable. The data used are panel data from 60 Bursa Efek Indonesia (BEI) infrastructure sector companies from 2019 to 2023, totaling 198 observations obtained using purposive sampling techniques. The results of the study, using the fixed effects model, provide empirical evidence of a significant negative relationship between external financing and earnings management, thus supporting signaling theory and emphasizing the importance of financial reporting transparency to reduce opportunistic earnings management practices. Conversely, book-tax differences have a significant positive effect on earnings management, illustrating how management weighs costs and benefits according to rational choice theory and the existence of principal-agent problems for personal gain. Product diversification has no effect on earnings management. Furthermore, managerial ability is only able to moderate the effect of external financing on earnings management by strengthening the negative relationship between these two variables.

KEYWORDS *Earnings Management; External Financing; Book-Tax Differences; Diversification; Managerial Ability.*

INTRODUCTION

In the last two decades, financial credit crises in various countries have triggered a number of executives to disguise company performance through manipulation of financial statements (Li et al., 2020). Earnings management, which is carried out without violating the law but still misleads investors (Saona et al., 2020), represents an agency problem resulting from managers exploiting information asymmetry for personal interests (Putra et al., 2021; Griffin et al., 2021). This practice leads to erroneous investment decisions and reduces the quality and reliability of financial statements (Duho et al., 2024; Soeprajitno et al., 2023). The earnings management case involving PT Waskita Karya (*Persero*), Tbk. and PT Wijaya Karya (*Persero*), Tbk. was uncovered when a bank suspected invoice discrepancies during credit restructuring. Suspicion intensified after a fictitious project case emerged, implicating Waskita's President Director, Destiawan Soewadjono. Both companies manipulated bookkeeping by concealing vendor

invoices since 2016, making liabilities appear lower and financial conditions seem healthier (Tempo Magazine, 2023).

Various studies have identified a range of factors affecting earnings management, including corporate financing patterns in different countries (Boachie dan Mensah, 2022; Hidayat *et al.*, 2025). Although global financial markets influence the availability of external financing, international studies have not thoroughly examined this relationship. Analyses in countries such as China, Vietnam, and Bangladesh show that firms tend to engage in earnings management when issuing equity, a tendency exacerbated by external factors such as political or economic instability. The findings are also diverse: some studies report a positive effect of external financing (Bui et al., 2022; Hong et al., 2023; Jing, 2023; Zhang et al., 2020), while Xiao & Uddin (2023) found a negative effect. This variation is attributed to differences in sample size (ranging from 3,780 to 75,790 observations), country scope (Vietnam, China, Bangladesh, and up to 43 countries), and the time period analyzed (2002–2021).

Next, book-tax differences (*BTD*), which arise from discrepancies between commercial and tax accounting standards, influence earnings management through tax planning that exploits regulatory loopholes. Companies seek to reduce taxable income relative to book income to minimize tax burdens, often by manipulating net income (Lembut et al., 2023; Muslim & Sari, 2023). However, research findings are mixed: some have found a positive effect of *BTD* (Gentle et al., 2023; Stoduto et al., 2021), while others report insignificant results (Floropoulos et al., 2024; Leal et al., 2022; Muslim & Sari, 2023). These differences are influenced by sample characteristics (sector type, sample size, study period) and institutional context (accounting standards, tax regulations, as well as methods for measuring *BTD* and earnings management) (Floropoulos et al., 2024).

On the other hand, product diversification—a strategy to enhance growth and competitiveness—can influence earnings management through increased operational complexity and information asymmetry (Chou & Chang, 2020). However, findings are mixed: Berrill et al. (2021) and El Mouttaqui et al. (2024) found a negative effect (diversification suppresses manipulation), while Ahmed et al. (2021) and Chou & Chang (2020) reported a positive effect (diversification increases manipulation), and da Silva (2021) found no significant effect. These discrepancies are likely due to variations in sample, geographic coverage, research period, and sector. For instance, studies in Nigeria (495 observations) and Europe (18,893 observations) reflect local dynamics, while global (62,067 observations) and US (71,758 observations) analyses capture different scales and complexities.

Furthermore, managers play a crucial role in financial decision-making because they have greater access to internal information, which can drive opportunistic behavior through selective reporting (Kong et al., 2022; Xiang et al., 2022). Differences in individual attributes such as expertise, risk preferences, and backgrounds increasingly contribute to variations in earnings reporting (Kumar & Goswami, 2024). Although some managers tend to manipulate earnings, managerial competence can suppress this practice by promoting transparency—such as minimizing debt and avoiding aggressive tax avoidance (Choo et al., 2021; Lee et al., 2024)—and ensuring the success of diversification strategies (Lee &

Foong, 2023). In Indonesia, the high debt levels of state-owned enterprises due to suboptimal management (Lisnawati, 2023) underscore the importance of managerial competence in financial decision-making.

This research is entitled "The Influence of External Financing, Book-Tax Differences, and Product Diversification on Earnings Management Moderated by Managerial Ability," referencing Bui et al. (2022); Hong et al. (2023); Jing (2023); Xiao & Uddin (2023); Zhang et al. (2020) for external financing, Floropoulos et al. (2024); Leal et al. (2022); Gentle et al. (2023); Muslim & Sari (2023); Stoduto et al. (2021) for book-tax differences, and Ahmed et al. (2021); Berrill et al. (2021); Chou & Chang (2020); da Silva (2021); El Mouttaqui et al. (2024) for product diversification. Managerial ability (Kumar & Goswami, 2024; Liao et al., 2023; Putra et al., 2021) is used as a moderating variable, with firm size and leverage as control variables. The data are drawn from infrastructure sector companies listed on the *Indonesia Stock Exchange* (*IDX*) for the 2019–2023 period.

Previous studies by Bui et al. (2022) and Hong et al. (2023) focus on external financing and its relationship with earnings management, highlighting the positive effect of external financing on the tendency to manage earnings, particularly in developing economies. However, these studies do not thoroughly consider how managerial ability and firm-specific characteristics might moderate this relationship, an aspect that is crucial for evaluating the impact of external financing on earnings management practices. Additionally, while these studies cover multiple countries, they do not address the unique challenges faced by companies in specific sectors, such as infrastructure, where factors like government regulations and project financing are especially relevant.

Similarly, research by Stoduto et al. (2021) and Floropoulos et al. (2024) examines book-tax differences (*BTD*) and their influence on earnings management, finding mixed results depending on sample variations and institutional contexts. However, these studies do not explore how managerial competence might mitigate opportunistic behaviors arising from *BTD*, which is critical for understanding the overall impact on earnings management. Furthermore, their emphasis on tax laws and accounting standards overlooks the role of other internal factors, such as the firm's diversification strategy and operational complexity, in shaping earnings management practices.

The purpose of this research is to analyze how external financing, book-tax differences, and product diversification affect earnings management, and how managerial ability moderates these relationships in the context of Indonesian infrastructure sector companies. By focusing on the interplay of these factors, the study aims to provide insights into how companies can improve financial transparency and minimize opportunistic earnings management. The findings will help policymakers, investors, and company managers better understand the key drivers of earnings management and provide strategies to enhance corporate governance, accountability, and sustainable financial practices in the infrastructure sector.

RESEARCH METHOD

This study employs a quantitative approach by utilizing unbalanced panel data to analyze infrastructure sector companies listed on the *Indonesia Stock Exchange* (*IDX*) during the 2019–2023 period. The unit of analysis is the company, specifically those that provide audited annual financial statements. The sample is selected based on specific criteria: the company must be listed on the *IDX* during the study period, must have published financial statements with a fiscal year ending on December 31, must report positive earnings, and must have data available for up to two years in advance. Data collection is conducted using a purposive sampling technique to ensure that the information gathered aligns with the research objectives.

The data analysis method in this study utilizes various statistical techniques and hypothesis testing to evaluate the relationships among external financing, book-tax differences, product diversification, managerial ability, and earnings management. First, descriptive statistics—including minimum, maximum, mean, and standard deviation—are used to summarize the data set. For model selection, several diagnostic tests are conducted: the Chow test for the *Common Effects Model*, the Hausman test for the *Fixed Effects Model*, and the Lagrange Multiplier test for the *Random Effects Model*. The null hypotheses for these tests are rejected if the p-value is ≤ 0.05, indicating the most appropriate model for the data.

For hypothesis testing, the Adjusted R^2 value is calculated to assess the model's goodness of fit, where higher values (closer to 1) indicate better explanatory power. The F-test is used to determine the overall suitability of the model, with the null hypothesis rejected if the significance value is ≤ 0.05, suggesting that the model is appropriate. Additionally, the t-test is employed to assess the significance of individual predictor variables, where the null hypothesis is rejected if the significance value is ≤ 0.05, indicating that the independent variables have a statistically significant effect on the dependent variable.

The regression model employed is a panel data regression, with the equation specified as:

$$em = \alpha + \beta_1 xfin + \beta_2 btd + \beta_3 div + \beta_4 lev + \beta_5 size + \beta_6 (xfin \times mngab) + \beta_7 (btd \times mngab) + \beta_8 (div \times mngab) + \epsilon$$

description:

em = *earnings management*
xfin = *external financing*
btd = *book-tax differences*
div = *diversification*
mngab = *managerial ability*
lev = *leverage*
size = *firm size*
ϵ = *residual errors*

RESULT AND DISCUSSION

The sample selection in this study used the purposive sampling method and the sample that met the criteria was 288 while the processed sample was 198.

Table 1. Research Sampling

No	Criteria	Total					
		2019	**2020**	**2021**	**2022**	**2023**	**Total**
1	Infrastructure sector companies listed on the IDX.	50	54	57	61	66	288
2	Publish financial statements that end December 31.	-	-	-	(1)	(2)	285
3	Earn profit in the current year.	(13)	(24)	(19)	(14)	(15)	(85)
4	Have data up to two years in advance.	-	-	-	-	(2)	(2)
	The number of samples meets the criteria	**37**	**30**	**38**	**46**	**47**	**198**

Source: Ms Excel (Data Processed)

Descriptive statistics

The results of descriptive statistics are shown in the following table.

Table 2. Statistics Descriptive

Variabel	*N*	*Min*	*Max*	*Mean*	*St.Dev*
ofit management (*em*)	198	(0,68447)	1,33477	0,00000	0,19305
ternal financing (*xfin*)	198	(0,74108)	0,78100	0,02382	0,19643
ok-tax differences (*btd*)	198	(0,06105)	0,70202	0,10134	0,11261
versification (*div*)	198	0,24857	1,00000	0,74308	0,23516
nagerial Skills (*mngab*)	198	(0,34062)	0,44409	0,00000	0,14222
erage (*lev*)	198	0,00641	1.331,99	7,24589	94,62395
mpany size	198	9,07718	19,47514	15,29174	2,12094

Source: Ms Excel (Data Processed)

Model Selection Test

Table 3. Model Selection Test

Chow Test		
Test	***Probability***	**Conclusion**
Cross-section fixed effects	0.0000	*Fixed Effects Model*
Hausman Test		
Test	***Probability***	**Conclusion**
Cross-section random effects	0.0000	*Fixed Effects Model*

Source: Eviews 13

Based on the results of the model selection test using *the Chow* and *Hausman test,* the model used is *fixed effects.* The *lagrange multiplier* test was not performed because *the Hausman* test had concluded the use of *a fixed effects model.*

Hypothesis Test

Coefficient of Determination Test (R2)

Table 4. Determination Coefficient Test Results

Coefficient	*Probability*
Adjusted R-squared	0.790747

Source: Eviews 13

Based on the results of the determination coefficient test, the *Adjusted R-squared* value was 0.790747. This shows that the variation of all independent variables (*xfin, btd, div*), control variables (*lev, size*) and interaction variables (*xfin*mngab, btd*mngab, div*mngab*) was able to explain the independent variable (em) by 79.07%. The remaining 20.93% was explained from other variables that were not included in this study.

Test F

This test is performed to see if all the independent variables included in the model have a combined influence on the dependent variables.

Table 5. F Test Results

Item	*Value*
F-statistic	12.11109
Prob(F-statistic)	0.000000

Source: Eviews 13

Based on the table above, a *probability value* of 0.00000 is obtained. If referring to the hypothesis of the F test, *H0* is rejected because the regression model is considered significant at the level of 5% (*p-value* less than 0.05). This means that independent variables (*xfin, btd, div*), control variables (*lev, size*), and interaction variables (*xfin*mngab, btd*mngab, div*mngab*) as a whole have a significant influence on the dependent variable (*em*).

Regression Analysis and t-Test

This test is carried out to find out how far an independent variable partially (individually) affects the dependent variable.

Table 6. Test Results t

	Variable and Hypothesis	Direction Prediction	*Beta*	*t-stat*	*prob.* (*one-tailed*)	Conclusion
H1	*xfin* has a negative effect on *EM*	-	0.139934)	2.729426)	0.003612	H1 is accepted.
H2	*BTD* Influential positive towards *EM.*	+	0.460571	2.893283	0.002236	H2 is accepted.
H3	*div* has a negative effect on *EM.*	-	0.004089)	0.056869)	0.477369	H3 was rejected.
	Lev		0.349990)	4.316932)	0.000016	
	size		0.262152	6.016548	0.000000	
H4	*mngab* amplifies the negative influence *of xfin* on *EM.*	+	0.706574	2.044443	0.021465	H4 accepted
H5	*Mngab* weakens the positive influence *of BTD* on *EM.*	-	(0.340508)	(0.308468)	0.379110	H5 was rejected.
H6	*The mngab* amplifies the negati	+	0.142951	0.924369	0.178506	H6 was rejected.

Variable and Hypothesis	Direction Prediction	*Beta*	*t-stat*	*prob.* (*one-tailed*)	Conclusion
influence *of the div* on *EM.*					

Source: Eviews 13

Based on *the intercept* and coefficients obtained from the regression analysis, the following regression equation is obtained.

$$\boldsymbol{em = -1,416569 - 0,139934\ xfin + 0,460571\ btd - 0,004089\ div - 0,349990\ lev + 0,262152\ size + 0,706574\ (xfin\ x\ mngab) - 0,340508\ (btd\ x\ mngab) + 0,142951\ (div\ x\ mngab)}$$

Information:
EM = *Earnings Management*
xfin = *external financing*
btd = *book-tax differences*
div = *diversification*
mngab = *managerial ability*
lev= leverage
size = *firm size*

Discussion

H1 acceptance, which states a negative relationship between external financing and profit management, is in line with signal theory and agency theory. Signal theory explains that companies seeking external financing must provide credible signals through transparent financial reporting to reduce information asymmetry and build trust with investors and creditors, thereby preventing profit manipulation. Agency theory, on the other hand, highlights that the need for external financing increases supervision and monitoring, which limits managers' opportunistic behavior and reduces agency costs. The results of this study support the view that external financing encourages companies to prioritize high-quality financial reporting, reducing profit management practices, as supported by Xiao & Uddin (2023). However, these findings contradict previous research by Bui et al. (2022), Hong et al. (2023), Jing (2023), and Zhang et al. (2020), which found a positive relationship between external financing and profit management.

H2 acceptance, which shows a positive relationship between *book-tax differences* and profit management, is in line with rational choice theory (RCT) and agency theory. RCTs explain that managers as rational decision-makers consider benefits and costs to maximize utility, where *book-tax differences* provide opportunities for them to reduce tax liabilities while increasing reported profits, thus encouraging profit management practices (Gentle et al., 2023). Agency theory complements this perspective by highlighting conflicts of interest between managers and shareholders, in which managers take advantage of information asymmetry to manipulate profits according to their incentives (Leal et al., 2022). This positive relationship suggests that the greater the difference between accounting profit and taxable profit, the greater the opportunity for managers to undertake profit management, thus emphasizing the importance of monitoring mechanisms to reduce agency conflicts (Stoduto et al., 2021). The results of this

study are in line with previous studies by Lembut et al. (2023) and Stoduto et al. (2021), which showed that book-tax differences create opportunities for profit manipulation, but contradict the research of Floropoulos et al. (2024), Leal et al. (2022), and Muslim & Sari (2023), which found no significant association between the two.

The H3 rejection, which hypothesizes a positive relationship between diversification and profit management, suggests that diversification does not significantly affect profit management as predicted by agency theory. Although agency theory states that diversification can increase agency costs and information asymmetry, giving managers more discretion to engage in profit manipulation (Berrill et al., 2021), the results of this study suggest that managers in diversified firms may be more focused on operational efficiency and resource allocation than opportunistic reporting, thereby reducing expected agency costs (da Silva, 2021). These findings are consistent with da Silva's (2021) study, which also did not find a significant association between diversification and profit management, but contradicts studies that show a negative relationship (Berrill et al., 2021; El Mouttaqui et al., 2024) and positive relationships (Ahmed et al., 2021; Chou & Chang, 2020) between the two.

H4 acceptance, which suggests that managerial ability reinforces the negative relationship between external financing and profit management, is in line with agency theory and signal theory. Agency theory emphasizes that competent managers reduce agency conflicts by increasing transparency, decision-making, and alignment of shareholder interests, thereby minimizing opportunities for opportunistic behaviors such as profit management (Liao et al., 2023). Meanwhile, signal theory explains that companies seeking external financing must demonstrate financial transparency and stability to build investor and creditor trust, where managerial capabilities reinforce the effectiveness of these signals, ensuring that external financing is associated with lower profit management practices (Xiao & Uddin, 2023). Combined with *H1* receipts, which show a negative relationship between external financing and profit management, these findings confirm that managerial competence plays an important role in increasing transparency and strengthening the integrity of financial reporting in companies that rely on external funding.

The H5 *rejection*, which hypothesizes that managerial ability weakens the positive relationship between *book-tax differences* and profit management, suggests that managerial ability does not significantly moderate the relationship between the two variables. Although agency theory states that competent managers can reduce agency conflicts by improving decision-making and transparency (Kumar & Goswami, 2024), *H2 acceptances* that show a positive relationship between *book-tax differences* and profit management indicate that managers continue to exploit these differences as a rational strategy to maximize utility. The *H5* rejection implies that even competent managers may remain involved in profit management when book-tax differences create opportunities, primarily due to external pressures or incentives that drive short-term financial outcomes.

The *H6 rejection,* which hypothesizes that managerial ability reinforces the negative relationship between diversification and profit management, is in line with

the H3 rejection, which finds no significant relationship between diversification and profit management. According to agency theory, diversification can increase agency costs by worsening information asymmetry and giving managers more flexibility, potentially driving profit management (Berrill et al., 2021). However, *the H3* results showing that diversification does not directly affect profit management indicate that managerial ability cannot strengthen non-existent relationships either. Thus, *the rejection of H6* implies that managerial ability does not play a role in moderating the relationship between diversification and profit management because diversification itself does not have a significant impact on profit management practices.

CONCLUSION

This study finds that external financing negatively influences earnings management, while book-tax differences have a positive effect, and product diversification does not exhibit a significant impact. Managerial ability strengthens the negative relationship between external financing and earnings management but does not moderate the effects of book-tax differences or diversification. The research is limited by the exclusion of many firm-year observations that do not meet profitability criteria and the inclusion of newly listed companies on the *IDX* lacking sufficient time series data, which may affect data consistency and comparability. For future research, it is suggested to extend the observation period, examine the effects of changes in state leadership and infrastructure budget allocations over time, and consider additional moderating variables to provide a more comprehensive understanding of the factors influencing earnings management.

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