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CORPORATE GOVERNANCE PRACTICES, SHARE OWNERSHIP STRUCTURE, AND SIZE ON EARNING MANAGEMENT

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ABSTRACT

This study tries to analyze the effect of corporate governance practices, ownership, and firm size on the amount of earnings management. It was conducted in the companies listed in Indonesia Stock Exchange. Ownership structure can be divided into institutional ownership and family ownership, firm size which were measured by market capitalization. The corporate governance practices were measured using three variables (quality audit, the proportion of independent board, and the existence of audit committee). Multiple-regression was employed for analysis with the empirical data from 117 samples of manufacturing companies listed in the Indonesia Stock Exchange. It was found that company size and family ownership have a significant influence on the amount of earnings management. The larger the company, the smaller management is on average earnings and earnings management in the firms with high family ownership. Those that are not a corporate conglomerate are higher than average earnings in the management of other companies. The practice of corporate governance and institutional ownership variable did not have significant effect on the amount of profit made by company management.

Key words: *corporate governance, ownership structure, firm size, and earnings management.*

PRAKTEK *CORPORATE GOVERNANCE*, STRUKTUR KEPEMILIKAN SAHAM, DAN UKURAN PERUSAHAAN PADA PENGELOLAAN LABA

ABSTRAK

Penelitian ini bertujuan untuk menganalisis pengaruh praktik corporate governnance, kepemilikan, dan ukuran perusahaan terhadap jumlah earning management. Penelitan ini dilakukan di perusahaan yang terdaftar pada Bursa Efek Indonesia. Struktur kepemilikan bisa dibagi menjadi kepemilikan institusi dan keluarga; ukuran perusahaan diukur dengan 3 variabel yaitu kualitas audit, proporsi dewan direksi independen, dan keberadaan komite audit. Multiple regresi digunakan untuk menganalisis data yang terdiri dari 117 perusahaan manufaktur yang tercatat di Bursa Efek Indonesia. Ditemukan bahwa ukuran perusahaan dan kepemilikan keluarga memiliki pengaruh signifikan terhadap jumlah earning management. Semakin besar perusahaan, semakin kecil earning management pada earnings rata-rata dan earning management di perusahaan yang nilai rata-ratanya lebih tinggi daripada kepemilikan keluarga. Perusahaan yang bukan konglomerat justru lebih tinggi earning managementnya. Praktik penerapan corporate governance dan kepemilikan perusahaan tidak berpengaruh secara signifikan terhadap earning management.

Kata Kunci: *corporate governance, struktur kepemilikan, ukuran perusahaan, dan pengelolaan laba.*

INTRODUCTION

It is stated that a financial statement is a means of communicating financial information to parties outside the corporation. This financial statement is expected to provide information to investors and creditors for making decisions related to investment funds. In preparing financial statements, the accrual basis should be chosen because it is more rational and fair in reflecting the company's financial condition in real terms. However, using the accrual basis may provide more flexibility for the management in choosing the method of accounting so that they will not deviate from the rules of the Financial Accounting Standards.

In general, the choice of accounting methods that are deliberately selected by management for specific purposes is known as earnings management. When the management did not succeed in attaining the target profit specified, the management will take advantage of the flexibility allowed by the accounting standards in preparing their financial statement. This is done for modifying the reported earnings. Management should be motivated to show good performance in generating value or the maximum benefit for the company. By doing so, they management can select and apply accounting methods that can provide a better return. The existence of information asymmetry allows the management to create earnings management. Research by Richardson (1998) showed a positive relationship between information asymmetry and earnings management.

One of measurements for corporate performance is often used as a basis for decision making. Such a measurement is the company's profit generated (Subramanyam, 1996), where profit is measured by the accrual basis. Accrued profit is considered as a better measurement because the corporate databases must address satisfaction better than operating cash flows. This is because accruals reduces the time and mismatch problems (mismatching) embodied in the use of short-term cash flows (Dechow, 1994).

Yet, the flexibility is always open in the implementation of Generally Accepted Accounting Principles (GAAP) that leads management to choose the accounting policies of the various policy options that exist. Thus, in turn, it also allows them to get for the flexibility of the earnings management by the company management (Subramanyam , 1996). In this case, Scott (2000) suggests that earnings management can make the companies efficient (increase in profit) and can be opportunistic. If earnings management is opportunistic, the information may lead to profit and make the wrong investment decisions for investors. Therefore, it is imperative to see the factors affecting the profits of the company management.

This study attempts to provide empirical evidence on the impact of Indonesia's corporate practice, ownership structure, and firm size on the magnitude of earnings management by the manufacturing companies listed in the Indonesia Stock Exchange.

It is also expected to contribute to the development of conceptual earnings management literature, by adding independent variable, namely the ownership (combined with a business group). This is considered important when concerning the condition of the stock ownership in Indonesia. They have been dominated by family ownership, and this is different from the structure of share ownership in the United States whose ownership is spread worldwide.

THEORETICAL FRAMEWORK

It has been the fact that the research on corporate governance is increasing rapidly along with the opening of large-scale financial scandals (e.g. Enron, Tyco, WorldCom and Global Crossing) involving accountants, one important element of good corporate governance. The scandals represent the negative consequences of weak governance system and seek to identify the determinants that can improve the implementation of corporate governance. Iskandar and Chamlou (2000), for example, stated that the economic crisis in Southeast Asia and other countries occurs not only due to macroeconomic factors but also weak corporate governance in those countries, such as weak legality of accounting standards and financial inspection (auditing) that have not been established, capital markets that are still under-regulated, weak supervision of commissioners, and the neglect of the rights of minorities. Such a condition also indicates that good corporate governance has not only a positive result for shareholders, but also for the wider community in the form of national economic growth.

In the above circumstance, the various economic institutions and the financial world such as the World Bank and International Monetary Fund are becoming interested in the enforcement of corporate governance in recipient countries because they assume that corporate governance is an essential part of an efficient market system. Good corporate governance development efforts aimed at encouraging the optimization of the allocation or use of company resources for growth and prosperity of the owner of the company intact.

In this case, corporate governance is essentially a matter of controlling the behavior of top corporate executives to protect the interests of company owners (shareholders). This problem arises because of the separation between ownership and company management. The owners of the company as suppliers of capital can delegate their authority of the management of the company to professional managers. As a result, the authority to use corporate resources is entirely in the hands of the executive. Shareholders expect management to act in a professional to manage the company. Any decision taken should be based on the interests of shareholders and existing resources used solely for the sake of growth (value) of the firms.

However, what often happens is that the decisions taken by management are not solely for the benefit of the company but also for the interests of executives. In fact, in many cases, decisions and actions taken have only often become the benefits but also harms for the corporate executives. In other words, management has an agenda which is different from the interests of the owners. The use of creative accounting, business failures, limited roles of auditors, the absence of a clear relationship between compensation and the performance of the system, emphasis on performance (accounting profit) at the expense of short-term long-term economic profits, and so on (Keasey and Wright, 1997) are some examples of the behavior deviations manager.

In general, corporate governance is the means, mechanisms, and structures that serve as control over self-serving behavior of managers (Short et al., 1999). The management of the companies that are open (transparent) and accountable can prevent the occurrence of self-serving behavior. As revealed by Keasey and Wright (1997) that the corporate governance is a key element that concern the enhancement of corporate performance via the supervision, or monitoring, of management performance and ensuring the accountability of management to shareholders and other stakeholders.

Thus, Good corporate governance can be defined as an interaction between structures and mechanisms which ensure control and accountability, but still encourage efficiency and performance of the company (Salowe, 2002). Anderson et al (2002) also stated that the company controlled by the family has a structure that reduces the agency conflict between shareholders and creditors, which the lender assumes the ownership by the family better, protect the interests of creditors. Anderson & Reeb (2002) showed that minority shareholders would benefit from the presence of family ownership. Arifin (2003) found that the public companies in Indonesia, family-controlled financial institutions or state or agency problems are better than a public company controlled by or without the main controller.

Family-controlled firms, a smaller agency problem is due to reduced conflicts between principal and agent. If family ownership is more efficient, the family holdings in companies with high earnings management which is opportunistic may be restricted. However, the more efficient of the control of the family's ownership it likely does not apply in the conglomerate, as it is widely available in Indonesia. For the conglomerate, usually most of the property owner does not reside in one company, but scattered in various companies.

If only a few property owners who are in companies that go public, so even if the company goes public, they are still a family controlled, but the opportunistic earnings management can be even higher. The possibilities for companies that go public are only used as a means of collecting funds from the public for use by the company. This is evident from the results of research Kim & Yi (2004) who found that the magnitude of earnings management is higher for companies that have affiliate group than those that do not have group or no affiliation. This means that firms with business group affiliation provides controlling shareholders more incentive and opportunity for earnings management.

It is advisable that the company should be controlled by the family and not a corporate conglomerate that can limit opportunistic earnings management (negatively related), but will drive earnings management that is efficient (positively related). Institutional investors often referred to as sophisticated investors and should be able to use the current period information in predicting future earnings as compared to non-institutional investors. Balsam et al (2002) found a negative relationship between discretionary accruals that are not expected to yield stocks around the announcement date, which is a negative relationship, varies depending on the level of investor sophistication.

The market reaction of the more sophisticated investors precedes that of unsophisticated investors. Jiambalvo et al (1996) found that the absolute value of discretionary accruals is negatively related to ownership of institutional investors. Mitra (2002), Koh (2003), and Midiastuty &. Machfoedz (2003) also found that the presence of high institutional ownership limits managers to manage earnings. However, Darmawati (2003) found no evidence of an association between earnings management and institutional ownership. If earnings management is done efficiently, the high institutional ownership would likely improve the earnings management (positively related). On the contrary, if the management of the company profits are opportunists, the high institutional ownership will reduce earnings management (negatively related).

The larger the company, the better the information available to investors in making investment decisions with respect to the shares of the company. Albrecth & Richardson (1990) and Lee & Choi (2002) found that larger firms have less impetus to do profit smoothing than small firms because large firms are seen as more critical by outsiders. Therefore, the expected size of the company can affect the amount of earnings management, in which when the of earnings management is opportunistic is higher, the company’s earning management is also better (negatively related), but if the efficient management of the greater profit of the company size, the higher the earnings management is (positively related).

Dechow et al (1996) in his research shows that companies manipulate earnings are more likely to have a board dominated by management and are more likely to have major directors who concurrently become commissioner. Chtourou et al (2001) and Wedari (2004) found that the independent board would restrict earnings management activities. However, Parulian (2004) found that the independent commissioner companies on the JSE are not found to significantly affect the management of corporate profits.

Klein (2002) found that the magnitude of discretionary accruals is higher for firms that have audit committees composed of independent commissioners less than companies that have audit committees composed of many independent commissioners. Wedari (2004) finds that discretionary accruals in companies that do not have audit committees significantly higher than the companies that have no audit committee.

While Parulian (2004) concluded that audit committees have a significantly negative relationship with negative discretionary accruals, but not significantly associated with positive discretionary accruals. Other studies on audit committees indicate the existence of audit committees which are less effective as one of the practice of corporate governance in companies listed on the JSE. Mayangsari (2003) investigated the influence of the existence of an audit committee for the integrity of financial reporting (as measured by the index of conservatism). It showed that the existence of audit committee was negatively related to the integrity of financial statements.

Unlike Nuryanah (2004), she found that audit committee did not significantly affect the value of the company. A system of corporate governance in companies believed to limit the opportunistic earnings management. It is due to the fact that it is expected with higher audit quality, the higher the proportion of independent board and audit committee of the less opportunistic earnings management (negatively related). However, if earnings management is efficient, it will be the opposite (positively related).

RESEARCH METHOD

The population consists of all the manufacturing companies listed on the Indonesia Stock Exchange with total of 157 units. These were selected based on purposive sampling method, and 117 units of the companies were taken as the sample, during 5 years, from 2002 to 2007.

These quantitative data were obtained from the capital market reference center, in the form of financial statements issued by companies listed on the Stock Exchange, Indonesian Capital Market Directory and Listing of Securities Exchange (DKE). In addition to determining whether the sample is a conglomerate company or not, it was determined through a survey of the literature books (such as Conglomeration Indonesia (2002) and Top Companies and Big Groups in Indonesia (2002).

The multiple regression was used to analyze the influence of corporate governance practices, ownership, and firm size towards the magnitude of earnings management. The formulation of the multiple regression models is as the following:

$$Y=\alpha + \beta_1 NAA + \beta_2 PKK + \beta_3 PPI + \beta_4 NLP + \beta_5 AUD + \beta_6 MDD + \beta_7 KAD + \beta_8 RTH + \beta_9 RPM + \varepsilon, \quad (1)$$

where:

NAA = absolute value of discretionary accruals. It is because this study is the amount of earnings management (discretionary accruals), rather than the direction (positive or negative).

PKK = 1 if firms have high family ownership (the proportion of family ownership> 50%) and they are not a conglomerate and 0 otherwise.

PPI = proportion of institutional investor ownership.

NLP = Natural logarithm of market capitalization.

AUD = If the companies audited by Big 4, they are given values 1 and 0 if otherwise.

MDD= proportion of independent board.

KAD = If the company has an audit committee in compliance with BEI, it is given a value of 1 and 0 if otherwise.

RTH = Ratio of total debt to total assets.

RPM = Sales growth.

Operational Variables

Profit Management

Total accruals (ACCR) is measured as the difference between net income before extraordinary items and operating cash flow (ACCR = EARN - CFO). This is to decompose total accruals into discretionary and non discretionary component of the formulation used (Dechow et al, 2002).

Family Shareholding

The whole sample is classified into families of high ownership (the proportion of family ownership> 50%) and low family ownership (the proportion of family ownership <50%). After this, it created a dummy variable for family ownership, which is 1 if the company that has high family ownership and not a conglomerate and 0 otherwise.

Institutional Ownership

Institutional ownership is the ownership of shares by financial institutions such as insurance companies, banks, pension funds, and investment banking.

Company Size

Firm size is measured by natural logarithm of firm equity market value at the end of the year, the number of shares outstanding at year end are multiplied by the price of the stock market by year end.

Corporate Governance Practices

This study used three proxies of corporate governance practices such as (1) Firm Size, used to measure the quality audit, which the companies are audited by Big 4 (public accountant office or large KAP) then it is he high-quality audits and if audited by non Big 4 (small KAP), it is the low audit quality, (2) The proportion of independent board is calculated by dividing the number of independent board members to total board. Information on the number of independent commissioners can be obtained from the annual reports of each company, Indonesian Capital Market Directory, and also of the announcement issued by the JSE, and (3) The existence of the Audit Committee, which is to determine whether the company has an audit committee or not will be checked in The annual report of each company and announcements issued by Indonesia stock exchange.

DATA ANALYSIS AND DISCUSSION

Testing the hypothesis in the study is valid when based on valid data or information, and the information is also valid if obtained from the data quality. Data contain outliers if the data are biased and not qualified. The test to determine whether there is data outlier in this study, with methods of descriptive statistics (Descriptive Statistics). The results showed that all research variable mean values were greater than the standard deviation, so that all variables contain no data outliers (Table 1). Therefore, all variables used in this study were analyzed to prove the hypothesis is feasible.

It showed that the average discretionary accrual is 0.0462 and the standard deviation is 0.0364. This suggests that earnings management among firms that do the variations is still quite high. Institutional ownership is relatively small at only 2.63%. Only 21.42% of the sample firms have a high family ownership and not a corporate conglomerate. Most of the sample firms (89.27%) were audited by Big 4. Family shareholding (PKK), proportion of institutional investor ownership (PPI), and KAP Audit by Big 4 (AUD) significantly correlated with the magnitude of earnings management (NAA).

Family shareholding (PKK) and the proportion of institutional investor ownership (PPI) are negatively correlated. This is because the measurement of family shareholding (PKK) uses a dummy variable where 1 for firms with high family ownership and is not a conglomerate and the public if the conglomerate has a size larger than the company's non-conglomerate firms.

The proportion of institutional investor ownership (PPI) and the Natural Logarithm of Market Capitalization (NLP) were positively correlated, where it shows a lot more institutional investors to invest in large companies than in small firms. Audit by Big 4 Firm (AUD) and the proportion of independent board (MDD) were positively correlated; meaning that companies have an audit committee also have a high proportion of independent commissioners. Natural logarithm of market capitalization (NLP) and KAP Audit by Big 4 (AUD) are positively correlated, meaning that large enterprises are

Table 1
Descriptive Statistics

Variabel	Mean	Std. Deviation	N
NAA	4.313	0.642	117
PKK	4.402	0.542	117
PPI	4.467	0.562	117
NLP	4.415	0.673	117
AUD	4.062	0.759	117
PDK	3.567	0.533	117
KAD	3.628	0.519	117
TRH	4.326	0.674	117
PPJ	3.429	0.528	117

Table 2
Results of Testing by Multiple Regression Model

Independent Variabel	Coefisient of Regression	T-test Statistics	Sig. Partial
Constant	1.141	5.644	0.074
PKK	0.462	6.436	0.037
PPI	-0.473	1.111	-0.063
NLP	-0.415	2.196	-0.017
AUD	0.181	3.409	0.524
PDK	0.290	4.053	0.309
KAD	-0.257	2.318	-0.204
RTH	0.364	4.637	0.104
PPJ	0.403	3.032	0.542

Source: Data processed

more frequently used than KAP KAP Non Big 4 Big 4.

The test results with the regression model (Table 2) shows as the following.

1. At a significance level of 5% on average earnings in the company's management with high family ownership (PKK) and not a conglomeration of companies which is significantly higher than average earnings in the management of other companies , with p-value 0.037;
2. The proportion of institutional investor ownership (PPI) negatively affect the magnitude of earnings management with a p-value of -0.063,
3. NLP has a positive influence on earnings management, but no significant influence on the amount of earnings management (NAA), with p-value 0.246. These results are consistent with the results of the study Darmawati (2003) who also found no evidence of a significant relationship between earnings management with institutional ownership,
4. Natural logarithm of market capitalization (NLP) has a significant negative impact on earnings management, with a p-value -0.017. This means that the larger the company will be smaller profits made by company management. These results are consistent with the findings of Lee & Chai (2002), in which small firms are more likely to manage earnings than large companies,

5. Audit by Big 4 Firm (AUD) has a negative effect on earnings management, but no significant effect on the management earnings, with a p-value 0.524;
6. The proportion of the board of commissioners (PDK) and do not have a significant positive influence on earnings management, with a p-value 0.309;
7. Audit by Big 4 Firm (ADK) has a negative effect and no significant of earnings management, with a p-value -0.204, and;
8. The variable ratio control total debt to total assets (RTH) has no significant positive effect on earnings management with a p-value 0.104. The test results are consistent with the debt covenant hypothesis. While sales growth variables (RPM) have negative but not significant effect with p-value 0.542.

CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

Company size variables consistently had a significant negative effect on the amount of earnings management by the company, meaning the larger the size, the smaller the amount the management company's profits. In addition, the average earnings management in companies with high family ownership and not a conglomerate, they are significantly higher than average earnings in the management of other companies.

It is suggested that researcher should conduct research focused on developing the model of measurement in earning management. It should be done more accurately such doing per industry. So, the industry characteristics which are different may influence earning management and this should be included in the research model. By doing so, it can identify the difference of management of earnings in every industry.

Developing instrument of measurement for calculating the index of corporate governance of public companies in Indonesia.

Doing research on the effect of independent board proportion and the existence of audit committee towards the earning management for the longer period.

Further research also identify which accounts the companies often do the earning management. Thus, it can also provide recommendation which is more specific towards *standard setter* for adding disclosures and towards investors for paying more attention to those accounts.

This study found evidence that earnings management in family-controlled company and not a corporate conglomerate is higher than earnings management in other companies. This can be indicative of earnings management taken by family-controlled company and not a conglomerate is more efficient than the other companies. Looking at the fact that the numbers of public companies are conglomerates, this study can be the input to the regulator to supervise the company's more on conglomerates, whose ownership is concentrated in one or a few parties.

Company size was proven to have significant negative effects of the magnitude of earnings management, indicating that the smaller the company the greater the earnings management is carried out. This could indicate that earnings management do small firms are not efficient. Therefore, the smaller the size of a company, the more control needs to be done by the regulators of small companies, without the supervision of the company's light great companies. Since there is a possibility, not all larger companies are increasingly to open opportunistic earnings management for earnings management in large companies that have been planned more than just using the accrual policy, making it more difficult to detect.

Quality audit, which using KAP size, the main test is shown to have significant influence on earnings management practices that are carried out by the management. Most of the public have the perception that large-scale KAPs can provide high quality audit. The results in this study can be stated that the public perception is less precise, because the companies which are audited by big profits are not shown to limit the management of the company.

A high proportion of independent commissioners and the existence of audit committees are not shown to limit the profits of the company management. There are several possible explanations for this. First, the appointment of an independent commissioner and the company's audit committee may only be carried out for regulatory compliance but are not intended to enforce good corporate governance (GCG) in the company.

Second, the minimum requirement of an independent board of 30% may not be high enough to cause the independent commissioner to dominate the measures taken by the board of commissioners. When the independent commissioner is a party to the majority that is > 50%, it may be more effective in carrying out the monitoring role within the company. But, if the appointment has not been based on the needs (needs) of the company but was limited to the fulfillment of regulations, then the proportion of the board of commissioners may not need to be copied, fixed in accordance with existing regulations (at least 30%), and viewed the effectiveness of the board and audit committee is also in a longer period of time.

In order for the appointment of an independent commissioner and the company's audit committee is not limited to compliance with any regulation, the regulators need to think of ways to better disseminate the need for enforcement of good corporate governance. Suppose, as a survey conducted by the GCG and to reward companies with good corporate governance best. The regulator may also publish writings that show evidence that companies implementing GCG obtain a positive reaction from the market, so it can grow in the company that needs to implement good corporate governance. In addition, for companies those have not raised an independent commissioner and in compliance with audit committees, they may also be subject to strict sanctions.

The present study also found that firm size negatively affects the magnitude of earnings management. This means that the smaller the company, the greater the earnings management. If the management of opportunistic profits is made, the greater the earnings management does not reflect the actual performance of the company. This needs to be a concern of investors in making investment decisions. Therefore, for investors, especially individual investors who are naive, probably, are better to buy stocks or invest in larger companies.

The presence of opportunistic earnings management can benefit the company in the short term, but this led to a loss on the investor. If the investor later realized that the company doing the opportunistic earnings management and lead investor is taking the wrong decision, the investors will lose confidence in the company and will appear in the company's negative image. Consequently, in the long run, investors are no longer interested in buying shares of the company and its share price will decline.

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