

The effect of earnings persistence on company performance in manufacturing companies listed on the Indonesia Stock Exchange 2004-2010

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ABSTRACT

Good earnings quality reflects a good condition of the company, in which the persistence of earnings is sustainable profits, or for a long period. This study aims to empirically examine the effect of earning persistence on the performance of manufacturing companies listed on the Indonesia Stock Exchange (IDX). The variable used is earnings persistence as an independent variable, and the dependent variable is the company performance measured by Tobin's Q as a measure of company's market performance and ROA as a measure of company's operational performance. The research also uses control variable: Growth and Size. The samples are manufacturing companies listed on IDX for seven years in 2004-2010. Statistical test used is quantitative research by using One Way ANOVA (The Analysis of Variance), and cross tab to descriptive analysis. The main statistical test in this research is using multiple linear regressions. The result of this study shows that there is an effect of earning persistence on the company performance as measured by using both ROA and Tobin's Q. It also shows that there is a significant effect of earnings persistence on the company performance as measured by using ROA and Tobin's Q. Yet, controlled variable with regression equation of earning persistence toward ROA and Tobin's Q, Growth and Size significantly have no effect on the company performance.

ABSTRAK

Kualitas laba yang baik mencerminkan kondisi perusahaan yang baik, di mana persistensi laba adalah keuntungan yang berkelanjutan, atau untuk jangka waktu lama. Penelitian ini bertujuan untuk menguji secara empiris pengaruh persistensi laba terhadap kinerja perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (BEI). Variabel yang digunakan adalah persistensi laba sebagai variabel independen, dan variabel terikat adalah kinerja perusahaan yang diukur dengan Tobin Q sebagai ukuran kinerja pasar perusahaan dan ROA sebagai ukuran kinerja operasional perusahaan. Penelitian ini juga menggunakan variabel kontrol: Pertumbuhan dan Ukuran. Sampel penelitian adalah perusahaan manufaktur yang terdaftar di BEI selama tujuh tahun di 2004-2010. Uji statistik yang digunakan adalah penelitian kuantitatif One Way ANOVA (Analisis of Variance), dan cross tab untuk analisis deskriptif. Uji statistik dalam penelitian ini menggunakan regresi linier berganda. Hasilnya menunjukkan bahwa ada pengaruh persistensi laba terhadap kinerja perusahaan yang diukur menggunakan ROA dan Tobin Q. Hal ini juga menunjukkan bahwa ada pengaruh yang signifikan dari persistensi laba terhadap kinerja perusahaan yang diukur dengan menggunakan ROA dan Tobin Q. Namun, variabel kontrol pada persamaan regresi persistensi laba terhadap ROA dan Tobin Q yaitu Pertumbuhan dan Ukuran secara signifikan tidak berpengaruh terhadap kinerja perusahaan.

1. INTRODUCTION

Financial reporting is a form of management ac-

countability in managing corporate resources to the parties interested in a company. It can also be used

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as a basis for making some decisions such as management performance appraisal, determination of management compensation, and provision of dividends to shareholders and others.

The financial statements users and investors usually only see earnings information, regardless of how the earnings are generated. This leads the management of the company to perform earnings management or earnings quality. As a response to the problem, the writer tries to examine the effect of earnings quality on the company performance by measuring earnings persistence. According to Schipper (2004) in Zaenal (2010), persistent earnings are earnings for the year that can be used as a good indicator for the corporate profits in the future. Earnings persistence is chosen because it is very relevant in the perspective of the decision usefulness and reflects the purpose of accounting information, as said in the Conceptual Framework FASB. The purpose is to provide useful information for decision-making by investors and creditors. Based on the background of the problem described in this research, the formulation of the problem posed is as follows: (1) Does earnings persistence affect ROA?, (2) Does earnings persistence affect Tobin's Q?

In accordance with the formulation of the problem above, the purpose of this study is to determine: (1) The effect of earnings persistence on ROA; (2) The effect of accruals quality on Tobin's Q. While the benefits that can be drawn from this study are: (1) For the development of theory and knowledge of earnings persistence and variables consisting of size and growth, as well as its consequences on the company performance. (2) Provide an alternative discourse to the users of financial statements and corporate organizers practitioners in understanding the factors that affect earnings persistence practices on the company performance. (3) For the company, the result of this study is also beneficial for the shareholders of the companies that want to realize better earnings quality.

2. THEORETICAL FRAMEWORK AND HYPOTHESIS

Previous Research

The discussion conducted in this study refers to previous studies such as:

Ririk (2011)

The purpose of this study is to investigate the effect of accounting-based earnings quality on the performance of manufacturing companies in Indonesia Stock Exchange. The objects of this

study are manufacturing companies in Indonesia Stock Exchange in 2006 – 2007. The independent variable is earnings quality with 6 measurement techniques: earnings persistence, predictability, variability, persistence, abnormal accruals, and accrual quality. The dependent variable is the company performance. The test equipment used is *multiple regression test* for the data per year, *One Way ANOVA test* for the data per group, and *Non- Parametric test* to see whether the data are normally distributed or not. The result of this study indicates that the higher the earnings quality, as measured by persistence and abnormal accruals, the better the performance of the company. This occurs when the persistence is measured by ROA and the abnormal accruals are measured by Tobin's Q. This is indicated by positive value of t count in the testing of persistence and abnormal accruals. So the profits generated by the manufacturing companies in Indonesia Stock Exchange possibly have earnings management elements in the financial reporting.

Sunarto (2010)

The purpose of this study is to examine the role of earnings persistence as a moderating variable in the relationship between the earnings aggressiveness and the cost of equity. The research object is the entire companies, other than property and financial sectors, whose shares are listed on the Indonesia Stock Exchange 2004-2006. The independent variable is earnings persistence, while the dependent variables are earnings aggressiveness and cost of equity. The test equipment used is interaction-based quasi moderation regression.

Zaenal (2010)

The purpose of this study is to test and to find empirical evidence of the effect of the volatility of cash flows, the amount of the accrual, sales volatility, debt levels, and operating cycle on the earnings persistence. The research sample is manufacturing companies listed on Indonesia Stock Exchange in 2001-2006 consisting of 141 companies. The independent variables are volatility of cash flows, the amount of accrual, sales volatility, debt level, and operating cycle, while the dependent variable is earnings persistence. The analysis of this study is using multiple regression analysis. The result of this research indicates that the volatility of cash flows, the amount of the accrual, sales volatility and debt levels significantly affect the earnings persistence. But operating cycle has no significant effect on earnings persistence.

Theoretical Basis

Agency Theory

The basic theory used in this study is the agency theory. According to agency theory, the separation between ownership and management of the company can lead to a conflict, called agency conflict. Agency conflict occurs due to the related parties such as the principal (who gives contract or shareholders) and the agent (who receives contracts and manages principal's funds) and both have conflict of interests. If an agent and a principal seek to maximize their own utilities, and have different desire and motivation, so there is a reason to believe that the agent (management) does not always act according to the desire of the principal (Jensen and Meckling, 1976) in (Andri & Hanung 2007).

Earnings Quality

Earnings quality is an important characteristic of the financial reporting. Schipper & Vincent (2003) in Pinasti, Margani & Meinarni (2009) classified the various constructs of earnings quality into four groups: (1) earnings quality construct which is derived from the time-series properties of earnings; (2) earnings quality which is derived from the relationship between earnings, accruals, and cash; (3) earnings quality which is derived from a qualitative concept in FASB conceptual framework; and (4) earnings quality which is derived from the implementation decisions.

Performance Measurement

The measurement of the company performance in this study is based on two categories:

1. The company's operational performance

The measurement of operational management, viewed from the internal side of the company, is using ROA ratio that indicates the company's ability to manage the company's assets by gaining net income. Return on Asset (ROA) is calculated using the following formula:

$$ROA = \frac{NetIncome}{TotalAssets} \quad (1)$$

2. The company's market performance

The measurement of the company valuation, viewed from the external side of the company, is using Tobin's Q. According to Bambang (2010), Tobin's Q is an indicator to measure the company performance, particularly on the value of the company that shows the performance of the management in managing the company's assets. Tobin's Q is also used to measure the effect of corporate governance applied in the company on the company's

stock price in the capital market (Klapper, Leora and Innesa 2002). Tobin's Q is calculated using the following formula:

$$Tobin's Q = \frac{(MVE + DEBT)}{TA} \quad (2)$$

Where:

MVE : The closing price of stock at the end of the year x the number of common shares outstanding

DEBT : Long-term Debt

TA : Total Assets

Size (Company Size)

Zahroh & Main (2007) said that a company, with big total assets, shows that the company has reached a stage of maturity. In this stage, the company's cash flow has been positive and considered to have good prospects in a relatively long period of time. In addition, it also reflects that the company is relatively more stable and able to generate profits better than the company with small total assets. Size (company size) can be used as a proxy for the uncertainty of the state of the company in the future.

According to Astiwi (2009), company size is the size or the magnitude of the company's assets. The result of the study of Jang, et al (2007) showed that company size significantly affects earnings quality, earnings persistence significantly has positive effect on earnings quality, and earnings growth has no positive effect but significantly has negative effect on earnings quality.

$$Size = \log(TA) \quad (3)$$

Growth

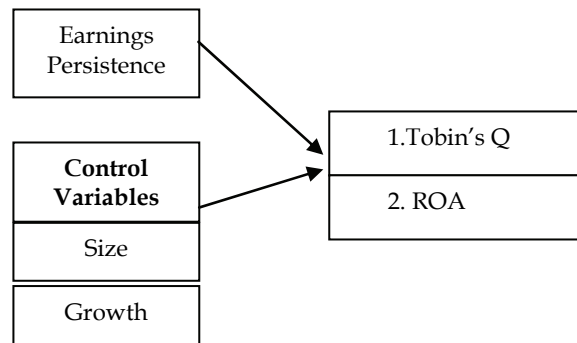
A company, with a high growth rate, requires strong amounts of capital to finance the company's activities. Increased profits will increase the capital, and the company tends to use relatively small debt because the company can finance most of the funding needs with internally generated funds. According to Astiwi (2009), growth is the change in sales revenue which is measured based on the comparison between the current net sales (net sales t) minus the previous net sales (net sales t-1) divided by the previous net sales (net sales t-1).

$$Growth = \frac{Sales_t - Sales_{t-1}}{Sales_{t-1}} \quad (4)$$

Relationship between Earnings Persistence and Performance

Earnings persistence is related to the performance of the overall company which portrayed in the corporate profits. High earnings persistence is reflected on sustainable profits for a long period of

Figure 1
Research Model



time. Huang, et al (2009) in Mahmud, Radziah, et al (2009) concluded that high earnings quality can lead to higher company performance. And vice versa, the company performance declines due to lower earnings quality.

Hypothesis

Based on the research model in Figure 1, the temporary conclusion of the hypothesis is:

H₁ : There is an effect of earnings persistence on ROA

H₂ : There is an effect of earnings persistence on Tobin's Q

3. RESEARCH METHOD

Research Variables

Variables used in this research are identified as follows:

The independent variable used is earnings quality which is measured using earnings persistence. The dependent variable used is the company performance which is measured using 2 measurement techniques, (1) ROA and Tobin's Q, (2) size and growth as the control variable.

Research Design

This research is a quantitative research that emphasizes on the testing of theories through the measurement of the study variables using number and performs data analysis with statistical procedure that aims to test the hypothesis (Nur and Bambang 2007).

Data Collection

The population consists of our manufacturing companies listed on the Indonesia Stock Exchange. The sample selection method in this study is using purposive sampling method with the specified criteria. The criteria of the samples used are:

1. Go-Public manufacturing companies listed on Indonesia Stock Exchange from 2005 to 2010 re-

spectively.

2. Disclosing full annual report from 2004 to 2010 respectively.
3. Companies that have complete EPS from 1993 to 2010, but at least from 2000 to 2010.
4. Having complex financial data required in this study.

Analysis Technique

The analysis technique is carried out as follows:

1. Tabulating the data associated with earnings quality by measuring the earnings persistence.
2. The calculation and determination of the value of earnings persistence are conducted with the following steps:
 - a. Tabulating EPS data in 1993-2010.
 - b. Filtering EPS data. EPS used is at least in 2000-2010 because the regression coefficients needed begins in 2004-2010. Earnings persistence is measured by the coefficient of EPSt₋₁.
 - c. Tabulating performance variable data.
 - d. Tabulating ROA data: net income and total assets in 2004-2010, with the formula 1.
 - e. Tabulating Tobin's Q data consisting of year-end closing price, the number of shares outstanding (shares trade), long-term debt, total assets of each year from 2004 to 2010 with the formula 2.
 - f. Tabulating control variable data. This study is using control variable of size and growth:
 - g. Tabulating total asset data in 2004-2010, with the formula 3.
 - h. Tabulating sales data in 2003-2010, with the formula 4.
3. Compiling research model with the following equations:

$$ROA = a + b_1 \text{persistence} + b_2 \text{Size} + b_3 \text{Growth} + e$$

$$\text{Tobin's Q} = a + b_1 \text{persistence} + b_2 \text{Size} + b_3 \text{Growth} + e$$

Formulating hypothesis:

H₀₁ : There is an effect of earnings persistence on Tobin's Q

H₁₁ : There is no effect of earnings persistence on Tobin's Q

H₀₂ : There is an effect of earnings persistence on ROA

H₁₂ : There is no effect of earnings persistence on ROA

4. Determining $\alpha = 5\%$

Determining criteria for rejection of hypothesis, where H₀ with significance result on significance < 0.05.

5. Using classical assumption test consisting of:

- a. Multicollinearity Test
- b. Autocorrelation Test
- c. Heteroskedasticity Test
- d. Normality Test
- e. Testing study model

It is conducted using F test, the model is said quite good (fit) if the result of F test is significant or the probability < 0.05. According to Imam Ghazali (2006), one way to detect whether any variables or residual are normally distributed is using the One-sample Kolmogorov-Smirnov Test.

Performing regression testing of the effect of earnings persistence, growth and size on Tobin's Q and ROA. The testing is done using t test, the model is said quite good if the result of the effect test produces probability < 0.05. The test of the effect of earnings persistence on the company performance. The testing of the research model also serves as the testing of the independent variable on the dependent variable.

Interpreting the results of the measurement based on the measurement technique taken.

Compiling conclusions based on the result of analysis test.

4. DATA ANALYSIS AND DISCUSSION

Based on the result of multiple regression test, when it is seen from the result of t test with a significance level of 5%, it can be concluded that the independent variable of earnings persistence has an effect on the dependent variable of the company performance with indicator of ROA, and the independent variable of earnings persistence has an effect on the dependent variable of company performance with the indicator of Tobin's Q, so the first and the second hypothesis are verified, with the results as follows:

The effect of earnings persistence on company performance (ROA indicator)

The value of the regression coefficient (b) which is approaching 1 indicates a high earnings persistence or the earnings quality is good, while the value of

regression coefficient (b) which is approaching 0 indicates low earnings quality or less good. The test results of regression analysis between earnings persistence and company performance with indicator of ROA can be concluded that the earnings persistence has or there is significant effect on the company performance with indicator of ROA, it can be seen from the value of t count of 2.623 with a significance level of less than 0.005 or 5% i.e. 0.009 and it also can be seen from the value of F count of 3.250 with a significant level of less than 5% i.e. 0.021. The effect of earnings persistence on the company performance indicates that earnings persistence has effect on the company performance with ROA indicator that is equal to 0.9% while the remaining 99.1% is influenced by other variables other than earnings persistence.

The researcher also adds control variables; company size and growth, but for the control variables of company size and growth do not significantly affect the company's performance. This could be due to the number of companies that is less than the average value for the control variables of company size and growth, in which the control variable of size is 52 companies or 47.37% where the value is more than the average value, and 57 companies or 52.63% where the value is less than the average value.

The effect of earnings persistence on company performance (Tobin's Q indicator)

The test result of regression analysis between the earnings persistence and the company performance with the measurement indicator of Tobin's Q can be concluded that the earnings persistence has a significant influence on the company performance with the indicator of Tobin's Q. It can be seen from the value of t count of 9.220 with a significant level of less than 0.005 or 5% i.e. 0.000. The effect of earnings persistence on the company performance indicates that earnings persistence has an effect on the company performance with indicator of Tobin's Q that is equal to 10.7% while the remaining 89.3% is influenced by other variables other than earnings persistence.

For the control variable of company growth, there is no significant effect on the company performance. This proves that the growth has no effect on company performance with the indicator of Tobin's Q. It could be caused by the number of companies whose value is less than the average value for the control variables of size and growth, in which the control variable of size is 52 companies or 47.37%, whose value is more than the average, and 57 companies or 52.63% whose value is

less than the average value. While for the control variable of size (firm size) significantly influences the company performance. This indicates that the higher the size of the company, the higher the earnings quality generated by the measurement of earnings persistence

The effect of earnings persistence on the company performance with the indicator of Tobin's Q indicates that the increase in earnings persistence contributed significantly to the increase in Tobin's Q, in which the result of this study shows that there are 3 types of companies that have average value proportion above the overall average i.e. 15.79% or 120 companies of the 763 companies surveyed, while the average value below the overall average value of the remaining 16 companies is 84.21%. The range can possibly also be a cause of significant test results on the existing hypothesis, because there are many companies that show that their earnings persistence toward the company performance with indicators of ROA and Tobin's Q are less than the average.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

This study aims to analyze the effect of earnings persistence on the company performance in manufacturing companies listed on Indonesia Stock Exchange in the period from 2008 to 2010. Theoretically, good earnings quality will improve the company performance both in company's market performance and in company's operational performance. Persistence is a measure of earnings quality which is based on the view that the more sustainable the earnings, the higher the earnings quality. The value of regression coefficient (b) which is approaching 1 indicates a high earnings persistence or good earnings quality, while the value of regression coefficient (b) which is approaching 0 indicates low earnings quality. If the value of the persistence is getting closer to 1, it indicates that last year's profits are increasingly able to influence or to predict future earnings, or it is increasingly able to predict the earnings of the following years. By looking at the results of the study as described in the previous chapter, then the suggestions that can be submitted are as follows:

For further research, the sectors of industries could be expanded, in the research, by involving all go public companies listed on Indonesia Stock Exchange in the sample selection.

For further research could conduct further testing or treatment when it is found classical assumption diseases while performing classical assumption test.

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