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Effect of Financial Leverage, Company Size, and Managerial Ownership of Profit Income in a Registered Manufacturing Company on the Indonesian Stock Exchange 2019-2021

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Abstract: This research was conducted with the aim of testing and analyzing the effect of financial leverage, company size, and managerial ownership on income smoothing in manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2019-2021. The data used in this study is secondary data obtained from annual reports of manufacturing companies listed on the IDX for the 2019-2021 period. The analytical method used by researchers is descriptive statistical analysis method and logistic regression analysis. The sampling technique in this study was carried out using a purposive sampling method for manufacturing companies listed on the Indonesia Stock Exchange (IDX) for 2019-2021. The test results show that financial leverage and firm size have no significant effect on income smoothing, while managerial ownership has a significant effect on income smoothing.
Keywords: income smoothing, financial leverage, company size, managerial ownership

1. Introduction

The financial statements are a reflection of the performance of the management, which is the result of the company's operational activities which will be reported to internal and external parties of the company. The purpose of reporting is to provide information through the media of a company's financial statements that is useful for users in making economic decisions. This shows that financial reports have a very important role (Rosita, 2008).

The main concern in financial reports is information about profits. Quality profits can determine how a company performs and will also affect the company's profits in the future. Recognizing the importance of this profit information, management tries to reduce profit fluctuations or maintain the stability of reported profits so that they are in accordance with the desired target by practicing income smoothing.

Income smoothing is one of the earnings management actions taken by managers to reduce reported profit fluctuations so that profits can look stable from period to period thereafter. Profits that look stable will attract investors to invest in the company, because stable profits indicate that the company's condition looks good. In income smoothing, managers try to make the movement or rise and fall of profits look smooth within the limits permitted by applicable accounting standards (Gayatri and Wirakusuma, 2013).

Financial leverage is the use of company funding sources that have fixed costs with the assumption that they will provide additional profits that are greater than fixed costs so that they can increase the profits available to shareholders (Sartono, 2008). The greater the financial leverage borne by the company, the greater the risk borne by the company. Companies with high levels of financial leverage will get more attention and supervision from creditors so that companies will find it difficult to even out profits (Budiansyah & Ardiansyah Rasyid, 2019).

Company size is thought to be one of the factors that drives management to practice income smoothing. According to Keiso and Weygand (2010: 260) in Peranasari and Dharmadiksa (2014) the larger the size of the company, the more attention it gets from investors, analysts, and the government. Company size is usually measured by investors' perceptions of the company's level of success which is often associated with the size of the company's assets. A high company size will make the market believe not only in the company's current performance but also in the company's prospects in the future.

According to Shien et al. (2006) in Hery (2017:96), managerial ownership is a share owned by company management. Management who is also a shareholder will avoid misleading financial reporting, because management acts as a supervisor and company investor who expects financial reports to be relevant and accountable (Marfuah and Murti, 2019).

The existence of management ownership in a company will lead to the perception that the value of the company will increase along with the increase in management ownership in a company. Managers will try harder to improve company performance which can ultimately increase company value and increase their own wealth.

Based on this background, the writer is interested in conducting research by taking the title "EFFECT OF FINANCIAL LEVERAGE, COMPANY SIZE, AND MANAGERIAL OWNERSHIP OF PROFIT INCOME IN A REGISTERED MANUFACTURING COMPANY ON THE INDONESIAN STOCK EXCHANGE 2019-2021"

2. Literature Review and Hypothesis Development

2.1 Agency Theory

Agency theory is an approach that can explain the concept of earnings management related to income smoothing. According to Setyaningrum (2016), agency theory is a relationship or contract between the principal and the agent where it is assumed that each individual is solely motivated by his own interests, causing a conflict of interest between the principal and the agent.

According to Watts and Zimmerman (1986), the relationship between agents and principals is often determined by accounting numbers. This encourages management as an agent to try to process accounting numbers in such a way through a systematic way by having certain methods or policies, so that accounting numbers (profits) reported from period to period can actually achieve the desired end goal.

2.2 Positive Accounting Theory

Positive accounting theory was put forward by Watts and Zimmerman (1986) with the aim of describing and explaining how the accounting process is from the beginning to the present and how accounting information is presented so that it can be communicated to other parties within the company. Sari (2019) explains three hypotheses that are applied to make predictions in positive accounting theory regarding management's motivation to manage earnings. The three Positive Accounting Theory (PAT) hypotheses are:

1) Bonus program hypothesis (the bonus plan hypothesis) This hypothesis states that companies that use bonus plans will tend to use accounting methods that can increase reported accounting numbers (profits) in the current period. The goal is to maximize the bonuses they will get because how much profit is generated is often used as the basis for measuring performance success.
2) The debt agreement hypothesis (debt convenant hypothesis) This hypothesis states that company managers who approach violations of debt agreements will tend to choose accounting methods that can increase profits. Companies that have high leverage (debt to equity ratio) will tend to use accounting methods that can move next year's profits to the current year so that the level of leverage is small and can reduce technical defaults. This is done because the debt agreement has a requirement for the company as the borrower to maintain leverage during the agreement period.
3) The political cost hypothesis (the political cost hypothesis) This hypothesis states that the greater the political costs faced by the company, the greater the tendency of the company to use accounting choices that can reduce profits, because companies that have high levels of profit are considered to receive attention. broad spectrum of consumers and the media which will also attract the attention of the government and regulators, causing political costs, including government intervention, higher tax imposition, and various other kinds of demands that can increase political costs.

2.3 Income Smoothing

One pattern or management action on earnings that can be done is income smoothing. Income smoothing can be seen as a deliberate profit normalization process in order to achieve a desired trend or level. According to Belkaoui (2007), income smoothing is a deliberate reduction or fluctuation of several profit levels that are currently considered normal by the company.

2.4 Financial Leverage

Financial leverage is important in determining the company's capital structure. According to Sartono (2004) financial leverage shows the proportion of using debt to finance its investment. The greater the company's debt, the greater the risk faced by investors so that investors will ask for a higher level of profit. As a result of these conditions, companies tend to practice income smoothing. From the explanation above, the hypothesis that can be formulated is:

H_1:Financial Leverage has an effect on income smoothing.

2.5 Company Size

Total assets are the most appropriate proxy for measuring company size. The total asset value reflects the company's assets or wealth. Thus it can be assumed that the greater the total asset value, the greater the size of the company and the company's performance can be said to be good, because the company is trying hard to continue to increase the value of its assets. However, large companies are expected to be able to avoid drastic profit fluctuations, because conversely if the value of company assets decreases, profits will also decrease and this will have a negative impact on the company. Therefore, the company practices income smoothing so that the condition of the profit generated by the company's assets looks stable. In this study, company size measurement uses the natural logarithm of market capitalization (Apriansyah, 2016). Based on other studies conducted by Dewi and Sujana (2014), and Puspareni (2015) concluded that company size has a significant positive effect on income smoothing practices. Based on this description, the hypothesis can be formulated:
H_2: Company size has an effect on income smoothing.

2.6 Managerial Ownership

According to Jensen and Meckling (1976) in Amanza (2012) suggests that share ownership by managers will affect the performance of managers in carrying out company operations. The existence of share ownership by managerial parties will provide managers with the flexibility to manage financial reports. The practice of income smoothing is caused more by management choosing to maintain a stable profit value than the profit value which tends to fluctuate, so that management will increase reported profit if the actual amount of profit decreases from the previous year's profit and conversely management will choose to reduce reported profit if the actual profit decreases. which actually increased sharply compared to the previous year's profit (Novita, 2009 in Aji and Aria, 2010). Based on this description, the hypothesis can be formulated:
H_3: Managerial Ownership affects income smoothing.

3. Research Method

3.1 Population and Sample

Table 1: Research Sample Selection Process

No	Criteria	Amount
1.	Manufacturing companies listed on the Indonesia Stock Exchange in 2019-2021.	185
2.	Manufacturing companies that publish annual reports in a row during the 2019-2021 period.	(14)
3.	Manufacturing companies that display complete data on the factors that influence the 2019-2021 income smoothing.	(99)
4.	Manufacturing companies that did not experience losses during the 2019-2021 period.	(30)
Total of research samples = 42 x 3 years		**126**
Outliers		**(2)**
Total sample data processed		**124**

Source: Data Process 2023

Based on the sample selection process in table 1, the population used is manufacturing companies listed on the IDX for 2019-2021. The data collection method used to obtain company data and information is secondary data obtained from the annual reports of manufacturing companies listed on the IDX for 2019-2021. In this study the sample used was purposive sampling, which means that the conditions are made as criteria that must be met in sampling. This study uses measurements for each variable, as follows:

Table2: Measurement of Variable

Variable	Indicators	Source
Income Smoothing	*Indeks Eckel :* $\frac{CV\Delta I}{CV\Delta S}$	Eckel (1981)
Financial Leverage	DAR= $\frac{Total\ Hutang}{Total\ Aktiva}$	(Setyani & Wibowo, 2019)
Company Size	Ln Total Asset	(Setyani & Wibowo, 2019)
Managerial Ownership	KM= $\frac{Saham\ yang\ dimiliki\ manajemen}{Jumla\ h\ saham\ yang\ beredar}$	(Nur Andiani & Astika, 2019)

3.2 Data Analysis Technique

In this research, hypothesis testing uses descriptive statistical analysis and logistic regression analysis. The logistic regression method is used because the dependent variable is measured nominally (dummy) and is in binary form, namely variables that only have two categories of value 0 or value 1.

$$\boxed{\mathrm{PL} = \alpha + \beta_1 \mathrm{FL} + \beta_2 \mathrm{UP} + \beta_3 \mathrm{KM} + \varepsilon}$$

Description:
α : Constant
PL : Income Smoothing
FL : Financial Leverage
UP : Company Size
KM : Managerial Ownership
ε : Error

4. Result and Discussion

4.1 Deskriptive Statistical Analysis

Table3: Descriptive Statistical Analysis Test Result

	N	Minimum	Maximum	Mean	Std. Deviation
Financial Leverage	124	0,0650	0,9114	0,412274	0,1845409
Company Size	124	25,05	33,54	28,7423	1,84426
Managerial Ownership	124	0,0000	0,8944	0,165214	0,2171668
Income Smoothing	124	0	1	0,45	0,500

Source: Data Process, 2023

Based on the results of the descriptive statistical tests in table 3, information is obtained regarding the minimum, maximum, average, and standard deviation values of each of the variables studied. Financial leverage as an independent variable with a sample size of 124 has a minimum value of 0,0650 and a maximum value of 0,9114. The average value of financial leverage is 0,412274 with a standard deviation of 0,1845409. Company size as an independent variable with a total of 124 has a minimum value of 25,05and a maximum value of 33,54. The average value of firm size is 28,7423 with a standard deviation of 1,84426. Managerial Ownership as an independent variable with a sample size of 124 has a minimum value of 0,0000 and a maximum value of 0,8944. The average value of managerial ownership is 0,165214 with a standard deviation of 0,2171668.Income smoothing as the dependent variable with a total of 124 has a minimum value of 0 and a maximum value of 1. The average value of income smoothing is 0,45 with a standard deviation of 0,500.

4.2 Discussion

The first step of logistic regression analysis is to assess the regression model as a whole. From the model it can be seen that the overall model fit test at -2 Log Likelihood Block Number = 0 shows a decrease at -2 Log Likelihood Block Number = 1 of 4.545. This decrease indicates a better regression model or in other words the model is hypothesized to fit the data. The Nagel Karke R2 value can be interpreted as the R2 value in multiple regression. The results of the model summary show the Nagel Karke R2 value of 0.048. This means that the variability of the dependent variable that can be explained by the independent variables is 4.8% while the remaining 95.2% is explained by other variables not used in this study. Hosmer and Lame show test value is 0.491. From these results it can be said that H0 is accepted, because the significant value obtained is more than 0.05. Because the significance value is further above 0.05, it means that the model is able to predict the observed value or it can be said that the model is acceptable because it is in accordance with the observations. The results of the classification test show that the ability of the model to predict the occurrence of income smoothing practices or the absence of income smoothing is 61.3%. The possibility of a company practicing income smoothing is 50.0% of a total sample of 124 data. While companies that do not carry out income smoothing are 70.6% of the total sample of 124 data.

Table 4: Results of Logistic Regression Analysis

Variable	B	Sig.	Description
Financial Leverage	0,574	0,588	H_1 Rejected
Company Size	-0,095	0,403	H_2Rejected
Managerial Ownership	-2,094	0,042	H_3Accepted

Contant	2,625	0,417

Source: Data Process, 2023

In this research, the logistic regression model can be arranged as follows:

$$PL = 2{,}625 + 0{,}574FL - 0{,}095UP - 2{,}094KM + \varepsilon$$

Based on table 4 above, the results of the hypothesis testing regression model in this study can be interpreted as follows:The results showed that the financial leverage variable has a regression coefficient of 0.574 with a significance level of 0.588 more than α = 0.05, then**H_1 is rejected.** This study proves that financial leverage has no effect on income smoothing. The greater the financial leverage borne by the company, the greater the risk borne by the company. Companies with high levels of financial leverage will get more attention and supervision from creditors so that companies will find it difficult to do income smoothing. These results are in line with research conducted by Yolanda Sesilia (2021) that financial leverage has no effect on income smoothing.

The results showed that firm size has a regression coefficient of -0.095 with a significance level of 0.403 more than α = 0.05, then**H_2 is rejected.** This study proves that company size has no effect on income smoothing. The total asset value reflects the assets or assets of the company. Thus it can be assumed that the greater the value of total assets, the greater the size of the company and the company's performance can be said to be good, because the company is trying hard to keep increasing the value of its assets. However, large companies are expected to avoid drastic fluctuations in profits, because vice versa if the value of company assets decreases, profits will also decrease and this will have a negative impact on the company. Therefore, the company practices income smoothing so that the condition of the profit generated by the company's assets looks stable. These results are in line with research conducted by Zulaika Wulandari and Irvan Rolyesh Situmorang (2020) that company size has no effect on income smoothing.

The results showed that managerial ownership has a regression coefficient of -2.094 with a significance level of 0.042 less than α = 0.05, then**H_3 is accepted.** This study proves that managerial ownership has an effect on income smoothing. Managerial ownership will motivate managers to improve their performance for the sake of shareholders and themselves. The greater the managerial ownership, the more flexibility management will have in managing financial reports and performing income smoothing. Therefore, the higher the managerial ownership of a company, the greater the tendency to practice income smoothing. These results are in line with research conducted by Maotama, N. S., & Astika, I. B. P. (2020) that managerial ownership has an effect on income smoothing.

5. Conclusion

Based on the results of the study it can be concluded that financial leverage and firm size have no effect on income smoothing, while managerial ownership has an effect on income smoothing. Further research is suggested to add samples other than manufacturing companies. This is recommended because in the manufacturing sector there are many companies that carry out income smoothing. Subsequent research can add to the research period for the results obtained and can be used as a basis for determining income smoothing practices. Further research is also recommended to use other factors that might influence income smoothing.

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