

**THE FACTORS THAT INFLUENCE EARNING
RESPONSE COEFFICIENT: IN THE CONTEXT
OF INDONESIAN CAPITAL MARKET
IN YEARS 2015-2018**

Thesis

**Submitted to meet the Graduation Requirements of
Master's Degree (M.A. in Economics)**



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**FACULTY OF ECONOMICS AND BUSINESS
UNIVERSITAS ISLAM INTERNASIONAL INDONESIA
DEPOK
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ABSTRACT

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Vincent Aurelio Benny, 03232110020, MA in Economics

Every investor aims to invest in a company that continues to generate quarterly profits. Investors certainly want to invest in companies with quality earnings. This earnings quality is the result of well-applied operational management and financial standards. The earning response coefficient measures how the capital market interprets the information in earnings. The existence of quality earnings by the company could either strengthen or weaken the market's perception of the content of this earnings information, depending on the interpretation of the capital market. The role of corporate governance is expected to moderate the relationship between market perception and earnings quality so that it can be a good internal control and provide investors with some protection. The existence of a good corporate governance role will boost the company's reputation. Good corporate governance can strengthen the positive influence of earning quality on information content in accounting earnings. This empirical study tries to find the relationship between conservatism, a method of presenting numbers in financial statements, return on assets, asset turnover and earning quality with corporate governance as the moderation variable on earning response coefficient as the dependent variable. Purposive sampling and panel data regression analysis were used in this study to examine manufacturing firms in the primary and chemical industries listed on the Indonesia Stock Exchange (IDX) between 2015 and 2018. Key findings from this study found that conservatism, return on assets, and asset turnover have a significant effect on the earning response coefficient. It was also found that earnings quality, moderated by corporate governance, also affects the earning response coefficient.

Keywords: *Conservatism, Asset Turnover, Return on Asset, Earning Quality, Earning Response Coefficient, Good Corporate Governance*

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LIST OF ABBREVIATIONS

CAR	:	<i>Cumulative Abnormal Return</i>
UE	:	<i>Unexpected Earnings</i>
NOACC	:	<i>Conservatism</i>
EQ	:	<i>Earning Quality</i>
CG	:	<i>Corporate Governance</i>
AT	:	<i>Asset Turnover</i>
ROA	:	<i>Return on Asset</i>

CHAPTER I

INTRODUCTION

1.1 Background

According to Budiarmo (2021), the Indonesian capital market has experienced an increase in investors every year since 2021; the growth in investor numbers is also due to the role of influencers who lure retail investors to invest more in the stock market. Social media's function in the pandemic era is also essential for retail investors can see the development of the stock they hold and transact better. However, compared to its vast population, the growth ratio of the involvement of the Indonesian population in investment in the capital market reached only 5% in the year 2020, far from Singapore's 26% and Malaysia's 9% (Uly, 2020)

Indonesia has the potential to become the fifth-largest economy in the world by 2024, according to the World Bank and IMF(Kencana, 2020). Although economic potential and investors lag, the Indonesian capital market can improve significantly. Generally, investment in the capital market aims to obtain a high capital return (Alexander, Nico, 2013).

To obtain the expected return, in their planning of shares purchasing, investors usually conduct a financial analysis such as analyzing the corporate financial statement data by converting them into various financial ratios: i.e., the return on assets, asset turnover, debt to equity ratio, and others. Moreover, investors should also estimate the quality of corporate earnings and their internal controls through good corporate governance.

Investors want to get profits when investing in the stock and do not want to invest in companies whose financial statements are indicated by earnings management or window dressing. With the window-dressing action taken by the company's management, the numbers in the financial statements do not reflect the actual numbers following the company's performance. Investors will also be wrong in making investment decisions with this window-dressing action because the numbers in the financial statements are getting better and arranged so that profits and growth for each period of the company increase.

On the corporate side, the company's operating performance improvement is

indicated by the profitability ratio given from its return on asset (ROA). Return on assets is widely used by investors when they want to buy a company's stock. Zaki (2017) reveals that stock prices are significantly impacted by profitability. In another study by Welan (2019), profitability has no impact on stock values. When making investment decisions, investors use other financial ratios more. For shareholders, the smaller the return on assets ratio means the company cannot use its assets to produce a more efficient return. It is interesting for researchers to re-do research to know the clarity of the effect of return on assets on information content in the stock market.

Profitability is one of the indicators to assess the company's capability to gain profit (Kasmir, 2010). At a low level of profitability, the company will use debt to finance its operational needs. Conversely, at a high level of profitability, the company will further reduce the use of debt. Companies with high profitability indicate that their internal funds are abundant, so they will allocate these internal sources of funds for their operational needs (Mardiyati, U. & Kurniati, 2018). Consistent with the pecking order theory, which states that the first choice in funding decisions is retained earnings, then use debt and equity. The company can use debt if the need for funds using retained earnings has not been fulfilled. Company value can also be assessed from its company's efficiency using the activity ratio. Asset turnover can inform investors about the company's efficiency in managing assets to generate income. Putra (2013), the profits made by the firm will rise if it can utilize its resources as effectively as possible to boost sales. As profits increase, the stock price returns will also increase (Putra, 2013). Putra (2013) discovered that asset turnover significantly influences stock returns.

One of the critical elements in determining a company's worth is its earnings level. Companies with high earnings quality can assess the earnings cycle features essential for making decisions (Dechow et al., 1995). One indicator that may be used to assess the effectiveness of a company's operations is profit. Information about earnings might indicate whether a firm is succeeding or failing in reaching its stated operational goals (Siallagan, Hamonangan dan Machfoedz, 2006).

Financial statement users use earnings information to make various important decisions. Creditors and investors use profits to assess management effectiveness,

determine earning potential, and forecast future earnings. However, in reality, users of financial statements often only focus on profit information without paying attention to how the profit is generated. The company's management will carry out several earnings management actions, which is the potential for accrual management to obtain profits.

Manipulated income that does not qualify appears in the financial statements, so it does not reflect the economic state of the business. According to Siallagan, Hamonangan, and Machfoedz (2006), because of the poor quality of earnings shown in financial statements, stakeholders, including decision-makers and outside parties, may make poor judgments that lower the company's potential. In other words, growth in company value will immediately be impacted by improved profit quality. Conversely, poor earnings quality will make the value of the company decrease (Jonathan & Machdar, 2018)

According to Dechow (1995), compared to operating cash flows, profits reported on an accrual basis are seen to be a better indicator of a company's performance since accruals eliminate the timing and mismatching issues that come with using cash flows in the near term. However, applying the accrual concept can potentially trigger management opportunities to increase or decrease the accrual amount in the income statement to control earnings.

There are several similarities between earnings management and earnings quality. The company's profits quality declines as earnings management increases. However, Lo (2008) argues that lower levels of earnings management do not guarantee sustainable profit quality in his journal. A wide range of other factors might influence the quality of a company's earnings.

Therefore, employing a proxy for discretionary accruals makes it possible to investigate the prospect of earnings management in financial statements. Discretionary accrual refers to an accrual component included in the management's policy and signifies that the manager can influence the accounting reporting process. Therefore, this study will assume that the factors contributing to earnings quality are constant.

Wardhani (2009), in his dissertation, uses four earnings quality measurements, namely: neutrality is measured by using discretionary accrual

measurement, which shows earnings management by management. This measurement uses the modified Jones model method (Dechow et al., 1995) because it is regarded as the finest model for detecting profit management. Timeliness by using the time lag of the fiscal year until the date the company announces its earnings to the public (submit financial statements to OJK). Representational reliability earning response coefficient in measuring earnings quality as seen from the connection between stock returns and earnings. Conservatism uses the 3-year average discretionary accruals to calculate negative and positive accruals.

The choice of policies in reporting financial statements also affects the company's worth in the eyes of investors. One of the choices of financial statement reporting policies is the principle of conservatism. Watts (2003) defines conservatism as a precautionary technique. The caution here means not reporting assets and income that exceed their fair value and not reporting liabilities and expenses below their fair value. According to Penman & Zhang (2002), choosing methods and estimates that keep the net asset value low is conservatism.

In the process of making financial statements, conservatism is seen as an accounting method that will produce the following results: delay in revenue recognition, direct expense recognition, the valuation of the asset value is lower than its actual value, the evaluation of the value of the obligation is higher than its actual value.

Conservatism treatment is a selection and estimation process used in accounting that shows that the actual asset value is lower than the original cost of the asset itself (Penman & Zhang, 2002). An example is the selection of fixed asset valuation using fair value, FIFO, and Bad Debt Expense.

Conservatism is one of the controversial accounting concepts, and there are many pros and cons to using this principle. Many criticisms arise about conservatism, meaning that when financial statements use a conservatism basis, biased interpretations will arise and do not reflect reality. As a result, the quality of earnings presented by managers is inaccurate for investors to analyze financial conditions

By implementing effective corporate governance, opportunistic managerial behavior in real earnings management may be kept to the bare minimum. By

focusing on management that adheres to the values of independence, fairness, and equality, good corporate governance (GCG) promotes corporate sustainability (KNKG, 2006). In the Indonesian Forum for Corporate Governance (FCGI, 2001a), the phrase "corporate governance" can describe how the board of directors, board of commissioners, firm management, and shareholders act in certain situations.

Corporate governance processes can function well if they adhere to disclosure, responsibility, accountability, independence, and fairness ideals. These five elements are crucial since it has been demonstrated that using GCG principles consistently raises the caliber of financial reporting. Additionally, four GCG mechanisms—audit committees, independent commissioners, institutional ownership, and managerial ownership—are frequently employed in research on GCG to decrease agency conflicts (Rachmawati & Triatmoko, 2007).

The audit committee oversees the financial statements, oversees external audits, and maintains an eye on the internal control system to minimize the opportunistic nature of management that manages earnings. The integrity of the creation of financial reports must be protected, and this is where the audit committee comes into play. By strengthening strong oversight and reducing agency conflicts brought by management's desire to advance their interests, an audit committee will be present.

One of the board features connected to the information content of profits is the makeup of the board of commissioners. The boards can affect management's preparation of financial statements through their involvement in the supervisory function, resulting in a high-quality profit report (Boediono, 2005). The possibility of misleading financial reporting can be reduced by the establishment of an external board of commissioners. In this case, the independent commissioner keeps an eye on management choices to reduce the likelihood of profit manipulation.

Institutional ownership is crucial to minimize agency conflict between managers and shareholders. Institutional investors are thought to be able to serve as an effective monitoring tool for every managerial move. Due to their involvement in strategic decision-making, institutional investors do not simply accept the idea of earnings manipulation. (Puteri & Rohman, 2012). In order to prevent managers from acting opportunistically, institutional investors will exert more supervision

when there is a greater level of institutional ownership.

By putting managers' interests in line with shareholders, managerial ownership has successfully reduced agency issues for managers. (Puteri & Rohman, 2012). The more stock they possess in the company, the more likely the management is to endeavor to improve performance for the sake of shareholders and their interests (Siallagan, Hamonangan dan Machfoedz, 2006) .

Thus, continuously implementing GCG principles might prevent integrated management initiatives that lead to financial statements that do not accurately reflect the company's core values. Instead of utilizing separate assessments for each component (audit committee, independent commissioner, institutional ownership, and management ownership) in this study, the internal control mechanism of GCG was measured across the board using factor scores.

One of the crucial elements that company managers must consider when deciding on the amount of their debt strategy is the size of their business. Large corporations enjoy an edge in activity and public perception compared to small businesses. The more substantial a firm is, the more open it will be about its financial performance with the public, which will help it win over creditors. Therefore, the bigger the financing of assets through debt financed by outside sources, the larger the firm (Husna, 2016). Additionally, a firm will need more capital the larger it is in order to fulfill all of its resource demands, including those for operations and investment.

Previous research from Mulyadi (2017) found a significant relationship between the effect of earning quality, in this case, the existence or absence of earnings management, and the earning response coefficient. Mulyadi (2017) also found that there is a market perception of earnings information content (earning response coefficient) amid the existence of earnings management practices that market assessments of corporate governance practices can indeed influence. The relationship between earning quality and market perception of information contained in earnings has been studied by many people. However, these studies (such as Pae (1999); Xue (2003); Whelan (2004); and Tian (2007) did not provide conclusive results. Some studies prove a positive relationship between earnings quality and market perception of information contained in earnings, while others do

not support this relationship.

For the context of the Indonesian capital market itself, as far as the author knows, there has been no empirical research linking earnings quality with the information contained in earnings (earnings response coefficient). Several existing studies (Mulyani, 2007; Riyatno, 2007; Sayekti, 2007; and Sefiana, 2009) only take one of them as the object of empirical testing, earning quality, or earnings response coefficients to be tied to other variables (such as corporate social responsibility variables by Sayekti, 2007)

At least this research provides two research contributions. First, this research tries to conduct integrative research. This study differs from earlier studies in several ways, which primarily examined the relationship between earning quality (with the presence or absence of earning management), the information content of earnings (earnings response coefficient), and corporate governance separately.

The majority of current research primarily looks at the connection between (1) earning quality and earning response coefficient, (2) earning quality and corporate governance, and (3) corporate governance and earning response coefficient. This research is one of few studies that test the relationship between the three in an integrative study. Second, this study provides a richer understanding of the role of good corporate governance in building the relevance of earnings information in the existence of factors that can potentially reduce the degree of relevance of accounting earnings.

The feature that sets this study apart from earlier research is that in this study, the conservatism variable was measured using the total accrual proxy. Activity performance was measured by asset turnover ratio, operating performance was measured by return on asset, and earning quality was measured by the modified Jones model. The CG score is used to calculate corporate governance as a moderating variable. Earning response coefficients containing market information are measured by cumulative abnormal returns and interactions with unexpected earnings. Based on the description above, this research was conducted under "**THE FACTORS THAT INFLUENCE EARNING RESPONSE COEFFICIENT: IN THE CONTEXT OF INDONESIAN CAPITAL MARKET IN THE YEAR 2015-2018**".

1.2 Research Problem

Based on the background information provided above, the research problem may be stated as follows:

The research problem in this paper is: a. Does conservatism affect the earning response coefficient?, b. Does asset turnover affect the earning response coefficient?, c. Does return on assets affect the earning response coefficient?, d. Does earning quality affect the earning response coefficient with moderation of corporate governance?.

The four research questions asked will be answered in chapter 3 and chapter 4. The explanations given regarding the answers to the results of the research questions will be answered in chapter 4. The conclusions that will be given as a result of the research questions will be answered in chapter 5.

1.3 Research Objectives

Based on earlier research issues, the following objective influenced this study's conduct:

1. It analyzes the effect of conservatism on the earnings response coefficient for the years 2015-2018 manufacturing businesses in the chemical and primary sectors that are listed on the Indonesia Stock Exchange and to obtain empirical evidence.
2. It analyzes the effect of asset turnover on the earnings response coefficient for 2015-2018 manufacturing businesses in the chemical and primary sectors that are listed on the Indonesia Stock Exchange and to obtain empirical evidence.
3. It analyzes the effect of return on asset on the earnings response coefficient for the years 2015-2018 manufacturing businesses in the chemical and primary sectors that are listed on the Indonesia Stock Exchange and to obtain empirical evidence.
4. It analyses the effect of the corporate governance mechanism on the relationship between earning quality and earning response coefficient for the years 2015 to 2018 manufacturing businesses in the chemical and primary sectors that are listed on the Indonesia Stock Exchange and to obtain empirical evidence.

1.4 Benefits of Research

The following benefits of this research are assumed based on the previous objectives:

1. For Practitioners

This research is considered used by corporate management to report earnings on the firm's financial statements. In addition, this research is expected to be considered in making investment decisions for investors.

2. For Academics

This study is anticipated to add to the knowledge of earnings quality based on conservatism, activity performance, operating performance, earning response coefficient, and corporate governance (CG) mechanisms in developing science, especially those related to financial economics. It is intended that this research might be used as a source of information for future studies on conservatism, good corporate governance (CG), and earnings quality.

1.5 Scope of Problem

In order to make the scope of the variables discussed in the study clearer, it is necessary to set a limit to prevent the discussion from being too broad. Therefore, the authors limit this research to several things, namely:

The first independent variable is conservatism. The second independent variable used in this study is asset turnover. The third independent variable used in this study is return on assets. The fourth independent variable used in this study is earning quality. The earnings response coefficient is the dependent variable. The moderating variable is good corporate governance. The data comes from secondary sources, such as corporate annual reports from the primary and chemical industries from 2015 to 2018 and other information on the Indonesia Stock Exchange (IDX) websites.

1.6 Systematic Discussion

The writing of this thesis consists of five chapters with the following systematics:

CHAPTER I INTRODUCTION

This chapter explains the problem's historical context, how it was put forth,

why it was researched, what it found to be helpful, how it had limits, and how it was organized. Chapter one also explains the background of the research and the concerns and points of interest in this study.

CHAPTER II LITERATURE REVIEW

In this chapter, the essential theory that guides the study is outlined, the relevant literature is assessed about the studied variables, and hypotheses are developed. In chapter two the theoretical basis of the variable selection foundation is explained. The foundation of the theory of the independent variables is also explained. The theoretical foundation of the dependent variable is also explained.

CHAPTER III METHODS STUDY

This chapter discusses research methodologies, including population, sample, and data sources; data collection strategies; empirical research models; operational variable definitions; and procedures for data analysis. In chapter three, various calculation formulations for each independent variable are explained. The dependent variable calculation formula is also explained in this chapter. The formula for each variable is also explained where the reference journal comes from.

CHAPTER IV RESULT AND DISCUSSION

The chapter discusses the study object, the analyzed data, and how the results should be interpreted based on how the analysis was done. In chapter four, the results of the panel data regression are explained. Model selection in panel data. Reason behind the hypothesis acceptance. Reason behind the rejected hypothesis. Various tests were used to avoid the data in this study being biased such as multicollinearity and heteroscedasticity tests.

CHAPTER V CLOSING

This chapter is a conclusion that includes the findings of the research that was conducted to answer all the problems raised, the importance of the findings, the study's shortcomings, and recommendations for more research. Suggestions for future research, and limitations of this study are also described in chapter 5. The conclusions of each research problem asked are answered in chapter 5.

CHAPTER II

THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

2.1 Basic Concept Definition

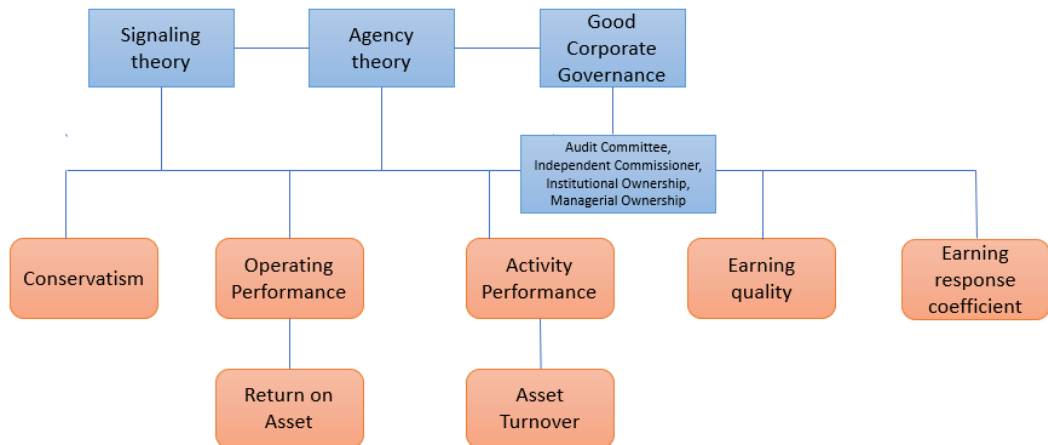


Figure 2.1 Basic Concept Definition

2.1.1 Agency Theory

Understanding the notion of agency theory is necessary to comprehend the fundamentals of corporate governance procedures. According to agency theory, there is an agreement or connection between managers acting as agents and shareholders acting as principals (Puteri & Rohman, 2012). The principle gives the agent instructions regarding how to proceed. The party tasked by the principal to administer the business is known as the agent. Agency conflict can arise in an agency partnership: role separation and conflicts result from the agent's and the principal's competing interests.

The principal and agent must spend agency expenditures to resolve or minimize agency issues. As stated by Puteri & Rohman (2012), There are three categories of agency costs:

- 1) Cost monitoring is the term for the expenses incurred and paid for by the principal to monitor and manage the agent's conduct.
- 2) The agent incurs bonding costs to establish and adhere to a system that guarantees the agent will operate in the principal's best interests.

- 3) Residual cost, or the sacrifice made in the form of decreased prosperity for the principal due to the agent's and the principal's divergent choices.

According to Jensen, MC & Meckling (1976), the presence of shareholders (principals) who choose managers (agents) to carry out a task on their behalf and give managers authority to make choices, including funding decisions, is explained by agency theory. Brigham & Houston (2012) cite agency theory to argue that when shareholders and managers have competing interests—shareholders want to grow their wealth and prosperity. However, managers also seek to improve their welfare, and a conflict of interest arises in their decisions. Conflicts of interest may develop between owners (principals) and managers due to managers' motivation to further their own goals at the expense of shareholders (agents).

Sulistiani & Agustina (2019) stated that high levels of institutional ownership would lower the use of debt because the principal fears the risk of default and bankruptcy if large amounts of debt are used. According to Anjana & Purwanto (2017), the principal is motivated to prosper with the company's constantly increasing profit level. Agents are driven to secure investments, loans, and compensation contracts to the greatest extent possible to satisfy their psychological and economic requirements.

Companies with a significant fixed asset component will find it easier to obtain debt because managers can pledge the company's fixed assets. Suppose the company has a significant debt guarantee to avoid using funds not under the purpose. In that case, the company will use debt so that management supervision can prevent conflicts of interest (Hardiningsih, P., & Oktaviani, 2012). Company size can affect agency problems; large organizations will likely face increased disclosure demands to reduce information asymmetry between agents and principals.

Agency theory based (Puteri & Rohman, 2012) claims that an agency issue may develop when one or more people (the principals) hire a different individual (the agent) to provide a service and then grant the agent decision-making authority. The separation of the company's ownership and management may cause conflict. A disagreement between the principal and an agent who has divergent interests is referred to as an agency conflict.

The principal's primary goal is to boost owner or shareholder wealth, which is the company's long-term emphasis on raising the business's value. On the one hand, the manager (agent) is morally obliged to maximize the owners' profits (principal). However, managers also have a stake in increasing their welfare. As a result, the corporation has two distinct interests, each of which aims to bring or maintain the required degree of success. It is therefore likely that the agent won't always act in the principal's best interests.

The agent is granted a contract and authority to manage the principal's resources. In accordance with the agency theory, there are relationships and problems among the principals (investors) and the agent (management). Separate ownership and management functions are due to the principal's poor managerial capabilities, which results in information asymmetry, with the agent knowing more about internal information and firm prospects than the principal does (Priantinah, 2008)

This issue resulted in a clash of interests between the two parties, which enabled management to put personal interests above representing primary interests (Rahmawati, 2005). This conduct may result in financial statements, particularly earnings declared by the firm, being unable to offer accurate information about company performance, resulting in profit information employed as a standard and foundation for decision-making becoming of doubtful quality. The quality of earnings information must be measured to ensure that users of financial statements, particularly investors, do not make incorrect decisions.

When the interests of the agent and principal are not congruent, agency relationships can potentially lead to moral hazard (agency problem). Shareholders lack the time necessary to manage the business independently. Even legally, shareholders are not entitled to direct control over the company (day-to-day business activities). Agency issues will exist if there is a connection between the principal and the agent. Due to differences in employment roles, access requirements, and skill levels, principals typically recruit agents. Issues with incentives and task completion discretion lead to agency difficulties. If an agent is encouraged to misbehave, the agent may be persuaded to act detrimental to the principal.

2.1.2 Signaling Theory

The signal theory is one of the theories that is often used in financial management. The signal can be defined as a signal the company gives to investors. There are several ways to convey signals, either through direct observations or a preliminary study for analysis (Fauziah, 2017). Signal theory indicates that high-quality companies give a superior signal about performance compared to competitors in the market (Connelly, 2010). Today, a signal theory is one of the most influential and vital theories of economic information in governing companies. This theory reduces the occurrence of asymmetric information between the two parties. (Connelly, 2010).

From an operational and growth perspective, companies can be distinguished into two models: high-quality and low-quality (Kirmani, A., & Rao, 2000). The company clearly understands the actual quality of the company. However, externals are limited to diving in. Thus, as a result, asymmetric information arises. Every business has the chance to show how truly exceptional it is to externals. Companies with higher standards are more driven to send signals than those with lower standards. Each signal has an impact on the perception of outside observers regarding the quality of the company. Companies can provide signals regarding company information through financial statements by showing conservative accounting practices that result in higher-quality results. The company believes this principle prevents exaggeration and presents non-overstated profits and assets. Investors receive this information, which they can interpret as either a strong signal (good news) or a weak signal (bad news). Regarding fundamentals and growth, good quality companies should provide good signals to the market (Connelly, 2010).

2.1.3 Conservatism

Conservatism is the tendency of accountants to acknowledge bad news before good news (Basu, 1997). Applying this principle shows that the greater the verification required for for-profit recognition, the greater the conservatism. The statement by Basu follows the statement by Watts (2003), “the requirement for differential verification in terms of the timeframe for recognizing profit and loss is what is known as conservatism.” Hille (2011) concludes that accounting

conservatism is a mismatch between verifying positive and negative cash flows.

Gains should be reported with more caution than when reporting losses incurred. The Financial Accounting Statements Board (FASB) defined conservatism as a reasonable response to uncertainty about profits and losses by ensuring that uncertainties and risks associated with the company's condition are evaluated effectively in Statement of Financial Accounting Concepts 2, 1980 (Neag, R., & Masca, 2015).

Conservatism is divided into two general parts but has different ways of recognition, unconditional and conditional conservatism (Beaver, W. H., & Ryan, 2005). The key distinction between the two types of conservatism is that unconditional conservatism makes use of data gathered from the start of an asset's life. Contrarily, conditional conservatism uses the most recent data gathered for the future (Basu, 2005).

Based on the opinion that, as stated above, the researcher concludes that accounting conservatism is an act of prudence by an accountant to make judgments before recognizing profits and losses.

Conservatism can be unconditional, meaning it might be based only on the balance sheet's accounting rules and ignore any positive or negative news (Chan et al., 2009). According to Ball and Shivakumar (2005), unconditional conservatism is regarded as ineffectual or incredibly neutral.

Investors and contractual parties can change their unconscious accounting habits by generating forecasts. Realizing losses regardless of the news to prevent the typical economic situations of the prior era is another name for unconditional conservatism (Sanchez et al., 2014).

Gotti (2008) created a new conservatism measure using his accounting conservatism analysis as a foundation. Gotti observed that positive and bad news about future profitability were perceived quickly in businesses with high debt-to-asset ratios. Managers who practice conditional conservatism will believe that the volatility of accruals should be higher for bad news than for good news (Dutta, S., & Patatoukas, 2017)

According to Ryan (2006), conditional conservatism is distinct from unconditional conservatism, which is affected by understating the previously assessed book value net assets in line with direct expenditures for expenses that have happened that are often tangible. Since managers must decide on the timing and extent of asset decline or asset restructure, conditional conservatism allows a greater degree of managerial choice, which leads to the speedier acknowledgment of the associated economic loss (Chan et al., 2009)

According to the above perspective, conditional conservatism is an accounting theory that emphasizes negative news before positive news to recognize losses more quickly than profits. Conservatism is the notion of caution in financial reporting. Businesses should not rush to identify and measure their assets and profits while immediately identifying potential losses and debts.

Conservatism is the idea that expenses and obligations should be recorded as soon as feasible, regardless of the outcome. However, revenue and assets should only be recorded once they are known to be received. According to the conservative principle, managers should report losses when there is doubt about them. On the other hand, managers should not record earnings if there is any doubt regarding them. As a result, the profit and asset values on the statement of profit typically reflect lower amounts as a precaution (Andreas et al., 2017).

According to the matching principle, all revenues must be matched with expenses resulting in their occurrence or existence. The interpretation of the matching concept practice becomes biased by performing further verification (asymmetry) due to this conservatism practice. Recognizing unprofitable things (expense, loss, and liability) is weaker and slower than recognizing profitable things (revenue, gain, and asset). In this instance, conservatism emphasizes the worry of overstating net assets and profits, which might result in inaccurate information (Andreas et al., 2017).

Conservatism prevents data provided on a conservative basis from being evaluated accurately because the precautionary principle causes the reported net income and gains to be lower than they should be. However, the reported numbers are relatively high, even with limited verification for adverse topics such as debt and loss. Additionally, it appears that conservatism goes against the goal of

reporting all pertinent information and can make financial statements less comparable because its application lacks a consistent norm (Aristawati & Rasmini, 2018).

2.1.4 Earnings Quality

The revenue in the financial statements must be high quality to provide helpful information. (Bandi, 2009). Financial statements must be relevant and truthful in a presentation to provide meaningful information. In order to accurately portray the company's actual financial performance, quality earnings must be able to demonstrate future earnings that can be sustained, as determined by the cash and accrual components (Sadiah, H. & Priyadi, 2015). Quality of earnings: " A company's financial performance can be better understood by looking at higher-quality earnings on the financial statement that is important to a particular choice made by decision-maker."(Dechow, 2010).

According to the objectives, three points of earnings quality must be highlighted (Dechow, 2010). First, the quality of the profits relies on relevant information while making judgments. As a result, the definition of profit quality given above only applies to a particular decision model. Second, whether the information accurately depicts a company's financial performance may be used to determine the quality of the reported profit income. Third, the importance of the financial performance supporting the choice and the quality of earnings jointly impact the choice.

Although earnings quality cannot be measured in absolute terms, it may be analyzed and explained using qualitative and quantitative methods (Indra, A. Z., Zahron, A., Rosianawati, 2011). The qualitative method is based on ideas or views based on logic, experience, and insight, whereas the quantitative approach utilizes ratio analysis. Earning quality is determined by earnings understatement and overstatement, the stability of income statement components, and the occurrence of asset risk, capital preservation, and potential predictive value rather than by high or low reported earnings.

Proxies of earnings quality into three main categories, namely (Dechow, 2010):

1. Earnings persistence, accrual size, residual accrual models, earnings smoothness, fast loss recognition, and residual model accrual are some of the characteristics of earnings.
2. The earnings reaction coefficient is a component of investor response to earnings (investor responsiveness to earnings) (ERC).
3. Restatements, ineffective internal control processes under the Sarbanes Oxley Act, and Accounting and Auditing Enforcement Releases (AAERs) are external indications of earnings misrepresentation (internal control procedural flaws revealed under the Sarbanes Oxley Act).

Earnings quality is also often used as a benchmark for making decisions. Earnings quality is a multi-dimensional concept with several aspects to consider in determining what earnings quality is. According to the PSAK (Indonesian accounting standard) conceptual framework, the criteria for quality earnings are relevant and faithfully representative. Quality earnings are divided into market-based and accounting-based criteria (Francis, 2004). From an accounting-based perspective, profit is considered quality if it is relevant for making decisions and on-time reporting. Meanwhile, from a market-based perspective, if earnings are of good quality, earnings are persistent and not fluctuating and can predict profits for the following year.

The different methods also influence earnings quality in reporting standards, which use different judgments and estimates. The difference measures earnings quality using a market-based approach, earnings relevance, and timeliness of earnings, using US GAAP and IFRS (Beijerink, 2008). His research said that earnings reported using IFRS would have a higher level of relevance and timeliness of earnings than earnings reported using US GAAP.

In reporting, earnings are also affected by conservatism treatment. Various arguments arise regarding conservatism's impact on earnings quality. Conservatism will reduce earnings quality because of the unrecorded reserves in the financial statements, thus biasing earnings (Penman, S. H., & Zhang, 2002). Conservatism treatment tends to make earnings fluctuate and not persistent (Mashayekhi, 2010).

The existence of conservatism makes earnings predictable so that it will make earnings quality (Kazemi, 2011).

Earnings quality is a crucial metric for effectively measuring a company. Higher earnings quality has more detailed financial performance data that is important for all parties that depend on the accounts contained in the financial statements (Dechow et al., 2010). The company income statement is the most crucial information influencing decision-makers (Sofian et al., 2011).

According to Molaei et al. (2012), high earnings quality demonstrates the value of income data for user decisions. According to Penman, S. H., & Zhang (2002), "sustainable income" should include high-quality profits. The most important component of financial statements that is very helpful in making decisions is the quality of the earnings. Complete and accurate information will enhance the quality of the profits exhibited. The organization's earnings management is used to gauge the quality of its earnings.

When managers manipulate transactions in financial statements and use their judgment when presenting financial data to deceive stakeholders about the business's financial success or influence the conclusion of contracts that depend on reported statistics, this is known as earnings management (Healy, PM, & Wahlen, 1999).

According to Setiawati, L., & Na'im (2000), interested parties have become users of accounting information, which is one of the causes of earnings management. These variables include the use of accounting data in agreements involving pay between managers and owners, the use of accounting data as a source for investors and the capital market, the use of data when debt contracts occur, and other variables. According to its nature, earnings management can be opportunistic and effective, which has a favorable or unfavorable impact on the company's success (Surifah., 2017).

Earnings management describes manager behavior that changes current reported earnings positively or negatively, but not in a way that promotes long-term economic success (Fischer, M., & Rosenzweig, 1995). Earnings management produces a bias that prevents consumers of financial statements from using them to make choices, which is one of the elements that lowers the credibility of financial

statements (Febriana, 2014).

Earnings management is the act of faking data that results from management abusing their power or a conflict of interest inside the organization. Applying an accounting theory within the organization might also result in procedures for managing earnings. Earnings management produces irrelevant numbers that prevent readers of financial statements who use financial statements to analyze the company from being wrong and that financial statements become unreliable. It harms stakeholders who depend on the financial statements published by the company every year (Febriana, 2014).

According to Jonathan & Machdar (2018), various specialists characterize earnings quality differently and do not provide a consensus. There are two ways to look at earnings quality. The first is decision usefulness, which states that earnings quality is in the high category and can help make decisions. Each user of financial statements might define it differently from this perspective (subjective).

The second viewpoint is economic-based and illustrates how well the earnings number captures the actual realities of the organization in question, often determined by examining the practice of earning management. By comparing the profit from the previous year with the profit from this year, this viewpoint may also evaluate the consistency of a company's earnings. The company's profits are inconsistent and come under low earning quality if they fluctuate yearly.

While a consistent profit year after year demonstrates the company's strong profits persistence, persistence in earning will lead to high-quality earnings. A focus on economics will result in quality profits. At the same time, a consistent profit year after year demonstrates the company's strong profits persistence. Persistence in earning will lead to high-quality earnings. Therefore, a persistent income will lead to a favorable economic viewpoint.

Dewi (2017) defines good earning quality as earnings with a strong propensity to forecast future profits. A high-quality earnings component is also required to anticipate future stock prices and returns and make the best decisions for the company.

The quality of profits may be influenced by several factors, such as systematic risk or beta, firm size, earnings persistence, capital structure, auditor quality,

liquidity, accrual quality, and strong corporate governance.

The effectiveness of a company's business continuity in enhancing financial performance increases with its size, would undoubtedly enhance financial performance and eliminate the need for profit manipulation by businesses (Wati, 2017). According to Wati (2017), large companies undoubtedly have more significant and broader access to sources of funds from outside the company, so obtaining loans will be less difficult because companies with substantial sizes have a better chance of making it in the market or staying in operation.

Earning quality is inseparable from the objective qualitative of financial reporting, namely relevance and reliability. The relevance of financial information is the ability to assist users in forming their predictions and expectations regarding certain future events, such as company performance or stock prices (Soetardjo, 2017).

Relevance is influenced by how much the resulting financial information has feedback and predictive value. Meanwhile, the reliability of financial information refers to the extent to which financial information is an honest presentation, is neutral, and can be tested. Here the extent to which financial information is delivered honestly and without the intention of influencing behavior or to achieve specific goals determines the reliability of financial information (Soetardjo, 2017).

The predicted future revision of accounting profit brought on by the accounting profit of the current year is known as the persistence of accounting profit. Changes in the year's profit correlated with changes in stock prices can be used to observe earnings persistence. A business that continuously experiences rising earnings during each accounting period is doing well. Naturally, this will result in high earning quality.

Earning quality may be assessed in several ways, including conservatism, estimation of accrual process mistakes, the persistence of accruals, and the lack of earnings management. According to Surifah (2017), the persistence accrual approach is used to gauge the quality of earnings.

Every company wants their company to be persistent in growing in line with the current tight competition in the economy. Therefore, the company will maximize its performance to produce good earning quality. Every company will

compete to produce high-earning quality because earnings information can be used to explain and predict the future and help investors make decisions (Susanto, 2011).

Each and every investor buys shares in order to earn capital gains, which are the excess of the selling price over the purchase price. When purchasing or selling shares, investors need to know the financial health of the company. Analyzing the financial statements of the organization is one of the things that is required. Investors will put their money into businesses with high earning potential, and the reverse is also true. Investors' desire to invest their money will be impacted if a company's earnings show a low amount.

Earning quality will affect the market reaction; high earning quality will produce a positive market reaction. Shareholders will benefit from this positive market reaction because it increases the share price. Earning quality will undoubtedly affect the market reaction, positively impacting it. So that the investment carried out by shareholders will generate profits, and the subject of the investment will make investors interested in investing. While poor earning quality may result in negative market trends, financial statement users may err in their judgment and choose the wrong investments, incurring losses.

Making the most profit feasible is a company's primary objective. To accomplish its objectives, the corporation will therefore act in accordance with its plan. A company that achieves its goals will undoubtedly get more value in the eyes of investors (Jonathan & Machdar, 2018).

Therefore, companies sometimes manipulate earnings reporting to generate the expected profits. Taking action by increasing or decreasing the accrual rate in the income statement can be said to be an action of earnings management. This earnings manipulation is known as earnings management. Employing earnings management, businesses will cause the company's profits to continue to change significantly, and this will undoubtedly cause the earning quality of a company to decrease. Existing accounting standards still guide actions that obtain personal or group benefits. However, preparing financial statements as a form of intervention can be called "earnings management" actions (Surifah, 2017).

The agency theory concept is the foundation of earnings management. According to the agency theory, one thing that can cause conflict is when a

company's owners differ from those who run it. Actions by management that want to report the company's profits as high as possible to benefit themselves the most (opportunistic) can cause agency conflicts, which can lower the quality of earnings.

The technique of earnings management provides insight into how well a corporation is able to generate revenue. The potential for using earnings management techniques investigated using a discretionary accruals (DACC) proxy. Discretionary accruals are one component of accruals within the policy's scope. Management authorities or managers can intervene in the process of preparing financial reporting. In general, how well a company can produce revenue is revealed by its earnings management strategy. Possibility of employing earnings management strategies on the income statement.

The usefulness of accounting earnings information can be affected positively or negatively by how earnings are managed. Earnings management can make accounting earnings more valuable by giving accounting earnings more information. However, earnings management can also make accounting earnings less useful by adding noise. Accounting reports have become less relevant (Susanto, 2011).

In the business world, earnings management practices are often associated with indications of earnings quality applied by the company. The market will react to the profit information in the financial statements, which is reflected in the quality of the earnings. The market response's strength will affect the ERC's (earning response coefficient) high and low values. The information influences the strength of the market response in earnings. Earning response coefficient (ERC) is one of the measuring tools or proxies used to measure the market reaction.

The agent and principal will experience agency conflict due to their distinct responsibilities and interests. These differences in interests and responsibilities will compromise the company's profitability and operations. Earnings management refers to management attempting to disclose earnings opportunistically to their advantage at the expense of numerous other parties. Companies that engage in earnings management will experience a decline in earnings quality.

Earnings quality reflects the data in the financial accounts that the market will respond. Financial statements that describe the relevant economic conditions of a

company will undoubtedly have to be quality, and this can will undoubtedly receive a favorable response from the market. Market reaction is proxied by ERC (earning response coefficient). A high ERC value demonstrates that the market has responded favorably to the information. contained in accounting earnings (Noto, 2017).

The company's fundamental value due to engineering results led to low earning quality in the financial statements; low earning quality can affect interested parties, such as investors and creditors, to be wrong in making investment decisions. There are various ways to minimize earnings management actions, including implementing IFRS (International Financial Reporting Standards) and limiting management's space to engage in self-serving behavior that could endanger shareholders. In addition to implementing IFRS (International Financial Reporting Standards), companies can also apply the company's control and management structure with the principles of good corporate governance to reduce the likelihood of earnings management.

The implementation of corporate governance may have an impact on the company's performance, including operations that lead to a misrepresentation of the company's fundamentals in the financial statements. Excellent corporate governance is predicted to increase the beneficial relationship between earning quality and market response since management activities that could harm shareholders can be definitely limited by implementing good corporate governance.

2.1.5 Activity Performance

The asset turnover ratio is one way that can be considered to see the activities the business engaged in investment decisions, which can lead to fluctuations in stock returns. Low company activity at a certain level of sales will result in more outstanding excess funds invested in unproductive assets, which can cause total asset turnover to decrease (Ika, 2012). An asset turnover proxy can be used to assess asset use efficiency. Asset turnover ratio measures how effectively a corporation uses its assets to produce sales. The asset turnover ratio is calculated by dividing the total sales by the total assets of the company.

The asset turnover ratio is further divided into two types depending on the type of asset to analyze. The current asset turnover ratio analyzes liquid assets such

as cash, receivables, and equipment, and the fixed assets ratio specifically analyzes less liquid assets such as buildings or intangible assets. However, in this discussion, we focus more on the total asset turnover ratio, which combines the analysis of the two types of assets and is used in calculating return on equity.

Assets are all resources owned by a company and are ready to be used to generate income for the company. This indicator is important because there are times when a company has assets that have been purchased but not used or used but not optimally.

Therefore, the company's performance will be more effective the higher the asset turnover ratio is in utilizing the available assets. Conversely, several asset uses must be maximized if the value is small.

Each industry has a different composition of assets. As a result, to compare the value of a company's asset turnover ratio, compare the company with other companies engaged in the same field. In particular, this indicator can help investors and related company management on several matters, such as: How are the company's profits impacted by the issuing of new shares? How does the purchase of new assets impact the company's revenue? How does the expansion program impact the company's revenue?. These financial indicators help measure the efficiency of the company's performance in using its assets.

A good company will certainly take advantage of every asset they have, including funds obtained from the issuance of shares, with careful consideration. Therefore, a good company will undoubtedly use investors' funds to increase income instead of paying off debt.

2.1.6 Operating performance

Return on Assets is a profitability factor that investors frequently take into account. The capacity of a company to generate earnings or profits from its assets is measured by the ROA ratio (Kasmir, 2010). ROA relates shareholder and creditor returns to the firm's total assets and is a more comprehensive profitability statistic than the return on ordinary stockholders' equity (Simamora, 2000). The higher profit a firm achieves, the better its position in terms of asset usage and the higher the ROA. Investors will find a company's shares more appealing to purchase if they can leverage its assets more effectively. The significant rise in investor interest in

the company's stock will drive up the price of the company's shares.

The functioning of the company's assets reveals the efficacy of the business in creating profits. Return-on assets can serve as a benchmark for business success and spur action taken by a corporation to manage earnings. Researchers will employ the profitability return on assets ratio in this investigation (ROA). In order to determine if a firm is healthy, ROA is a crucial metric that investors use to inform their choices. The more effectively a corporation uses its assets to create profits, the higher its ROA. Investors will be drawn to a firm with significant earnings because of its greater rate of return. In other words, the more this ratio is significant, and the more productive assets are at generating net profits.

Investors who invest in the stock market want to hold shares of companies with a significant return on assets. Investing in the stock market is complex, and many market participants are worried about their capital. Choosing a company for the best long-term investment, look for a company with a wide moat. One of the characteristics of a company with a wide moat is that it has a super significant return on assets. Usually, many investors only pay attention to return on equity because it is more popular and is often used by stock market players. Return on assets is rarely used and is only suitable for use in several industrial sectors such as banking. A good standard for banking stocks is that the return on assets must be above 2%. If the return on assets is below 2%, then it is not a characteristic of a banking company worthy of being held long-term.

2.1.7 Earning Response Coefficient

Different market responses to earnings are caused by several things, namely earnings persistence, beta, company capital structure, growth opportunities, and information content contained in prices (Sayekti & Wondabio., 2007).

Companies with more persistent earnings in the future are predicted to have higher ERC (earning response coefficient) values. The market response will increase if a company can maintain its profits. The market response shows that the company's reported earnings information is of good quality. The better the earning quality, the higher the ERC value.

The beta value of a corporation indicates the systemic risk of the company. Investors often examine a firm's profitability to forecast its future earnings and

returns. The less an investor would respond to unexpected profits, the riskier the company's future returns will be. The ERC value decreases as the beta value increases (Sayekti & Wondabio., 2007).

The corporation uses the capital structure to ensure that profits exceed its assets' cost and utilizes funding sources. Shareholder returns will be higher when knowing that the company gets a profit that grows every year. Financial leverage increases as a company's amount of debt increases. In this case, shareholders assume creditors benefit more if a company's profit improves. Companies with high financial leverage will have lower ERC values.

Growth Possibilities held by the business are anticipated to offer high profitability and produce more steady profits. Businesses with lots of room for development have a higher ERC value (Scott, 2000 in Yosefa and Wondabio, 2007).

One thing that affects how the market reacts is the informational quality of market pricing. In this instance, the corporation's size serves as a proxy for the informational content of the market price. The more prominent the company is, the more the public has access to corporate information. A large firm may not always be able to profit; it is possibly heavily indebted to finance its daily operations. Investors pay more attention to the company's market circumstances than its overall assets. Investors think that small businesses do not necessarily provide low earnings for their investors and that huge businesses do not always create high profits. Consequently, the higher the information content of the stock price, the lower the earning response coefficient value (Scott, 2000 in Yosefa and Wondabio, 2007).

The concept of an earnings response coefficient (ERC) is as follows: "An earnings response coefficient denotes the degree of an abnormal market return in response to an unexpected component of the issuing firm's reported profits" (Sayekti & Wondabio, 2007). From this definition, it can be interpreted that the ERC measures the level of abnormal stock returns of a particular company in response to the accounting profit that the corporation claimed, having an unexpected profit component.

The market reaction can be seen in transaction volume or price changes. So the degree of usefulness or relevance of accounting profit can be determined from

the extent to which transaction volume or price changes occur after accounting profit information is available on the market (Noto, 2017). The information in accounting earnings causes the market to need to adjust stock prices to accommodate the arrival of new information (Noto, 2017).

The market's reaction is reflected in the stock price movement near the earnings announcement date. If the reported profit exceeds the anticipated profit, the stock price will rise, and vice versa. The share price will decrease if the company's reported profit falls short of expectations (Kurniawati, 2014).

Companies with persistent earnings in the future are predicted to generate higher ERC values (Sayekti & Wondabio., 2007). In addition, companies with better earning quality are predicted to produce better ERC values. ERC estimates changes in the company's stock price caused by publishing the company's stock earnings information to the market (Fransisca Intan Galantika, 2016). Companies that experience losses have a smaller ERC than companies that profit (Fransisca Intan Galantika, 2016). A high ERC rate reflects quality earnings. Teets and Weasley (1996) in Soetardjo (2017), using an econometric model to calculate ERC, describe how the market response to accounting earnings information is measured.

There are two methods of calculating ERC for research that uses ERC as the object of research or one of the research variables of Teets and Weasley (1996) in Soetardjo (2017). Firm-Specific Coefficient Methodology is the first technique (FSCM). Each business that serves as the study sample will have its ERC value determined independently using this procedure. If there were 130 firms in the study sample to be observed, the researcher needs to explicitly calculate the ERC amount of the 130 companies to create varied quantities of ERC.

Cross-Sectional Regression Methodology is the second technique (CSRSM). Combining data from each company's observations during the observation period into a single CAR regression analysis will generate a single ERC value for the whole sample of firms when computing ERC using this approach. This approach estimates a single ERC representative of the whole study sample while ignoring any variances in ERC among all sample firms.

Using the CSRSM calculation approach will result in drastically different ERC values than those computed using FSCM calculations, claim Teets (1996) in

Soetardjo (2017).

The release of information on firm performance has a direct impact on how the market responds. Investors have a substantial demand for the information contained in financial statements since they utilize it as a guide and as an input when making investment decisions, and technical information required by investors when analyzing and conducting investment activities.

Wahyuni (2010) defines ERC as a measure of stock returns generated when earnings figures are published. Therefore, the market will respond when the company's earnings are reported. A high earnings response coefficient (ERC) number indicates that the market has responded strongly to earnings news. The quality of earnings and market response are closely related.

2.1.8 Corporate Governance Mechanism

The direct relationship between the independent and dependent variables may be impacted by the other variables. Moderating factors, or the elements that either strengthen or weaken the direct correlation between the independent and dependent variables, are one approach. A moderating variable affects the nature or trajectory of the relationship between variables, either favorably or unfavorably. The corporate governance framework was the moderating variable in this study.

According to agency theory, the division of labor and disparities in interests between agents and principals can lead to disputes that impact the standard of a company's profits. Agents or management with particular interests tends to create profit reports that serve their goals rather than the principal's interests. A control mechanism that can reconcile the conflicting interests of the two parties is required in an agency conflict like this. Boediono (2005) asserts that the corporate governance system can provide a financial report that includes earnings data.

Due to disparities in interests between the agent and the principal, agency conflicts may arise. The management's ability to set profit targets contrary to the company's objectives might result in lousy earning quality inside the organization. Therefore, a system, namely the corporate governance mechanism, must regulate the disparities in management and shareholder interests. A corporate governance mechanism's ability to supervise shareholder investments to offer shareholder advantages, like rising shareholder value and dividends, may significantly minimize

agency conflicts.

Corporate governance is a system of organizational structure that controls how internal and external parties are assigned tasks, obligations, and rights in line with their responsibilities. The internal parties include the staff, board of commissioners, and directors. Creditors, investors, the government, society, and other interested parties (stakeholders) are some examples of the company's external parties (Boediono, 2005)

Controlling the transparency of the company's operations is necessary to fulfill organizational goals, enhance the quality of earnings information, and ensure corporate responsibility. Additionally, organizations' benefits from applying corporate governance are listed by the Indonesian Institute for Corporate Governance (IICG) (Pratiwi, 2016).

1. Enhanced public appreciation

For both the general public and investors, corporate image is crucial. Because it will result in higher dividends and shareholder value, shareholders will be pleased with the company's success. The long-term benefits of corporate governance will outweigh the short-term costs.

2. Boost the stock price of the firm

It is possible to increase the value of the company's shares by persuading investors to make investments in the business. A number of factors, such as the standard of the board of commissioners, are taken into account before investors buy shares from a firm.

3. Decrease the cost of capital

A strong and well-run business will give creditors a good investment return. The firm's financial performance will improve and reduce the cost of capital that the company must bear if the company wishes to apply for a loan.

4. Reduce agency expenses

Shareholders must pay agency expenses due to giving management authority, and monitoring costs necessary to stop fraud can result in a loss. Management and internal parties that utilize corporate resources for personal gain might commit fraud. Agency costs can be reduced with a sound framework.

According to the Forum for Corporate Governance in Indonesia (FCGI, 2001a), corporate governance aims to generate value for all parties involved (stakeholders). Corporate governance refers to all aspects of a company's culture, ethics, values, processes, business procedures, rules, and organizational structures that affect the quality of its decision-making. Its objectives are encouraging and assisting business growth, more effective resource and risk management, and shareholder and stakeholder accountability.

A directive created by the National Committee on Governance Policy (KNKG, 2006) served as a framework for implementing corporate governance. The KNKG outlines the fundamentals of corporate governance in these recommendations as follows:

1. Transparency

Companies must present essential and pertinent information in a way that stakeholders can access and understand to retain objectivity in corporate operations. Companies must try to provide information necessary for shareholders, creditors, and other stakeholders to make decisions, in addition to the data needed to comply with laws and regulations.

2. Accountability

A requirement for establishing long-term success is accountability. Companies must be able to fairly and transparently account for their performance for the practical, quantifiable business management that balances the needs of the firm with the interests of shareholders and other stakeholders.

3. Responsibility

Corporate businesses must follow all rules and regulations, take care of their responsibilities to the community, and protect the environment in order to maintain long-term economic stability and be recognized as good.

4. Independence

Companies must be handled autonomously to prevent corporate organs from dominating one another and allow third parties to intervene, speeding up the use of ethical corporate governance principles.

5. Fairness and Equality

While conducting its operations in accordance with the principles of equity and equality, the company must always take the interests of its shareholders and other stakeholders into account.

In addition to the five principles above, audit committees, independent commissioners, institutional ownership, and managerial ownership are four corporate governance mechanisms frequently used in studies on corporate governance to lessen agency conflict, according to Rachmawati & Triatmoko (2007). Institutional ownership is understood based on the institution's ownership of shares, such as those of other businesses or banks. Institutional ownership will support a rise in better performance oversight of the business.

Pratiwi (2016) the mechanism for corporate governance is divided into two parts: external and internal procedures. The external mechanism influences the external factors of the corporation, including public accountants, investors, lenders, and organizations that certify legality. Internal firm components such as the audit committee, independent commissioner, institutional ownership, and management ownership influence the internal process.

Companies that practice effective corporate governance will benefit from increased value from all interested parties (stakeholders) and can lessen management-related risks. Investors and creditors will feel more confident investing in a firm with sound corporate governance. Naturally, suppose effective corporate governance is practiced. In that case, it will reduce the manipulation of financial statements and quickly give accurate, relevant, and trustworthy information so that the company's reported profit figures can be believed.

The supervision efforts will be more successful when more institutional investors hold a firm's shares since they have more influence over the managers' potential for opportunistic conduct (Sintyawati, NL, & Dewi, 2018). Share ownership concentrated by institutional investors will further optimize the effectiveness of monitoring management activities because of the number of funds invested (Syadeli, 2013). Companies with a large percentage of institutional ownership will use low debt levels. Supervision by external parties causes managers to use low levels of debt to avoid the risk of bankruptcy that will be experienced by

the company (Tjeleni, 2013).

According to Tjeleni (2013), institutional ownership refers to a company's stock owned by institutions such as banks, insurance companies, and investment organizations. According to Daud and Ardika (2015), institutional ownership is the proportion of a company's invested capital corresponding to the number of shares held by institutional investors. Olivia (2012) states that institutional ownership comprises the government, financial institutions, legal entities, foreign institutions, and trust funds. Institutional ownership refers to the shareholdings of governments, insurance companies, banks, and legal entities.

According to Iswara (2014), corporate governance is a set of rules that control how a corporation's internal and external stakeholders interact with their rights and duties or with the system that governs it. The World Bank defines effective corporate governance as the implementation of democratic, efficient markets, responsible development management, avoiding errors in the distribution of investment money, and eliminating corruption.

According to Porta (2000), corporate governance is a collection of processes intended to safeguard investors from takeovers by parties within the firm. Corporate governance connects the company and all stakeholders (Arsoy, AP, & Crowther, 2008). By separating ownership and control, corporate governance seeks to reduce conflicts of interest between management and shareholders (Baydoun, 2012).

Selfish behavior that disregards investors' interests is a hallmark of poor corporate governance in a corporation (Franita, 2018). Corporate governance is a rule intended to allocate responsibilities among positions to reduce unlawful conduct. Corporate governance is meant to give investors confidence that the manager will act in their best interests and not embezzle funds or engage in projects designed to maximize profits. A company's management must be based on openness, accountability, responsibility, independence, justice, and equality principles. It is anticipated that applying good corporate governance will make a corporation sustainable.

If corporate governance is implemented, investors will accurately evaluate the quality of financial reporting. The corporate governance mechanism can also monitor managers' nature, motivation, and performance in their company

responsibilities. Control and maintain control over the motivation and goals of managers in carrying out the company's operational performance, ensuring good behavior to carry out their responsibilities, and protecting the interests of shareholders (Oktaviani, 2015).

The principle of good corporate governance can strengthen the relationship between earnings quality and market reaction and prevent practices not following company objectives, such as earnings management, from producing fair financial reports. In this study, corporate governance measurement uses a score involving several indicators: the audit committee, independent commissioners, institutional ownership, and managerial ownership.

2.1.9 Audit Committee

A committee created by and accountable to the board of commissioners and owned by issuers or publicly traded companies is what the Financial Services Authority Regulation Number 55 / POJK. 04/2015 (POJK, 2015) refers to an audit committee. This committee supports the board of commissioners as it fulfills its obligations. Following the Indonesian Audit Committee Association (IKAI), the audit committee is one of the institutional components in the context of good corporate governance that is anticipated to contribute significantly to the level of implementation. The audit committee's presence is anticipated to enhance the company's internal control standards and maximize the checks and balances system, which maximizes protection for shareholders and other stakeholders.

Establishing an audit committee is crucial as a key instrument in implementing corporate governance. The audit committee must adhere to the business's guiding principles and organizational fundamentals with openness, independence, responsibility, and accountability (A. Lestari, 2017).

The audit committee is supposed to be able to enhance internal controls and financial reporting quality, maintain regulatory compliance and maximize internal audit functions to offer the most significant level of shareholder and other stakeholder protection.

According to Susanto (2011), the audit committee's responsibility is to monitor the correctness of information in financial reports, the caliber of external auditors' work, and the efficacy of internal controls.

According to the Decree of the Chairman of BAPEPAM and LK No. Kep-643/BL/2012, the board of commissioners established the audit committee. It is responsible for aiding the board of commissioners in carrying out its duties and exercising its authority. The audit committee's job is to monitor the management of the organization. The audit committee, a more recent addition to the company's control framework, serves as a point of contact for matters pertaining to control between the management, the board of commissioners, and shareholders.

As required by the BAPEPAM chairman's decision and LK no. Kep-643/BL/2012, when assembling the company's financial statements, the audit committee must be present at a meeting with management (KKRI, 2012). At least once every three months, the audit committee convenes in regular sessions. Only when at least fifty percent (50%) of the committee's members are present can meetings of the audit committee be arranged.

According to theory, the audit committee's main duty is to support the board of commissioners in carrying out its supervision responsibilities. The internal control system, financial reporting accuracy, and effectiveness of the internal audit division are all evaluated by the audit committee. The audit committee evaluates the risks facing the company and makes sure that all legal requirements are met. According to Financial Services Authority Regulation Number 55 / POJK. 04/2015 (POJK, 2015), at least three audit committee members must represent independent commissioners and organizations from outside the issuer or public corporation, and an independent commissioner must chair the committee.

According to POJK No. 33/POJK. 04/2014 (POJK, 2014), concerning the directors and board of commissioners of issuers or public businesses, independent commissioners must comply with specific rules.

According to the decision of the chairman of BAPEPAM and LK No. Kep-643/BL/2012 (KKRI, 2012), the audit committee must operate independently and honestly. For the company's financial accounts to accurately reflect current circumstances without siding with any one party, independence is required. In order to identify significant misstatements in the financial statements and to quickly spot manipulation of the company's financial statements, the audit committee also has to be knowledgeable in financial accounting.

2.1.10 Independent Commissioner

Independent commissioners are board of commissioners members who are not affiliated with the issuer or public entity and satisfy the standards of the OJK, as per Financial Services Authority Regulation Number 33 / POJK. 04/2014 (POJK, 2014). The principal commissioner, sometimes known as the president commissioner, is one of the minimum two members of the board of commissioners. If there are two board members of commissioners, one is an independent commissioner. Moreover, if there are more than two members on the board of commissioners, at least 30% of them must be independent.

Point 1b of Bapepam Regulation Number IX.I.5 on the Establishment and Guidelines for the Work Implementation of the Audit Committee specifies that an Independent Commissioner must be a member of the commissioner who:

1. Comes from a source other than the issuer or public firm
2. Do not directly or indirectly own any shares of issuers or public corporations.
3. It has no connection to the issuer, public corporation, its commissioners, directors, or principal shareholders.
4. No commercial connections to the issuer's or public company's operations, either directly or indirectly.

The board of commissioners is crucial to the operation of the business, especially when it comes to implementing sound corporate governance. The board of commissioners serves as a vehicle for oversight, advice, and direction for firm executives (FCGI, 2001). The composition of the board of commissioners is one of the board characteristics related to the informational value of corporate governance. The board's makeup can affect management's preparation of financial statements through its involvement in the supervisory function, resulting in a high-quality profit report (Boediono, 2005).

One type of board feature that may have an indirect relationship with the informational value of earnings is the makeup of the board of commissioners. The board's makeup can impact how management develops and prepares financial reports through its roles and responsibilities in monitoring and supervision activities. To provide financial reports that the capital market will view as an example of opportunistic or effective earnings management and produce earnings

that genuinely disclose complete profit information (Christiawan, 2007).

The board of commissioners is crucial in managing the business, particularly in implementing corporate governance. According to FCGI (2001), the board of commissioners is a mechanism used to oversee and offer guidance in the firm's operation. The independent board of commissioners is a component of the board of commissioners, but it comprises people not affiliated with the company. It acts independently to supervise and monitor management policies and offer input so that management can be directed to avoid fraud like earnings management.

The company's responsibility to the environment and other stakeholders. The company is also responsible for performance to increase stakeholder value. The cooperation in management is expected to reflect good relations between the board of commissioners and independent commissioners.

2.1.11 Institutional Ownership

According to Jensen, MC, & Meckling (1976), institutional ownership reduces agency conflicts between managers and shareholders. Institutional investors are thought to be able to serve as an effective monitoring tool for every managerial move. Institutional investors participate in strategic choices and do not readily accept the existence of earnings manipulation.

Based on the knowledge gained from the information collected through the market's response to the release of profits that may be known through the mechanism of institutional ownership, management can determine the efficacy of using corporate resources. In order to decrease management actions or discretion in managing earnings, institutional ownership has the capacity and competence to oversee and supervise the management efficiently. The number of a certain percentage of shares held by institutions can also affect and interfere with the creation of financial statements. Therefore, the accrual of policies as intended by management is still possible (Christiawan and Tarigan, 2007).

Boediono (2005) asserts that institutional ownership can reduce the incentives carried out by managers who are merely motivated by self-interest through regular and stringent oversight and monitoring. Institutional ownership can reduce management's tendency to implement policies that may harm the company in the future. Also, Reduce management's attempts to provide falsified financial figures

to achieve their goals.

In order to avoid agency conflicts between principals and agents, institutional ownership is one of the methods that may be employed. According to Puteri and Rohman (2012), a large institutional ownership percentage will increase the business's external control, lowering agency costs for the company. Because institutional ownership can potentially indirectly monitor the performance and activities taken by management, an effective monitoring strategy is believed to decrease or limit earnings management actions. The percentage of shares held by institutions whose ownership percentage will be determined at the end of the year is known as institutional ownership (Octavia, 2017).

Due to institutional ownership, it is anticipated that outside organizations with stock in the firm would take action to monitor the choices and policies established by the company to protect the interests of shareholders. Based on information generated by market reactions to earnings announcements, institutional ownership makes it feasible to assess how well management manages the company's resources. Specific percentages of shares owned by institutions may influence the compilation of financial statements, but this does not exclude actualization in the management's best interests (Boediono, 2005).

High institutional ownership may also motivate investors to exercise more control over management to deter opportunistic behavior. Institutional investors resist earnings manipulation because they participate in strategic decision-making (Jensen and Meckling, 1976) (Puteri, 2012).

2.1.12 Managerial Ownership

Puteri (2012) quotes Jensen and Meckling (1976) as saying that increasing managerial ownership in the business is one way to reduce agency conflict. The ownership of shares may indicate a shared interest between management and shareholders by management. Ross et al. (1999) said in Siallagan and Machfoedz (2006) that the greater the level of management ownership in a company, the more likely it is that management will try to improve its performance to benefit shareholders and its gain.

According to Christiawan and Tarigan (2007), management ownership refers to circumstances where managers also own shares in the company. The manager's

significant ownership stake in the business depicts this condition in the financial accounts. Managers who are also shareholders in a firm with management ownership will align their interests with those of shareholders. Institutional ownership can reduce management's propensity to use discretion in financial statements, enhancing the accuracy of reported results (Rohman and Puteri, 2012).

In addition to his role as manager, the manager also becomes a shareholder in the business (Christiawan and Tarigan, 2007). According to Christiawan and Tarigan (2007) and Wahidahwati (2002), managerial ownership refers to a degree of share ownership held by management that actively engages in acts critical for the firm's continued existence, such as directors, management, and commissioners. In a condition known as managerial ownership, a company's managers serve as the company's management and shareholders who actively participate in decision-making.

The management's objectives and interests will diverge due to this circumstance. Agency conflict is the term used to describe the conflict resulting from the separation of ownership and management roles in finance theory. The possible contrasts in objectives and interests between outside shareholders and firm management might be perceived as being united by management ownership of company shares (Jensen and Meckling, 1976 in Puteri and Rohman, 2012). Therefore, agency problems will be reduced if managers simultaneously function as owners.

Low managerial ownership firms will opt to use accounting procedures and guidelines that might encourage an increase in reported earnings. As a result, the financial statements will not accurately reflect the company's financial stability, economic health, and general state of affairs. Due to pressure from the financial market, this was done (Christian and Tarigan, 2007).

The percentage of the company's shares owned by managers, as shown in the financial statements, serves as a proxy for managerial ownership. Naturally, the interests of a manager who simultaneously occupies similar roles as a shareholder or a firm with management ownership will be aligned. According to Octavia and Nita (2017), managerial ownership is when the management owns company shares.

2.2 Literature Review

Previous studies have analyzed the effect of conservatism, activity and operating performance, earning quality, and corporate governance mechanisms on earning response coefficient. However, until now, there have been no consistent results. The following can be seen as a summary of previous research.

Several previous studies reveal that earning quality has a significant positive effect on market reactions, such as in the research conducted by Kurniawati (2014) in Asia and Europe. They were supported by the study by Soetardjo (2017), which disclosed that market reaction is influenced by the practice of earning management by managers in the company. However, according to Jonathan and Machdar (2018) research, earning quality does not affect the market reaction.

According to Herusetya (2017) study, which used earning management as an independent variable and earning response coefficient as a dependent variable, it was discovered that there was a negative correlation between earning response coefficients and earnings information content that included earning management. This study contradicts Kurniawati's (2014) study, which found that earning quality influences market reactions. According to Oktaviani (2015) study, earnings management significantly affects the quality of earnings. Halimatus (2015) study discovered that investing opportunities have a favorable impact on earning quality.

However, Farichah (2017) revealed that earnings management implemented with IFRS would negatively affect earnings quality by proxying earnings persistence. Other studies look at the impact of corporate governance on earnings quality, market reactions, and the link between earnings quality and market reactions, in addition to the impact of earnings quality on market reactions.

Studies on the effects of good corporate governance on profit quality include studies by Oktaviani et al. (2015). Oktaviani et al. (2015) The researchers examined the relationship between corporate governance and earnings quality using earnings management as an intervening variable. According to the Oktaviani (2015) study findings, corporate governance, a variable proxied by institutional ownership, the board of commissioners, and the audit committee, significantly influences earning quality through earnings management.

According to research by Lestari (2017), the size, independence, and

managerial ownership of the audit committee have a significant positive impact on the quality of the earnings, while the number of meetings, audit committee competence, and independent commissioners has no impact on the quality of the earnings. Therefore, it may be said that corporate governance affects earning quality.

Furthermore, Nurdina (2017) research in examining corporate governance on market reaction shows a significant effect in the test. An independent board of commissioners, institutional ownership, a board of directors, and an audit committee serve as the proxy for the corporate governance structure. The study findings demonstrate that the mechanisms of corporate governance have a positive impact on market responses.

According to Yulika (2017), institutional ownership, which serves as a proxy for corporate governance, reduces the impact of information asymmetry on earnings management techniques. Management ownership and the audit committee are unable to moderate this relationship. The audit committee's and independent commissioners' competence does not affect earnings quality. In a different study on corporate governance, Lestari (2017) discovered that managerial ownership, audit committee size, and independence all had a favorable and substantial impact on profit quality.

Additionally, Soetardjo's (2017) findings show that corporate governance procedures have a moderating impact on the link between earning management and earning response coefficient.

According to Rachmawati and Triatmoko's (2007) research, neither an audit committee nor the independent commissioners, institutional ownership, nor management ownership impacts the quality of the revenues in the CG mechanism. Contradicts the findings of Boediono (2005) and Siallagan and Machfoedz (2006) studies.

In his research, Boediono (2005) looked at the impact of earnings management and corporate governance procedures on the quality of earnings. Institutional ownership, management ownership, and the board of commissioners are proxies for corporate governance. The findings of his study demonstrate that corporate governance impacts the caliber of earnings.

Additionally, Siallagan and Machfoedz (2006) use managerial ownership, the board of commissioners, and the audit committee as a proxy for corporate governance structures in their study of the impact of such mechanisms on earnings quality and company value. Meanwhile, discretionary accruals serve as a substitute for the earnings quality variable. His study's findings demonstrate that the mechanisms of corporate governance have a favorable impact on the quality of profitability.

In addition, the findings of Adriani (2011) study on the impact of the CG mechanism show that profits quality is affected by independent commissioners, institutional ownership, and management ownership rather than the proportion of independent audit committees. According to Rohman and Puteri (2012), management ownership and the audit committee have no impact on earnings quality, but institutional ownership and the volume of audit committee meetings do.

2.3 Thinking Framework and Hypotheses

2.3.1 Effect of Conservatism on The Earning Response Coefficient

Conservatism, a principle that applies the precautionary principle in recording profit and loss, causes companies to recognize losses more quickly. Loss recognition is based on bad news by the company and anticipation of it. The application of this principle will have an impact on the earnings quality presented by the company. Khotari et al. (2010) argue that conditional conservatism limits earnings management practices because of the impetus for companies to apply high verification standards to profit recognition and loss recognition as soon as possible based on bad news, even though there is no adequate evidence.

The impact arising from applying the principle of conditional conservatism will reduce managerial opportunities to practice earnings management. Encourage an increase in earnings quality presented by the company in the financial statements without earning management practices. Previous research has examined the principles of conservatism as a whole.

With the principle of conservatism that applies prudence in recognizing profits quickly, this can lead to numbers in the financial statements that are not exaggerated so that the information content of earnings in the financial statements will follow accurate figures that reflect the actual operational performance of the

company. Earning response coefficients that reflect the information content that contains profit will also be more relevant and faithful in reporting. Market participants will also feel that the annual financial statement figures are real numbers and should not be exaggerated. This research will try to use conditional conservatism as one of the research variables. Based on the theory and background above, the hypothesis in this study can be formulated as follows:

Ha1: Conservatism has a significant negative effect on the earning response coefficient

2.3.2 Effect of Activity Performance (Asset Turnover) on Earning Response Coefficient

Assets are all resources owned by a company and are ready to be used to generate income for the company. This indicator is important because there are times when a company has assets that have been purchased but not used or used but not optimally.

Therefore, the greater the value of the asset turnover ratio, the more efficient the company's performance in utilizing the available assets. Conversely, several asset uses must be maximized if the value is small.

Each industry has a different composition of assets. As a result, to compare the value of a company's asset turnover ratio, compare the company with other companies engaged in the same field. These financial indicators help measure the efficiency of the company's performance in using its assets.

Asset turnover can determine whether the company's performance is efficient or not in using assets to generate profits. If the company's profits increase yearly, investors will be pleased considering the company they bought shares in; every year, the profit increases. The company's stock price is also expected to increase with increased profits. With the increase in stock prices, the market reaction and sentiment towards these stocks will also be better and more purchased.

Based on the theory and background above, the hypothesis in this study can be formulated as follows:

Ha2: Asset turnover has a significant positive effect on the earning response coefficient.

2.3.3 Effect of Operating Performance (Return on Asset) on Earning Response Coefficient

The bigger the ROA, the greater the level of profit achieved by the company and the better the company's position in terms of asset use. The more effective the company in empowering its assets, will more attractive to investors to buy company shares. Investor interest in the company's stock is increasing big will push to increase the company's share price.

Investors who invest in the stock market want to hold shares of companies with a significant return on assets. Investing in the stock market is complex, and many market participants are worried about their capital. Choosing a company for the best long-term investors should look for a company with a wide moat. One of the characteristics of a company with a wide moat is that it has a super significant return on assets. Usually, many investors only pay attention to return on equity because it is more popular and is often used by stock market players.

The return on assets can determine the company's performance and whether the assets owned by the company can generate profits. The greater the return on assets, the greater the company can generate profits from its assets. When choosing to invest in the company, investors will usually see whether the return on assets is significant. If the company's profits increase yearly, investors will be pleased considering the company they bought shares in; every year, the profit increases. Based on the theory and background above, the hypothesis in this study can be formulated as follows:

Ha3: Return on the asset has a significant positive effect on the earning response coefficient.

2.3.4 Effect of Good Corporate Governance on Relationship between Earning Quality and Earning Response Coefficient

The impact of corporate governance procedures on the quality of earnings and the market response is mainly studied as a single effect, namely the relationship between corporate governance practices on earning quality and the relationship between corporate governance practices on market reactions.

Irawati (2017) investigated how earning quality is affected by company governance in the food and beverage sectors. The findings of this study demonstrate

that management ownership and institutional ownership have a detrimental impact on earning quality. Therefore, earning quality decreases when institutional and management ownership concentrations increase. At the same time, factors such as the audit committee and audit quality significantly impact earning quality.

According to Novi (2013), management ownership, institutional ownership, and the audit committee do not significantly affect earning quality. However, the board of directors does. The findings of this research prove that the structure of the board of directors in a company in its functions can make and control managerial decisions and monitor activities for all company activities, including monitoring the quality of financial statement information, which is still very minimal.

Taruno (2013) presents a different result, which explains that the board of commissioners and institutional ownership serve as the corporate governance system has a positive effect on earning quality. While Kurniawati (2016) proves the significant influence between earning quality and institutional ownership, the supervisory component of the company's performance will rise with increasing institutional ownership in the corporate governance system. Expanding this oversight will motivate management to enhance business performance and reduce earnings management actions to produce quality reports.

Additionally, several earlier research has demonstrated how significantly the corporate governance system affects market responses. According to this report, investors prefer using a corporate governance framework when making investment decisions (Mukti, 2013). Lestari (2017), who found that the corporate governance system has a substantial favorable impact and is directly related to stock returns, also corroborates this research.

According to several earlier studies, using effective corporate governance systems would lead to good earning quality, which will naturally positively impact the market. Conclusion: Using corporate governance measures improves the connection between earning quality and market response.

Implementing corporate governance may support resource management, business growth, and investment opportunity risks by assisting management in making effective and consistent decisions with the company's values, culture, and policies.

A company's corporate governance will be considered reasonable if it produces good internal control. In this case, the internal auditor is one of the components. In order to determine if internal control has been implemented effectively, it is essential to evaluate the effectiveness of the corporate governance structure. Based on this assertion, the researcher believes that the presence of corporate governance can increase the link between earning quality and market response. The likelihood of profit management will be decreased by the amount of monitoring that is appropriately implemented. It is believed that reducing earnings management activities will improve earning quality.

According to agency theory, the division of labor and disparities in interests between agents and principals can lead to disputes that impact the standard of a company's profits. According to Puteri (2012) and Jensen and Meckling (1976), financial reporting that uses accounting figures should reduce disputes between interested parties. The principal can evaluate, measure, and track the level to which the agent is working to increase their welfare and recompense agents thanks to the financial accounts presented by the agent as accountability for its performance.

According to Puteri (2012), Jensen and Meckling (1976) argue that increasing managerial ownership in the business is necessary to reduce agency conflicts. Siallagan and Machfoedz (2006) claimed that the management would strive to enhance the firm's performance for the benefit of shareholders and its own sake, the more significant the company's management ownership. Along with managerial ownership, the board of commissioners' function is anticipated to enhance earnings quality by lowering the extent of earnings management through the financial reporting monitoring function.

According to Jensen and Meckling (1976), institutional ownership reduces agency conflicts between managers and shareholders. In addition, the audit committee, a specialized entity established within the company, is expected to enhance the supervisory duties previously performed by the board of commissioners.

The impact of corporate governance (CG) procedures on profit quality have been examined in several prior studies, including work by Siallagan, Machfoedz, and Boediono (2005). In his research, Boediono (2005) looks at how corporate

governance practices and earnings management affect the caliber of results. Institutional ownership, managerial ownership, and the makeup of the board of commissioners all serve as stand-ins for corporate governance processes. The findings of his study demonstrate that the method of corporate governance impacts the quality of earnings.

Additionally, Siallagan and Machfoedz (2006) use managerial ownership, the board of commissioners, and the audit committee as proxies for corporate governance structures in their study of the impact of such mechanisms on earnings quality and company value. Meanwhile, discretionary accruals serve as a substitute for the earnings quality variable. His study's findings demonstrate that the mechanisms of corporate governance have a favorable impact on the quality of earnings.

The relationship between earning quality and market reaction can be further strengthened by implementing good corporate governance. Good corporate governance is expected to boost the company's reputation so that its existence has a positive influence (or has a negative influence) on the existence of earning quality on the market reaction. The existence of good corporate governance can increase market confidence in the company. Earning quality is growth and stable yearly, produced by companies with good corporate governance so that the market reaction will be positive.

Companies implementing good corporate governance can make the company more trustworthy and credible. Of course, implementing good corporate governance will increase investor confidence in making investment decisions. Earning quality is indicated as the ability of earnings information to respond to the market; at least, it will be more credible with good corporate governance and implemented according to the standards that have been set. The existence of good corporate governance can increase the value of the company and monitor the company. Good corporate governance prevents companies from practicing earnings management and can increase investors' expectations of the company.

The market response to the information content of accounting results is anticipated to reflect the quality of the firm's earnings more favorably the better the company's corporate governance system is rated. The following hypothesis can be

made from the previous explanation:

Ha4: Good corporate governance significantly positively affects the relationship between earning quality and earning response coefficient.

The following is a framework that is formed based on the hypothesis to be tested:

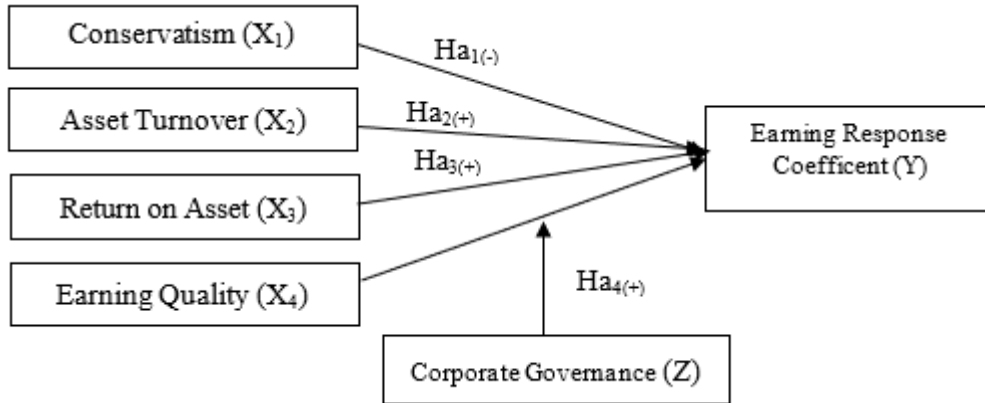


Figure 2.2 Thinking Framework

CHAPTER III

RESEARCH METHODS

3.1 Population, Sample, Data Source

The population can be defined as a collection of data that identifies a phenomenon. At the same time, the sample is a collection of data taken or selected from a population (Santoso, 2016).

Thirty-five manufacturing companies active in the primary and chemical industries listed on the Indonesia Stock Exchange (IDX) during the years 2015–2018 are the population of this study.

The data utilized in this study is secondary data gathered and acquired from the company's yearly financial statements from 2015 to 2018, available on the company's website, www.emiten.kontan.co.id, www.idx.co.id, and www.finance.yahoo.com.

Purposive sampling was used for this study's sampling. Purposive sampling, a sampling approach, involves choosing based on specific criteria in order to ensure that the sample accurately represents the population (Nasution, 2017). The criteria for the sample to be used in this study are as follows:

- a. Manufacturing companies listed on the IDX in 2015-2018.
- b. The company has published consecutive annual financial reports for 2015 to 2018 containing information and data that may be used for this study. The financial statements have been audited and backed by a report from an independent auditor.
- c. The company does not issue annual financial statements in foreign currency but in Indonesian Rupiah (IDR).

Table 3.1 Table of Research Sample Selection Procedures

Sample criteria	Total
Number of manufacturers registered on the IDX between 2015 and 2018 in the basic and chemical industries	64
Number of manufacturing companies in the basic and chemical industry sectors that publish annual reports and financial reports in currencies other than the rupiah	-13
Number list manufacturing firms in the domains of basic and chemical industries whose share values are not available at www.finance.yahoo.com	-16
Total research sample	35
Total number of companies multiplied by four years of the research period	4
Total observation data	140

3.2 Data Collection Techniques

The data collection technique used was taken from secondary data. Secondary data is obtained from the first source (primary data), which has been further processed to make the resulting information more informative (Umar, 2003). This study used financial statements and annual reports from companies as secondary data.

Purposive sampling is the technique utilized to get the data. Selecting according to specific criteria is "purposive," a sampling approach to ensure that the sample accurately represents the community. The advantage of this technique is that the sample is selected to be relevant to the research design. While the weakness of this technique is that not all of the selected samples are representative (can represent) because they were chosen randomly (Nasution, 2017).

The data obtained through websites and trusted sites contain theories about what is needed for research. Websites like www.idx.co.id, www.finance.yahoo.com, www.emiten.kontan.co.id, and business websites are just some sources.

3.3 Empirical Research Model

The empirical research model aims to test whether corporate governance affects the relationship between conservatism, operating performance, activity performance, and earning quality with corporate governance as a moderation variable on earning response coefficient, using panel data regression modeling to regress this model. The presence of unexpected earnings (UE) in model one is multiplied by conservatism (NOACC) because it is to determine the market response in the component of changes in earnings per share. In this case, conservatism in reporting financial statements also affects changes in earnings per share every period (Soetardjo, 2018).

Model I:

$$CAR_{it} = \alpha + \beta_1 UE_{it} + \beta_2 AT_{it} + \beta_3 UE_NOACC_{it} + \beta_4 ROA_{it} + \varepsilon$$

Model 2 is used because the moderating variable of corporate governance affects the relationship between earning quality and earning response coefficient. The existence of unexpected earnings (UE) in model two is multiplied by earning quality (EQ) and corporate governance (CG), to find out how the market responds

through changes in earnings per share, it is hoped that the existence of quality earnings and strict corporate governance supervision can produce relevant earnings (Soetardjo, 2018). The research techniques will be as follows:

Model II:

$$CAR_{it} = \alpha + \beta_1 UE_{it} + \beta_2 UE * EQ * CG_{it} + \beta_3 AT_{it} + \beta_4 UE_NOACC_{it} + \beta_5 ROA_{it} + \varepsilon$$

Information:

- CAR : Cumulative Abnormal Return, (to measure earning response coefficient)
- UE : Unexpected Earnings (to measure earning response coefficient)
- EQ : Earning Quality
- CG : Corporate Governance
- AGE : Company age
- AT : Asset turnover
- ROA : Return on Asset
- NOACC : Conservatism
- ε : Error

3.4 Definition of Operational Variables

A variable is a quality or characteristic that expresses the essence or value of a subject, thing, or activity. It has a particular variation chosen by the researcher to be investigated, from which inferences are made. Four different categories of variables, including independent, dependent, moderating, and control factors, are used in this study. In this study, earning quality functions as an independent variable, and earning response coefficient as a dependent variable. This study employs a corporate governance model as a moderating variable, whereas the organization's profitability and asset turnover are also independent variables.

3.4.1 Dependent Variable

1. Earning Response Coefficient

The output variable, the criterion, and the consequent are other common names for the dependent variable. The dependent variable becomes a variable that can be explained by the independent variables used in the model (Umar, 2012). The

dependent variable utilized in this study was the earning response coefficient.

Earning response coefficient measures how well the market receives a company's financial statement information. The earning response coefficient is quantified in this study as a gauge of how the capital market interprets information about accounting earnings. The model put out by is used in the formulation of the earnings response coefficient (Teets, 1996) in (Soetardjo, 2017), namely:

$$CAR = \beta_0 + \beta_1 UE + \varepsilon$$

A coefficient known as the earning response coefficient is derived from the relationship between cumulative abnormal returns (CAR) and unexpected earnings (UE). A Cross-Sectional Regression Methodology (CSRM) technique was used to determine the Earning Response Coefficient for this study.

a. Cumulative Abnormal Return

The calculation of CAR in this study was also carried out by Sayekti & Wondabio., (2007), Riyatno (2007), and Soetardjo (2017). Abnormal Return (AR) is accumulated into CAR, which is computed daily with a 15-month interval beginning in January to March

$$AR_{it} = R_{it} - RM_t$$

Information :

AR_{it} : Abnormal return for the stock i in year t

R_{it} : Stock return in year t

RM_t : Return on the market index for year t

The difference between today's Composite Stock Price Index (IHSG) and yesterday's IHSG is used to compute the daily market rate of return, which is scaled to the previous day's IHSG.

$$RM_t = \frac{IHSG_t - IHSG_{t-1}}{IHSG_{t-1}}$$

Information :

RM_t : Return on the market index for year t

$IHSG_t$: Composite Stock Price Index on day t

$IHSG_{t-1}$: Composite Stock Price Index on day t-1

The difference between the share price today and the share price (close price)

yesterday, scaled to yesterday's closing price, is then used to compute the daily rate of return on the company's shares.

$$R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}}$$

Information :

R_{it} : Return on stocks price in year t

P_{it} : Share price i on day t

P_{it-1} : Stock price i on day t-1

b. Unexpected Earning

This research also includes (Sayekti & Wondabio., 2007) a scale of their definition of unexpected earnings (UE) by the earning per share at the end of the preceding year. They define UE as the difference between profits per share before exceptional items in one year and earnings per share before extraordinary items in the previous year.

$$UE_{it} = \frac{EPS_{it} - EPS_{it-1}}{EPS_{it-1}}$$

Information :

UE_{it} : Unexpected stock I earnings in year t

EPS_{it} : Earnings per share in the year t

EPS_{it-1} : Earnings per share in the year t-1

This formula is also used in the research of (Riyatno, 2007)(Mulyani, Sri & Andayani., 2007) and (Soetardjo, 2017)

3.4.2 Independent Variables

Independent variables are factors that explain or impact the dependent variable. (Umar, 2003). This study's independent variable is earnings quality, a measure of whether the earnings generated follow predetermined reasonable standards. While reporting earnings that do not correspond with actual profits results in low earning quality, the information acquired from the financial statements becomes skewed, potentially deceiving creditors and investors when making judgments.

A. Earning quality

Earning quality is closely related to the company's actions in choosing accounting policies without the intention of influencing specific actions of users of accounting earnings information and without achieving specific goals. Earnings management uses certain accounting procedures to alter accounting earnings to influence behavior or attain specific objectives. As a result, the availability of earnings management methods ensures the reliability of accounting earnings. Here, the practice of earnings management in the company will positively or negatively affect the accounting earnings quality. Earning quality of a reliable company certainly does not apply earnings management practices.

In this study, the modified Jones model calculates discretionary accruals to measure earning quality (DACC) approximatively. DACC is calculated by subtracting non-discretionary accruals from total accruals (TACC). Because the modified Jones model is considered superior to other models for gauging earnings management, DACC is calculated using this research model (Dechow et al., 1995) (Rachmawati & Triatmoko, 2007). Earnings management is similar to earning quality, so this study uses this proxy to measure earning quality. The model being used is as follows:

1. Total Accruals (TACC)

The difference between earnings after taxes and cash flows from operational activities is what this research refers to as total accruals

$$\mathbf{TACC_t = NI_t - OCF_t}$$

Information :

$TACC_t$: Accruals total for the year t

NI_t : Net income in the t year

OCF_t : Operating cash flow for year t

The following regression analysis model (Ordinary Least Squares) produced estimates of company-specific parameters as follows:

$$\frac{TACC_t}{TA_{t-1}} = \alpha_1 \left(\frac{1}{TA_{t-1}} \right) + \alpha_2 \left(\frac{\Delta REV_t - \Delta REC_t}{TA_{t-1}} \right) + \alpha_3 \left(\frac{PPE_t}{TA_{t-1}} \right) + \varepsilon_t$$

Information:

$TACC_t$: Accruals total for the year t
 TA_{t-1} : Company's total assets at the end of year t-1.
 ΔREV_t : Revenue difference between years t-1 and t
 ΔREC_t : Differences in net receivables from year t-1 to year t
 PPE_t : Plant, property, and equipment totals for the year t
 ε_t : error

2. Non-Discretionary Accruals (NDACC)

The modified Jones model is used to determine non-discretionary accruals, and the results are as follows:

$$NDACC_t = \alpha_1 \left(\frac{1}{TA_{t-1}} \right) + \alpha_2 \left(\frac{\Delta REV_t - \Delta REC_t}{TA_{t-1}} \right) + \alpha_3 \left(\frac{PPE_t}{TA_{t-1}} \right)$$

Information:

$NDACC_t$: In year t, non-discretionary accruals
 TA_{t-1} : Company's total assets at the end of year t-1.
 ΔREV_t : Revenue difference between years t-1 and t
 ΔREC_t : Net receivables differences from year t-1 to year t
 PPE_t : Property, plant, and equipment totals for the year t

3. Discretionary Accruals (DACC)

Discretionary accruals can be specified as follows, and total accruals are made up of both discretionary and non-discretionary accruals:

$$DACC_t = \left| \frac{TACC_t}{TA_{t-1}} \right| - NDACC_t$$

Information:

$DACC_t$: Absolute value of discretionary accruals in year t
 $TACC_t$: Accruals total for the year t
 TA_{t-1} : Company's total assets at the end of year t-1
 $NDACC_t$: In year t, non-discretionary accruals

After getting the results from the calculations above, the value is absolute and then multiplied by minus one. The regression results from the model are multiplied by minus one because the relationship between earning quality and earning

management is inversely proportional. Therefore, the quality of the earnings declines when earnings management is applied more frequently.

B. Conservatism

The measurement of conservatism in this study uses a proxy in the paper of (Givoly & Hayn, 2002) and also listed in (Andreas et al., 2017) paper, which in that paper uses the accrual method in measuring conservatism. Accrual means earnings that can be freely determined by the actions of managers in influencing earnings. Earnings whose reporting is not freely determined by manager actions are also called unaccruals. In both papers, non-operating accruals are used to measure conservatism.

$$NOACC_{it} = \frac{NI_{it} - CFO_{it} \times (-1)}{TA_{it}}$$

$NOACC_{it}$ = Conservatism level of firm i in year t

NI_{it} = Net income for the company in year t

TA_{it} = Company i's total assets as of year t

CFO_{it} = Cash flow from operational activities for firm i in year t

If the value of $KA_{it} > 0$ ensures that the firm has a high level of conservatism

If the value of $KA_{it} < 0$ ensures that the firm has a low level of conservatism

C. Operating performance

The functioning of the company's assets reveals the efficacy of the business in creating profits. Maintain business success and be a driving force behind efforts to control earnings. Researchers will employ the profitability return on assets ratio in this investigation (ROA). ROA is crucial for determining a healthy company in terms of operating performance in the financial statements and affecting investors' choices. The more effectively a corporation uses its assets to create profits, the higher its ROA. Investors will be drawn to a firm with significant earnings because of its greater rate of return. In other words, the more this ratio is significant; the more productive assets are at generating net profits. The return on asset variable is calculated as follows.

$$\text{Return on Asset} = \text{Net Income} / \text{Total Asset}$$

D. Activity Performance

Assets are all resources owned by a company and are ready to be used to generate income for the company. This indicator is important because there are times when a company has assets that have been purchased but not used or used but not optimally.

Therefore, the greater the value of the asset turnover ratio, the more efficient the company's performance in utilizing the available assets. Conversely, several asset uses must be maximized if the value is small.

The calculation of the asset turnover is as follows:

$$\text{Asset turnover} = \text{Net sales} / \text{Total Asset}$$

Measure how efficiently firm assets are used to generate sales.

3.4.3 Moderating Variables

The moderating variable is a factor that influences how strongly or how weakly the independent and dependent variables are related. (Umar, 2003) Corporate governance mechanisms were the moderating variables in this study. Since corporate governance is qualitative, it cannot be precisely quantified.

Depending on how well investors are protected in a given country, different countries may have different effects of corporate governance on firm success. (Klapper & Love, 2004). Investors in nations with usually weak investor protection tend to place a higher value on companies with strong corporate governance procedures. In support of this claim, we can anticipate the market to judge corporate governance subjectively depending on the ownership and control structure of the firm. For example, although good corporate governance practices are carried out well, there are suspicions that owners commit fraud to maximize their interests at the expense of other shareholders.

The empirical literature offers a variety of proxies for measuring corporate governance, from elements to a scorecard approach that incorporates all corporate governance factors. There are significant differences between the calculation of corporate governance using individual factors and those using the CG score. If using individual factors, the researcher must find the components needed in calculating the ratio and then calculate and calculate one by one to get the ratio for

each factor comprising institutional ownership, an independent board of commissioners, an audit committee, and managerial ownership.

While the calculation using the CG score is done using the scoring criteria with the weights set for each component. The score component comprises independent commissioners, audit committees, management ownership, and institutional ownership. Each is assigned a weighted rating based on how important it is to regulate corporate governance.

By measuring the CG score, academics can gauge how the corporate governance process affects earning quality and how the market responds. Consequently, in this study that is consistent with (Klapper & Love, 2004) (Shah et al., 2009) (Wahidahwati, 2012), the following equation has been used to estimate the corporate governance mechanism:

$$CG = f(KI, KA, KM, IN)$$

Provided information:

KI : Independent commissioner

KA : Audit committee

KM : Managerial ownership

IN : Institutional ownership

With the same grading criteria as in the previous study, four CG mechanisms, independent commissioners, audit committees, managerial ownership, and institutional ownership, were applied (Wahidahwati, 2012); the following is research on Indonesian corporate governance practices:

Table 3.2 Scoring Criteria for Corporate Governance

Scoring standards	Weight (%)
Independent commissioner (KI)	45
Audit committee (KA)	20
Managerial ownership (KM)	20
Institutional ownership (IN)	15

A theoretical framework for evaluating strong corporate governance processes, particularly in Indonesia, is shown in the table above. According to each function's significance in earnings management controls, a weight has been assigned. In Appendix B, the methodology for calculating the corporate governance score is laid out. Each element of the corporate governance process that is the subject of the scoring evaluation is described as follows:

1. Independent commissioner

Four factors are used to evaluate independent commissioners: the board of commissioners, the selection of independent commissioners, the percentage of shares owned by the board of directors, and the usage of Big Four external auditor services. The number of board commissioners indicates the number of board members in the organization. The composition of independent commissioners is the ratio of independent commissioners owned by a company to all board of commissioners members. The proportion of shares owned by the board of commissioners corresponds to the proportion of the company's shares that board members personally own. Using external auditor services indicates whether the associated company employs Big Four external auditors such as EY, PwC, Deloitte, or KPMG.

2. Audit committee

The audit committee is evaluated using three criteria: the composition of the audit committee, which compares the members of the firm's audit committee to the total number of audit committee members, the composition of the independent audit committee, which compares the members of the firm's independent audit committee to the total number of audit committee members, and the competence of the audit committee, which is determined by asking committee members if they possess the required expertise.

3. Managerial ownership

Three characteristics are used to evaluate managerial ownership: the board of directors membership, the percentage of shares owned by the board, and the relationships between the boards. The board's composition reveals the number of board members in the company. The board's share ownership is determined based on the board's proportionate ownership of the company's shares. The existence of relationships or family ties between council members may determine the familial ties between councils.

4. Institutional ownership

One measure for assessing institutional ownership is the institution's number of shares. Institutional share ownership quantifies the proportion of shares held by institutional investors. Institutional ownership can reduce earnings

management, which will unquestionably affect the quality of earnings through an effective monitoring system.

The researcher revised the calculation used (Wahidahwati, 2012). Companies with a high level of institutional ownership can mean that the company can be more controlled and supervised by institutional parties and outside companies. (Wahidahwati, 2012) found that the score for corporate governance decreased as institutional ownership increased. Corporate governance is more valuable for a corporation with more institutional ownership. Share ownership of a company dominated by institutional parties means that management cannot arbitrarily make decisions that can harm those with share ownership. Of course, institutional parties can monitor the actions and decisions of management to avoid abuse of authority or power for their interests that can harm shareholders.

3.5 Data Analysis Method

The validity of the hypothesis regarding the link between the variables in this study is examined using several tests. The analytical research instrument is software with installed EViews (Economic Views) version 10.

1. Descriptive Statistical Analysis

In order to understand the features of the data, such as the average, the degree of variation, and other factors, from the study sample, descriptive statistics are used to evaluate and display quantitative data (Santoso, 2016). Descriptive statistics aims to summarize or describe data based on a variable's lowest and maximum values, average, standard deviation, sum, range, and skewness. (Latan & Temalagi, 2013)

2. Multiple Regression Analysis

The independent variable is anticipated to affect the dependent variable while doing a regression analysis. Multiple regression analysis provides an objective research measure of the type and strength of the relationship between the independent and dependent variables. The relative regression coefficient represents the importance of each independent variable in predicting the dependent variable.(Sekaran & Bougie, 2017). Because the dependent variable in this study has a ratio scale and there are several

independent variables, multiple regression analysis was performed.

3. Moderation Regression Analysis

In this study, the way to test regression with moderating variables is to use a moderated regression analysis. According to (Ghozali, 2013), the application of multiple linear regression called moderated regression analysis includes interaction features in the regression equation. Moderation regression analysis in this study was used because there were moderating variables and tested for interactions that could strengthen or weaken them.

3.5.1 Data Analysis Assumptions

A regression model must be checked for classical assumptions using the Ordinary Least Square (OLS) approach before it can display the outcomes of the Best Linear Unbiased Estimator (BLUE) (Latan & Temalagi, 2013). To get BLUE findings, a regression model must be devoid of normality, heteroscedasticity, multicollinearity, and autocorrelation. As a result, the assumption tests in this work include the heteroscedasticity and multicollinearity tests.

3.5.1.1 Multicollinearity Test

According to (Latan & Temalagi, 2013), finding out if the independent variables in the regression model are correlated is the aim of the multicollinearity test. The conventional multicollinearity assumption test can only be carried out if the regression model has several independent variables. A good regression should have no relationship between the independent variables.

Sekaran & Bougie (2017) stated that to find out the multicollinearity problem by examining the independent variables correlation matrix. If the coefficient value exceeds 0.8, this is the first indication of significant multicollinearity. If it is less than 0.8, the independent variables are not significantly correlated. In order to prevent multicollinearity issues. It can be seen from the variation inflation factor (VIF) and tolerance values to detect multicollinearity. There is no multicollinearity if the VIF value is less than ten and the tolerance value is more than 0.10.

3.5.1.2 Heteroscedasticity Test

According to (Nuryanto & Pambuko, 2018), testing is done to check whether

the regression model exhibits heteroscedasticity or a persistent difference in variance between the residuals of different observations. Good regression models are defined as those that do not have heteroscedasticity issues.

The White test approach, which does not require assuming that the residuals are normal, will be used in this study to test for heteroscedasticity. The following is the formulation of the hypothesis that will be investigated in this study:

H0: Homoscedasticity

H1: Heteroscedasticity

The probability value of Obs*R-Square is used to determine whether or not there is heteroscedasticity. The regression equation deviates from the heteroscedasticity assumption if the likelihood value is lower than 0.05, in which case H0 is rejected, and H1 is accepted. The regression equation has the same variance or homoscedasticity assumption; if the probability value is larger than 0.05, H0 is accepted, and H1 is rejected.

3.5.2 Best Model Selection Test

Since this study used panel data, it is necessary to test the best model option before determining whether to use the common effect model, fixed effect model, or random effect model to describe the phenomena that occur in research. This study's best model was determined using the Chow test and the Hausman test.

1. Chow Test

According to (Nuryanto & Pambuko, 2018), based on the following criteria, the common effect model and the fixed effect model were chosen for statistical testing in the Chow test:

H0: Common Effect Model

H1: Fixed Effect Model

Whether to utilize the selected model depends on the probability value of the cross-section F. If the probability value is less than 0.05, H0 is rejected, and H1 is accepted. The estimated model is a fixed effect. If the probability value is more than 0.05, the estimating model, which is a common effect, is accepted, and H1 is rejected. If H1 (the fixed effect model) is accepted, the model is retested using the random effect model.

2. Hausman Test

According to Nuryanto & Pambuko (2018), based on the following criteria, the Hausman test was performed for statistical testing by deciding between random effects models and fixed effects models:

H0: Random Effect Model

H1: Fixed Effect Model

The decision to accept the selected model is made using the likelihood of a random cross-section. When the probability is lower than 0.05, the estimated model is a fixed effect; in this instance, H0 is rejected, and H1 is accepted. If the probability value is greater than 0.05, which denotes that the estimated model is a random effect, H0 is accepted, and H1 is rejected.

3.5.2.1 Coefficient of Determination (R-squared)

The coefficient of determination gauges the degree to which the model can explain the dependent variables. The value produced by the coefficient of determination is between zero and one. The r square number sees the ability of the independent variable to explain the dependent variable. The ability of the independent variables to explain the dependent variable in the study is considered substantial if the adjusted R-squared value shows a value close to 1, so the research model is said to be feasible.

One of the problems with this coefficient test is that it has biases in favor of the total number of independent variables included in the models. The dependent variable's value will grow if the independent variable increases, whether it affects the dependent variable. The value may rise or fall if the model has a different independent variable. Therefore, while determining which model is the best, many other researchers prefer to utilize the adjusted r-square value (Latan & Temalagi, 2013).

3.5.2.2 Simultaneous Significance Test (Statistical Test F)

According to (Latan & Temalagi, 2013), the F statistical test is conducted to ascertain if each independent variable used in the regression model affected the dependent variable simultaneously. Comparing the significant value achieved in the

study with a specified significant value of 0.05 can be used to make decisions. The computed F value and sig will be acquired from the ANOVA table, and the comparison of the sig value with = 5% determines whether the model is significant. As a result, decision-making can be informed by:

- a. If $\text{sig} < 0.05$, there is an influence between the independent variable toward the dependent variable (hypothesis accepted).
- b. There is no relationship between the independent and dependent variables. The hypothesis is rejected if the value of $\text{sig} > 0.05$.

3.5.2.3 Individual Parameter Significance Test (Test Statistical t)

The t-test shows how well one independent variable can explain the dependent variable. The basis for conclusions in the t-test test can be built on the enumerated criteria below. The t-test shows how well one independent variable can explain the dependent variable. The following standards can serve as the basis for evaluations in t-tests.(Latan & Temalagi, 2013).

- a. If the sig value is less than 0.05, the independent variable used in this study may affect the dependent variable (the hypothesis is accepted).
- b. The independent variable utilized in the study does not affect the dependent variable if the sig is greater than 0.05. (the hypothesis is not accepted)

CHAPTER IV

RESULTS AND DISCUSSION

4.1 Research Results

4.1.1 Description of Research Object

Thirty-five manufacturing companies from primary and chemical industries registered on the Indonesian Stock Exchange (IDX) during 2015 and 2018 make up the sample for this study. There are 140 data in total, which are utilized as a sample. Purposive sampling was utilized in sampling, as explained in Chapter III. Table 4.1 provides the following information about the sample choice made for this study:

Table 4.1 Table of Analysis Sample Selection Procedures

Sample Criteria	Amount
Number of the primary industrial and chemical producers listed on the IDX2015-2018	64
Number list manufacturing firms in the domains of basic and chemical industries that publish annual reports and financial statements in currencies other than the rupiah	-13
Number of firms that produce goods for the fundamental and chemical industries sector whose share value not available at www.finance.yahoo.com	-16
Total research sample	35
Total number of research companies multiplied by four years period	4
Total observation data	140

Source: Author Processed Data.

Manufacturing firms in the primary and chemical industrial sectors include divided into eight sub-sectors. The following is Table 4.2 as a breakdown of the number of companies based on their business sectors used in this study:

Table 4.2 Summary of Number of Samples by Sub-sector

No.	Sub-sector	Number of Companies	Total Company	Sample Percentage (%)	Number of Companies (%)
1	Cement	2	5	40	5.71
2	Ceramics, Porcelain, and Glass	4	6	66.66	11.42
3	Metal, etc	9	16	56.25	25.71
4	Chemical	6	9	66	17.41
5	Plastic and Packaging	7	13	53.84	20
6	Animal feed	3	4	75	8.57
7	Wood and processing	1	2	50	2.85
8	Pulp and Paper	3	9	33.33	8.57
Total		35	64	54.68	100

Source: Author Processed Data

Based on table 4.2 above, 54.68% of the total primary and chemical industrial sector manufacturing companies listed on the Indonesia Stock Exchange during the study period 2015-2018 are primary and chemical industrial sector manufacturing

companies that meet the purposive sampling method criteria. One sub-sector fulfills the criteria of half or 50% of the total companies, namely the wood and processing sub-sector.

Of the eight primary and chemical industry sub-sectors, the sub-sector with the highest number of companies is metal and similar, with a total percentage of 25.71%. Then followed by plastic and packaging companies with a percentage of 20%. Meanwhile, of the eight primary and chemical industry sub-sectors, the sub-sector with the smallest percentage of companies is the wood and processing sub-sector, with a percentage of 2.85%.

Research Data Analysis Test Results

4.1.2 Descriptive Statistical Analysis

Table 4.3 Descriptive Statistical Analysis Results

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
CAR	140	-.5448	1.441	.1888	.4659
UE	140	-4.375	3.772	-.1544	1.629
EQ	140	-.2655	-.0045	-.06303	.0623
CG	140	7.300	15.60	10.22	1.744
AT	140	0.016	14.14	1.257	7.864
UE_NOACC	140	-7.750	1.825	-0.133	0.909
UE_EQ_CG	140	-3.827	12.08	.2379	1.560
ROA	140	-.1682	.1290	.0247	.0648
Valid N (listwise)	140				

Source: Author's Processed Data based on the Results of Regression Analysis Eviews 10.

The study employed 140 data samples, as indicated by the table above. With a minimum value of -0.5448 and a maximum value of 1.444, the independent variable market reaction (CAR) has an average (mean) value of 0.1888 and a standard deviation of 0.4659. The standard deviation number is below 2.5, which leads to the conclusion that the CAR variable data distribution is acceptable.

The unexpected earning (UE) variable has a mean of -0.1544, a standard deviation of 1.6296, a range of -4.3755 to 3.7727, and an average (mean) of -0.1544. Because the standard deviation value is less than 2.5, it can be inferred from these statistics that the UE variable data distribution is considered acceptable.

Then, with a minimum value of -0.2655 and a maximum value of -0.00451, the dependent variable earning quality (EQ) has an average (mean) of -0.063 and a standard deviation of 0.0623. The link between earning quality and the earnings management proxy calculated using DACC is inverse. Therefore, the value of

DACC is absolute and then multiplied by -1, resulting in a negative EQ number. The standard deviation number is below 2.5, which leads to the conclusion that the EQ variable data distribution is acceptable.

The study's moderating variable, the corporate governance mechanism (CG), has an average (mean) value of 10.22, a standard deviation of 1.744, a minimum value of 7.30, and a maximum value of 15.6. Because the standard deviation number is less than 2.5, it can be argued that corporate governance variable data is acceptable.

The average (mean) of the variable UE EQ CG utilized to investigate model 2 is 0.237. The standard deviation is 1.56, with a minimum value of -3.82 and a maximum value of 12.08. These results conclude that the UE EQ CG variable's data distribution is acceptable since the standard deviation is less than 2.5.

The asset turnover (AT) has an average (mean) of 1.257, a standard deviation of 7.86, a minimum value of 0.016, and a maximum value of 14.14 for the variable AT. Additionally, the control variable ROA (return on assets) has a mean (average) of 0.024, a standard deviation (variance) of 0.064, a range of -0.168 to 0.12, and an average (mean) of 0.024. These results indicate that the asset turnover and return on asset variable data are considered to be of good standard because the standard deviation value is less than 2.5.

The average (mean) of the variable UE_NOACC utilized to investigate model 1 is -0.133. The standard deviation is 0.9, with a minimum value of -7.7 and a maximum of 1.8. These results conclude that the UE_NOACC variable's data distribution is acceptable since the standard deviation is less than 2.5.

4.1.3 Data Analysis Assumption Test Results

In conducting regression analysis, requirements must be satisfied to have a regression equation with value accuracy, consistency, and unbiased. The results of the assumption test of data analysis explain the tests carried out on the research model in the form of the multicollinearity and heteroscedasticity tests.

4.1.3.1 Multicollinearity Test Results

The multicollinearity test will examine whether there is a correlation between independent variables in the regression analysis. A good regression model may not

have any correlation problems between the independent variables. Regression equations that occur in multicollinearity problems will cause estimation uncertainty, so the conclusions drawn are inaccurate in this study, multicollinearity testing using the variance inflation factors method. The variance inflation factors method examines the value-centered VIF, and it can be concluded that the prediction model does not have a multicollinearity issue if the value is less than 10.

Table 4.4 Multicollinearity Test Results Regression Equation 1

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.002630	1.68	NA
UE	0.000664	1.13	1.12
ROA	0.379482	1.16	1.01
AT	0.000665	2.23	1.56
UE_NOACC	0.003233	1.73	1.69

The study is judged free of multicollinearity problems if no correlation-centered VIF score lower than 10 shows no connection between the research's independent variables. (see table 4.4 above).

Table 4.5 Multicollinearity Test Results Regression Equation 2

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.002488	1.68	NA
UE	0.001361	2.45	2.43
ROA	0.362746	1.17	1.02
AT	0.000630	2.24	1.56
UE_NOACC	0.003127	1.77	1.74
UE_EQ_CG	0.001345	2.25	2.20

Source: Author's Processed Data based on EViews 10 Regression Analysis Results.

Table 4.5 above shows no correlation-centered VIF values lower than 10, indicating no significant correlation between the research's independent variables. As a result, the study is deemed to be free of multicollinearity issues.

4.1.3.2 Heteroscedasticity Test Results

To ascertain whether the regression model's residuals from one observation differed from those from another in terms of variance, heteroscedasticity testing was done. Good regression models are defined as those that do not have heteroscedasticity issues. The White test technique will be used for heteroscedasticity in this investigation. The following is the formulation of the hypothesis that will be investigated in this study:

H₀: Homoscedasticity

H₁: Heteroscedasticity

The probability value of Obs*R-Square is used to determine whether or not there is heteroscedasticity. The regression equation deviates from the assumption of heteroscedasticity if the likelihood value is less than 0.05, in which case H₀ is rejected, and H₁ is accepted. In contrast, if the probability value exceeds 0.05, H₀ is accepted, and H₁ is rejected, which signifies that the regression equation adheres to the homoscedasticity assumption and does not exhibit heteroscedasticity.

Table 4.6 Heteroscedasticity Test Results Regression Equation 1

<i>F-statistics</i>	0.91	<i>Prob. F(4,135)</i>	0.45
<i>Obs*R-squared</i>	3.71	<i>Prob. Chi-Square(4)</i>	0.44

Source: processing results with EViews version 10

The probability value of Obs*R-Square is 0.44 according to the heteroscedasticity test results of regression equation 1 in table 3.1 above. The number is greater than 0.05, demonstrating that H₀ is accepted, indicating that regression equation 1 has homoscedasticity or constant variance from one observation to the next. It can thus be said that regression equation 1 does not have an issue with heteroscedasticity.

Table 4.7 Results of the heteroscedasticity test Regression Equation 2

<i>F-statistics</i>	1.87	<i>Prob. F(5,134)</i>	0.10
<i>Obs*R-squared</i>	9.14	<i>Prob. Chi-Square(5)</i>	0.10

Source: processing results with EViews version 10

The probability value of Obs*R-Square is 0.10 according to the heteroscedasticity test results of regression equation 1 in table 3.2 above. The probability chi-square value implies that H₀ is accepted because the value is larger than 0.05, which shows that regression equation 2 has homoscedasticity or a constant variance from one observation to the next. As a result, it can be said that regression equation 2 does not have an issue with heteroscedasticity.

4.1.3.3 Best Model Selection Test Results

1. Results of the Tests for Selecting the Best Model for Regression Equation 1

a. Chow Test Findings

The Chow test was used to determine the best regression model for regression equation 1 between common and fixed effect models. The

following are the Chow test hypotheses:

H0: Common Effect Model

H1: Fixed Effect Model

For H0 to be rejected and H1 to be accepted, its probability cross-section chi-square value must be less than 0.05; otherwise, the fixed effect model is applied. On the contrary, if such probability cross-section chi-square value is greater than 0.05, H0 is accepted, and H1 is rejected, signifying that the common effect model was used. The following table 4.6 lists the outcomes of the Chow test conducted using the EViews 10 program:

Table 4.8 Chow Test Results1 Regression Equation

<i>Effects Test</i>	<i>Probability</i>
<i>Cross-section F</i>	0.00

Source: processing results with EViews version 10

The probability value in the cross-section chi-square has a value according to the results of the Chow test in table 4.6 is 0.00. In this case, H0 is rejected, while H1 is approved because the value is less than 0.05. Therefore the fixed effect model was selected. The chosen Chow test result will also be checked once more using the Hausman test because it is a fixed effect model.

b. Hausman Test Results

The Hausman test was used to compare the random effect model against the fixed effect model to determine the best regression model. to utilize in regression equation 1. The following is the Hausman test's proposed hypothesis:

H0: Random Effect Model

H1: Fixed Effect Model

If the random cross-section probability value is less than 0.05, the fixed effect model is employed, and in that case, H0 is rejected, and H1 is accepted. However, if the probability value of the random cross-section is greater than 0.05, in whose case H0 is accepted and H1 is rejected, the model used is a random effect model. Table 4.7 below displays the results of the Hausman test performed on the EViews 10 application.

Table 4.9 Hausman Test Results1 Regression Equation

<i>Test Summary</i>	<i>Probability</i>
<i>Cross-section random</i>	0.00

Source: processing results with EViews version 10

The probability value, as in the random cross-section, does have a value of 0.00, which denotes that such a value is less than 0.05, according to the findings of the Hausman test in table 4.7. The fixed effect model is the one that was chosen in regression equation 1 since the result will be less than the 0.05 significance threshold, which means that H0 is rejected and H1 is accepted.

2. Test Results for Deciding on the Best Models for Regression Equation 2

a. Chow Test Results

The Chow test was used to find the best regression model for regression equation 2 between the common and fixed effect models. Below are the Chow test hypotheses.:

H0: Common Effect Model

H1: Fixed Effect Model

If the probability cross-section F value is much less than 0.05, the fixed effect model is utilized when H0 is rejected, and H1 is accepted. However, if a probability cross-section F value is greater than 0.05, H0 is accepted, and H1 is denied, the common effect model is used. Table 4.8 below provides the results of the Chow test conducted using the EViews 10 application.

Table 4.10 Chow Test Results Regression Equation 2

<i>Effects Test</i>	<i>Probability</i>
<i>Cross-section F</i>	0.00

Source: processing results with EViews version 10

Probability value within cross-section F does have a value, according to the results of the Chow test in table 4.8. of 0.00, less than the significance threshold of 0.05. Consequently, H0 is rejected, and H1 is accepted, leading to the choice of a fixed effect model. Additionally, the selected Chow test result will be checked once more using the Hausman test because it is a fixed effect model.

b. Hausman Test Results

The Hausman test compares the random effect model with the fixed effect model used in regression equation 2. The following is the Hausman test's proposed hypothesis:

H0: Random Effect Model

H1: Fixed Effect Model

If the random cross-section probability value is much less than 0.05, the fixed effect model is employed; in this instance, H0 is rejected, and H1 is accepted. However, if a probability value of the random cross-section is greater than 0.05, in whose case H0 is accepted and H1 is rejected, the model used is a random effect model. Table 4.9 below shows the results of the Hausman test conducted on the EViews 11 software.

Table 4.11 Hausman Test Result Regression Equation 2

<i>Test Summary</i>	<i>Probability</i>
<i>Cross-section random</i>	0.00

Source: processing results with EViews version 10

Given that the probability value within the random cross-section is 0.00 and less than the 0.05 significance standard, H0 is rejected. At the same time, H1 is accepted based on the Hausman test findings in Table 4.9, and the fixed effect model was chosen as the model in Regression Equation 2.

3. Coefficient of Determination Test Results (Adjusted R2)

Testing the regression model's coefficient of determination (Adjusted R2) is a way to gauge how well it can gather data and explain the dependent variable. The coefficient of determination's value ranges from 0 to 1. The independent variable can give all the required information and explain the dependent variable if the modified R2 value is near 1. In contrast, if the adjusted R2 value is near 0, the independent variable cannot offer the necessary details and can not account for the dependent variable. Concerning this, table 4.10 below displays the findings of the coefficient of determination test for regression equations 1 and 2:

Table 4.12 Results of the Coefficient of Determination testing (Adjusted R2)

Regression Equation	<i>Adjusted R-squared</i>
1	0.83
2	0.86

Source: processing results with EViews version 10

The adjusted R-squared value is 0.83, as determined by the regression equation 1's coefficient of determination findings, displayed in table 4.10. According to these findings, 83% of the earning response coefficient variable can be explained by the variables of conservatism, operational performance, and activity performance variable. The remaining parts are explained by other variables not considered in the model under investigation.

The adjusted R-squared value is 0.86 according to the regression equation 2 coefficient of determination values in table 4.10. Based on the results of finding earning response coefficient as the dependent variable can be explained by conservatism, operating performance, activity performance, and earning quality with corporate governance moderation by 86%. Other variables that can explain the remaining 14% are not in this research model.

4. Simultaneous Test Results (F Test)

The F test is applied to determine whether the research regression model has a degree of model viability or whether all independent variables utilized in the regression model impact the dependent variable simultaneously from the studied data. The F-probability statistic's value is the foundation for the value used to gauge the model's viability. The independent factors may collectively impact if the dependent variable's probability value falls below the probability <0.05 . The independent factors alone do not impact the dependent variable if the probability value exceeds the significance threshold of 0.05. Table 4.11 below displays the findings of the F test on regression equation 1 and regression 2:

Table 4.13 F Test Results

Regression Equation	<i>Probability (F-statistics)</i>
1	0.00
2	0.00

Source: processing results with EViews version 10

According to the F test results for regression equation 1 shown in table 4.11, the probability value of f is 0.00, below the significance threshold of 0.05, in which the outcomes of the F test in regression equation 1 are significant statistically. Conclusion: The dependent variable of earning response coefficient may be explained by the independent variable of conservatism, operating performance, and activity performance. The model used in this study is suitable for use.

According to the F-test results of regression equation 2 shown in table 4.11, the probability value of f is 0.00, and less than the significance threshold of 0.05, in which the outcomes of the F-test in regression equation 2 are significant statistically. Conclusion: By using conservatism, operating performance, activity performance, and earnings quality with the moderation of corporate governance as independent variables in this study, it is conceivable to describe the earning response coefficient, the dependent variable. The model used in this study is suitable for use.

5. Statistics t Test Results

The significant impact of each independent variable on the interpretation of the dependent variable is shown using the t-test. It is possible to determine the effect of the independent variable on the dependent variable by looking at the magnitude of the probability value of each variable from the results of testing the regression equation. The hypothesis (H_a) is accepted if the probability value is less than the significance level of 0.05, which indicates that the independent variable relatively minimally impacts the independent variable. The hypothesis (H_a) is rejected if the probability value surpasses the 0.05 significance threshold, which shows that the independent variable has a somewhat non-significant impact on the independent variable.

Table 4.14 Statistics T Test Results

Variable	Regression Equation 1		Regression Equation 2	
	Coefficient	Probability	Coefficient	Probability
C	0.28	0.00	0.28	0.00
UE	0.06	0.00	0.15	0.00
UE_NOACC	-0.21	0.00	-0.25	0.00
ROA	4.98	0.00	4.73	0.00
AT	-0.18	0.00	-0.20	0.00
UE_EQ_CG			0.18	0.00

Source: processing results with EViews version 10

It is recognized that conservatism (UE_NOACC) has a negative significant influence on earning response coefficient based on table 4.12. The probability value of 0.00 indicates this. The probability of 0.00 (in the regression equation 1), where the degree of significance of the results is proven below 0.05. The first hypothesis (Ha1), which claims that conservatism has a significant negative effect on earning response coefficient, is accepted based on the probability value of statistically significant. The conclusion is that from 2015 to 2018, conservatism negatively impacted the earning response coefficient of manufacturing businesses listed on the Indonesia Stock Exchange.

It is recognized that operating performance (return on asset) has an impact on earning response coefficient based on table 4.12 that has been shown—demonstrated by the probability values of 0.00 in regression equation 1, where both findings are significant below 5%. The second hypothesis (Ha2), which indicates that return on the asset has a significant effect on earning response coefficient, is accepted based on the probability value of return on the asset being statistically significant. The conclusion is that from 2015 to 2018, manufacturing businesses listed on the Indonesia Stock Exchange saw a significant effect from the return on the asset on the earning response coefficient.

It is recognized that asset turnover has a negative impact on earning response coefficient based on table 4.12 that has been shown. The probability value of 0.00 (in regression equation 1), where outcomes are demonstrated to be significant, is below 5%. The third hypothesis (Ha3), which argues that asset turnover positively affects earning response coefficient, is rejected. The conclusion is that from 2015 to 2018, manufacturing businesses listed on the Indonesia Stock Exchange saw a negative impact from the asset turnover on the earning response coefficient.

It is known that earning quality with the moderation of good corporate governance significantly impacts the earning response coefficient based on table 4.12, which has been given. The probability value is 0.00 (in regression equation 2), which demonstrates that outcomes are below the 0.05 level of

significance. The fourth hypothesis (Ha4), which states that good corporate governance moderates the relationship between earning quality and earning response coefficient, is accepted based on the probability value of earning quality and good corporate governance as a moderation variable being statistically significant. The conclusion is that the earning response coefficient in manufacturing businesses listed on the Indonesia Stock Exchange between 2015 and 2018 was significantly influenced by earning quality and good corporate governance as moderation variables.

4.2 Discussion

This study was conducted to discuss hypothesis testing regarding i) the effect of conservatism on earning response coefficient, ii) the effect of profitability on earning response coefficient, iii) the effect of activity performance on earning response coefficient, iv) the effect of earning quality on earning response coefficient with corporate governance as moderation variable. The tests carried out in this study used the EViews version 10 program with a total of 140 sample data during the 2015-2018 period.

1. Effect of Conservatism on Earning Response Coefficient

In this study, the first hypothesis is that conservatism has a negative effect on earning response coefficient. As a result, the findings indicate that the hypothesis (H1) is accepted, which suggests conservatism negatively impacts the earning response coefficient.

H0 : Conservatism has no negative effect on the earning response coefficient

H1 : Conservatism has a negative effect on the earning response coefficient.

Conservatism is a controversial accounting concept that raises pros and cons. According to Wilopo (2002), financial statements produced with conservatism tend to be biased and do not reflect reality, causing much criticism if a financial report uses the principle of conservatism. According to Dwiputro (2010), the more conservative the accounting method used, the more the book value of equity will be biased because it varies with time. Bias because in this period, accounts such as assets will be overstated, and

liabilities will be understated. While in the next period, it will cause overstating financial performance, which cannot be called prudent. Inconsistent with neutrality and freedom from bias. In the results of this study, conservatism has a significant negative effect on the earning response coefficient because there is a tendency for investors to see conservatism as bias method in valuing a company so that they do not increase the stock market price so that the market reaction to the information content of accounting earnings that applies the principle of conservatism has a negative effect. Financial statements that apply the principle of conservatism will result in biased interpretations and causes the earning response coefficient, which represents the market reaction in response to being irrelevant and not prudent so that the market reaction tends to be negative.

The earning response coefficient is negatively impacted by conservatism due to recognizing losses at the beginning and profits at the end, so stock returns do not respond to the relevance of earnings due to timely loss recognition.

Some of the kinds of literature that concluded the negative relationship between conservatism and earning response coefficient are as follows. Suaryana (2008) research, which examines conservatism's treatment of the earning response coefficient, Suaryana (2008), found a negative relationship between accruals and earning response coefficients because of the recognition of losses at the beginning and recognizing profits at the end. Thus causing the financial statements to be irrelevant due to understated or overstated numbers in the next period. The research of Chan (2004) also got significant negative results between accruals and equity gains due to the effect of delayed response or timely loss recognition, which will make earnings unable to explain changes in returns in the market or known as the earnings response coefficient. With time loss recognition, there is a time lag when the market responds to earnings changes that occur. So the earnings generated by the company are not responded to well by market participants.

2. Effect of profitability (represented by return on assets) on earning response coefficient

The second hypothesis in this study that will be tested is the relationship between profitability and earning response coefficient. The study's findings suggest that the hypothesis (H2) that profitability positively affects the earning response coefficient is accepted based on the outcomes of the run tests. Consequently, the findings show that profitability significantly affects earning response coefficient.

H0 : Profitability has no positive effect on the earning response coefficient.

H2 : Profitability has a positive effect on the earning response coefficient.

The market views the profit created by the firm as a large amount of net income generated in the income statement. The cash flow statements are pertinent and representational information. Investors may make informed investment decisions based on the firm's financial statements, which the company releases quarterly and annually. Different results were obtained in Permatasari (2017) research, where there was no influence between return on assets and market reaction in this study.

This research is also proportional to Van Rate (2017), which shows that return on assets significantly affects the market reaction. Also, this study's results align with the research found by Kindangen (2016), where the return on assets significantly influences earning response coefficient. By looking at the company's performance with the size of the return on assets that increases, it is expected that the information in the earnings that the market responds to, represented by the earning response coefficient variable, will also increase, and the response will be better. The market will assess this as a company worth investing in, and market participants will assess the company's profitability performance as relevant.

The study's findings show that profitability performance, in this study using return on assets, impacts the informational value of earnings in financial statements. The quality of the earnings information in the financial statements will grow with the firm's degree of profitability, in this case, the return on

assets, which will also result in more positive investor responses and an increase in the company's stock price on the stock market.

3. Effect of activity performance (represented by asset turnover) on earning response coefficient

In this study, asset turnover negatively impacts the earning response coefficient, contrary to the third hypothesis under examination. The study's findings indicate that the hypothesis (H3) is rejected based on the outcomes of the run tests.

H0 : Asset turnover does not have a positive effect on the earning response coefficient

H3 : Asset turnover has a positive effect on the earning response coefficient.

The results of this study accept H0 because the results of the asset turnover regress on the earning response coefficient get a negative coefficient value. The explanation that can be given why asset turnover negatively affects the earning response coefficient (market response) is because the value of sales is greater than the value of assets. This happens because the value of assets used by the company to support sales activities is not stable. A high activity ratio can be caused by the assets owned by the company in the long term, getting older and experiencing depreciation. Therefore, even though the activity ratio value rises, the market responds negatively so that the stock price falls. The other explanation that can be given is that the market reaction represented by the earning response coefficient has assessed that the asset turnover generated in 2017, 2018, and 2019 period has been affected by PSAK 73, which causes operating leasing assets that were previously off-balance sheet, are required to appear on the balance sheet in the asset account. So that the company's total assets will increase, the asset turnover ratio will decrease with the increase in total assets. Asset turnover will be lower because of the leased asset's additional right-of-use, which now has to be capitalized on the balance sheet. Decrease because lease assets will be recognized as part of total assets. The turnover asset ratio, whose value decreases due to changes in PSAK 30 regulations to PSAK 73. It makes the turnover asset ratio figure

less prudent and neutral. The market reaction when investing is less relevant to the asset turnover ratio because the company still has to adapt to this regulatory change.

The advantage of applying PSAK 73 is that assets used during operating leases are not presented in the statement of financial position as assets or off-balance sheet, causing better financial ratios. Moreover, efficiency ratios, such as activity ratios, are better. In the 2017 and 2018 periods, there was an implementation of PSAK 73 where operating lease assets had to be on the balance sheet so that the market is already aware that the asset turnover ratio increases or decreases in value due to the transition of accounting standards. Although the value of the asset turnover ratio increases in value, the market perception decreases because it considers the current asset turnover value does not reflect the actual efficiency of the company because it is in the transition period of changing financial accounting standards.

The increase and decrease in the value of the asset turnover ratio are more due to changes in the PSAK 73 regulation and not by the company's activities. Market to assess the activity ratio as less relevant and not prudent to use as a ratio when making investment decisions during the transition period.

The increase in total assets occurred because the company owns assets acquired using the operating lease option. The company does not include it because the regulations regarding previous leases do not require this. PSAK 73, on the lease itself, requires that the company record the lease. PSAK 73, which contains a single recording system for the lessee, causes the classification of operating leases no longer permitted. Classification of operating leases is no longer permitted. Thus the operating lease asset must be recorded by the company in the Balance Sheet of the company. The company's total assets increase after applying PSAK 73 on Leases.

The market assumes that companies that experience an increase in the asset turnover ratio have not implemented the latest PSAK 73 standard. Hence, the market considers it less relevant, and its perception of the company's asset turnover ratio decreases. At the same time, the market thinks

that companies that experience a decrease in the asset turnover ratio in the 2017-2018 period are due to the transition and application of the new accounting standard PSAK 73. Hence, the company's asset turnover value is expected to decrease due to adjustments. Of course, the market will respond better because this company has applied the principles of the latest PSAK 73 accounting standards even though the asset turnover ratio has decreased. However, this company is more compliant with standard regulations in presenting financial statements whose changes can cause financial ratios to change.

4. The effect of corporate governance as moderating variables on the relationship between earning quality and earning response coefficient.

The fourth hypothesis test in this study is the influence of good corporate governance as a moderating variable on the relation between earning quality and earning response coefficient. Since the hypothesis (H4) is accepted based on the results of the run tests, the study's findings show that effective corporate governance significantly moderates the relationship between earning quality and earning response coefficient.

H0 : Corporate governance does not positively affect the relationship between earning quality and earning response coefficient.

H4 : Corporate governance positively affects the relationship between earning quality and earning response coefficient.

In other words, they can oversee the roles of directors and managers to be more aware of generating relevant profits and not take earnings management actions that can damage the quality earnings of the company and harm investors in decision-making. Good corporate governance includes the board of commissioners, institutional ownership, managerial ownership, and the role of independent commissioners.

Following the research of Mulyadi Noto (2017), the study found a significant influence on the relationship of good corporate governance to earning response coefficient. In addition, the results of this study follow the research of Nur (2015). In this study, the Audit Committee, Board of Commissioners, and Institutional Ownership all significantly affect the

quality of earnings. With good corporate governance, it is hoped to properly monitor and carry out the principle of internal control so that the company's operations generating profits are of higher quality and relevant in making decisions for investors. Markets and investors will also better assess companies carrying good corporate governance principles and producing high-quality earnings.

CHAPTER V

CONCLUSION

5.1 Conclusion

This study was conducted to determine the effect of conservatism, operating performance, activity performance, and earning quality on the dependent variable, which is the earning response coefficient, and to see whether corporate governance can moderate the effect of earning quality on earning response coefficient. This study found that conservatism, operating performance, and earning quality moderated by corporate governance jointly influence earning response coefficient.

1. Effect of Conservatism on Earning Response Coefficient

When the principle of conservatism is applied in financial reporting, it can disrupt the quality of neutrality of numbers in financial reporting. Applying conservatism can cause bias in reporting financial position and the company's financial performance. The bias of understatement on the company's asset side and overstatement on the liability side in one reporting period can lead to overstating financial performance in the next period. Contrary to the principle of neutrality in presenting financial statements, which is free from bias. The information content assessed by the market will also be worse in the eyes of the market because the numbers in the financial statements do not reflect real numbers, thus causing investors to make wrong decisions. The results of this study provide an initial picture that the practice of conservatism has a negative effect on the earning response coefficient. Earning response coefficient is widely used to measure market response. The practice of conservatism makes the market reaction in response less relevant in assessing a company's financial statements. While in research conducted by Indriani & Amalia (2019) found that conservatism has no significant effect on earning response coefficient.

2. Effect of Operational performance on Earning Response Coefficient

This study found that operational performance measured using return on assets significantly positively affects the earning response coefficient. The company's operational performance, as measured by return on assets, can significantly affect the information content of earnings in the financial

statements. The increasing return on assets yearly will provide a better market reaction and a high return on asset ratio and is more appreciated by the market exchange. With an increasing return on assets, the company encourages growth and performance that is improving every period. ROA growth every year is appreciated and is a concern for investors who buy company shares. Investors will also be satisfied because the company's return increases every period. The results of this study follow research conducted by Anwar (2021), where operational performance significantly affects earning response coefficient.

3. Effect of Activity Performance on Earning Response Coefficient

As measured using the asset turnover ratio, activity performance negatively affects the earning response coefficient. This ratio measures net sales from the point of view of profits generated from the company's asset turnover. The different direction relationship between asset turnover and earning response coefficient can conclude that the asset turnover variable has a significant influence with a negative direction on market reaction. The negative direction means that companies with a decreasing asset turnover can cause an increasing market reaction. In this study, the direction of the negative coefficient on the relationship between activity performance (asset turnover) and earning response coefficient is more due to the issuance of PSAK 73 in the 2017 period, which caused the asset turnover ratio to decrease. The market responds to asset turnover that decreases more due to changes in accounting policies by applicable standards. The market responded positively to the declining asset turnover value and assumed that the company was adapting to follow the PSAK 73 policy required for every company. Conversely, companies whose turnover assets increase when affected by PSAK 73 make the market ask questions about compliance in implementing applicable accounting standards. When investing in the company, the market responds with worry and wary.

4. Effect of Earning Quality on Earning Response Coefficient with Good Corporate Governance as a Moderating Variable

This study found that good corporate governance can moderate the effect of earning quality on earning response coefficient. Good earnings quality generated by the company's performance will encourage the information

content in earnings in the financial statements to be more appreciated by stock exchange players in the stock market. The quality of earnings that is relevant and reliable in its usefulness can also be influenced by internal control supervision in management functions, such as the role of good corporate governance. With the role of good corporate governance, good earnings quality is increasingly becoming a catalyst for the market. In this case, investors better perceive the company that will be used as an investment target. This research is in line with Soetardjo's (2017) research, where the role of good corporate governance can affect the relationship between earning quality and earning response coefficient.

5.2 Limitations and Suggestions

5.2.1 Limitations

The researcher knows that such research cannot be free of problems and errors since it still has several limits and limitations due to the analysis and assessment of the study's sample data. The following are this study's shortcomings:

1. The manufacturing businesses in the primary & chemical major industries listed on the IDX between 2015 and 2018 comprise the data sample chosen from this study's manufacturing companies.
2. The model used for this study and the outcomes is inextricably linked. The researcher uses the modified Jones method to assess the behavior of earning quality. Because it depends on the outcomes of discretionary accruals used to detect earnings management, its model cannot adequately provide the computation of the degree of earning quality.
3. Very few calculations currently employ the scoring system to evaluate corporate governance procedures. As a result, few research journals are available to consult while employing this approach.
4. The variables used in this study only consisted of four independent variables, namely conservatism, operational performance, activity performance, and earning quality on earning response coefficient as the dependent variable, and one moderating variable, namely good corporate governance, which moderated the relationship between earning quality and earning response coefficient. Therefore, other variables can explain earning response coefficient more

broadly, so the results of this study cannot be generalized.

5.2.2 Suggestion

Based on the study's results and the limitations stated above, suggestions for further research are a. Further research is expected to increase the number of samples and expand the scope of the sample, namely by including the company sector other than manufacturing, b. Further research is expected to expand the scope of the research period beyond the four years better to describe the company's state over a more extended period. Future research is expected to add or replace independent variables not used in this study, such as free cash flow and business risk.

The results of this study are expected to provide a reference for manufacturing companies to find the right decisions regarding company capital, where the decision must look at one of the factors that influence it, namely return on asset or asset turnover.

For further research, it is hoped that it can make a valuable contribution to scientific development, especially in the field of investment regarding factors that can influence earning response coefficient taken by company management, namely operational performance, activity performance, and earning quality which can significantly influence earning response coefficient.

For investors, it is hoped that the results of this study can provide an overview and insight into a good assessment of the company's management decisions regarding the proper method for financial statement reporting method as conservatism, assess operational performance, activity performance, and assess the earning quality of a company, and find out whether the internal control of a company is running well or not through the role of good corporate governance which has carried out its role or not in the company.

Further research can use other proxies to examine earning quality variables, market reactions, and corporate governance mechanisms. Researchers use the scoring method in assessing the mechanism of corporate governance. This method needs further investigation to be a more convincing proxy for assessing corporate governance mechanisms.

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APPENDICES

Appendix 1. List of Research Sample Companies

No.	Company Code	Company Name	Sub-Sectors
1	INTP	Indocement Tunggul Prakarsa Tbk	Cement
2	SMGR	Semen Indonesia Persero Tbk	Cement
3	ARNA	Arwana Citra Mulia Tbk	Porcelain Ceramic and Glass
4	IKAI	Inti Keramik Alam Asri Industri Tbk	Porcelain Ceramic and Glass
5	MLIA	Mulia Industrindo Tbk	Porcelain Ceramic and Glass
6	TOTO	Surya Toto Indonesia Tbk	Porcelain Ceramic and Glass
7	ALKA	Alaka Industrindo Tbk	Metals and similar
8	ALMI	Alumindo Light metal Industry Tbk	Metals and similar
9	BAJA	Saranacentral Bajatama Tbk	Metals and similar
10	GDST	Gunawan Dianjaya Steel Tbk	Metals and similar
11	INAI	Indal Aluminium Industry Tbk	Metals and similar
12	ISSP	Steel Pipe Industry of Indonesia Tbk	Metals and similar
13	LION	Lion Metal Works Tbk	Metals and similar
14	LMSH	Lionmesh Prima Tbk	Metals and similar
15	PICO	Pelangi Indah Canindo Tbk	Metals and similar
16	BUDI	Budi Strach & Sweetener Tbk	Chemical
17	DPNS	Duta Pertiwi Nusantara Tbk	Chemical
18	EKAD	Ekadharna Internasional Tbk	Chemical
19	ETWA	Eterindo Wahanatama Tbk	Chemical
20	INCI	Intan Wijaya International Tbk	Chemical
21	SRSN	Indo Acidatama Tbk	Chemical
22	AKKU	Alam Karya Unggul Tbk	Plastics and Packaging
23	AKPI	Argha Karya Prima Industry Tbk	Plastics and Packaging
24	BRNA	Berlina Tbk	Plastics and Packaging
25	IGAR	Champion Pacific Indonesia Tbk	Plastics and Packaging
26	IMPC	Impack Pratama Industri Tbk	Plastics and Packaging
27	SIMA	Siwani Makmur Tbk	Plastics and Packaging
28	TRST	Trias Sentosa Tbk	Plastics and Packaging
29	CPIN	Charoen Pokphand Indonesia Tbk	Animal Feed
30	JPFA	Japfa Comfeed Indonesia Tbk	Animal Feed
31	MAIN	Malindo Feedmil Tbk	Animal Feed
32	TIRT	Tirta Mahakam Resources Tbk	Wood and Processing
33	FASW	Fajar Surya Wisesa Tbk	Pulp and Paper
34	KDSI	Kedaung Setia Industrial Tbk	Pulp and Paper
35	SPMA	Suparma Tbk	Pulp and Paper

Appendix 2. Calculation of Corporate Governance Mechanism

The following are the scoring criteria used in the calculation of corporate governance mechanisms based on Wahidahwati (2012) with revisions to the institutional ownership scoring:

Scoring Criteria	Weight (%)
Independent Commissioner (IC)	45
Audit Committee (KA)	20
Managerial Ownership (KM)	20
Institutional Ownership (IN)	15

1. INDEPENDENT COMMISSIONER (45%)	Range	Score
a. COMMISSIONER_SIZE (<i>Size of Commissioner</i>)	0-3	2
	4 -6	4
	6-8	6
	9 - 11	8
	> 11	10
b. COMMISSIONER_IND (<i>Independent commissioner</i>)	0 - 20%	2
	21 - 40%	4
	41 - 60%	6
	61 - 80%	8
	> 80%	10
c. COMMISSIONER_OWEN	0 - 20%	2
	21 - 40%	4
	41 - 60%	6
	61 - 80%	8
	> 80%	10
d. AUDITOR (<i>Big Four</i>)	Yes	5
	No	0

2. AUDIT COMMITTEE (20%)	Range	Score
a. AUDIT_SIZE (<i>Size of Audit Committee</i>)	0-3	2
	4 -6	4
	6-8	6
	9 - 11	8
	> 11	10
b. AUDIT_IND (<i>Independent Audit Committee</i>)	0 - 20%	2
	21 - 40%	4
	41 - 60%	6
	61 - 80%	8
	> 80%	10
c. FINANCIAL EXPERT	Yes	5
	No	0

3. MANAGERIAL OWNERSHIP (20%)	Range	Score
a. DIRECTORS_SIZE	0-3	2
	4 -6	4
	6-8	6
	9 - 11	8
	> 11	10
b. MANAGERIAL_OWN (<i>Managerial Ownership</i>)	0 - 20%	2
	21 - 40%	4
	41 - 60%	6
	61 - 80%	8
	> 80%	10
c. FAMILY RELATIONS (<i>Family Relations</i>)	Yes	0
	No	5

4. INSTITUTIONAL OWNERSHIP (15%)	Range	Score
a. INSTITUTIONAL_OWN (<i>Institutional Ownership</i>)	0 - 20%	2
	21 - 40%	4
	41 - 60%	6
	61 - 80%	8
	> 80%	10

Appendix 3. Eviews Output Results

Descriptive Statistical Analysis Results

	CAR	UE	ROA	AT	UE_EQ_CG	UE_NOACC
Mean	0.188856	-0.154456	0.024720	1.257988	0.237966	-0.133674
Median	0.116832	-0.131927	0.027061	0.918434	0.037784	0.000152
Maximum	1.441608	3.772727	0.129089	14.14726	12.08366	1.825250
Minimum	-0.544856	-4.375575	-0.168249	0.016009	-3.827519	-7.750499
Std. Dev.	0.465940	1.629603	0.064821	1.923239	1.560485	0.909178
Skewness	0.839552	0.018727	-1.014974	5.385153	3.698012	-5.738090
Kurtosis	3.565259	4.575304	4.769751	33.15471	27.62351	43.88657
Jarque-Bera	18.31030	14.48409	42.30744	5980.951	3855.942	10519.92
Probability	0.000106	0.000716	0.000000	0.000000	0.000000	0.000000
Sum	26.43987	-21.62380	3.460831	176.1183	33.31519	-18.71435
Sum Sq. Dev.	30.17697	369.1294	0.584044	514.1400	338.4807	114.8980
Observations	140	140	140	140	140	140

Multicollinearity Test Results (Regression Equation 1)

Variance Inflation Factors

Date: 12/09/22 Time: 15:34

Sample: 1 140

Included observations: 140

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.002630	1.684566	NA
UE	0.000664	1.132090	1.121939
ROA	0.379482	1.162441	1.013919
AT	0.000665	2.239700	1.565214
UE_NOACC	0.003233	1.736426	1.699425

Multicollinearity Test Results (Regression Equation 2)

Variance Inflation Factors

Date: 12/06/22 Time: 15:02

Sample: 1 140

Included observations: 140

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.002488	1.688374	NA
UE	0.001361	2.457562	2.435526
ROA	0.362746	1.177278	1.026861
AT	0.000630	2.245908	1.569552
UE_EQ_CG	0.001345	2.257472	2.205808
UE_NOACC	0.003127	1.779243	1.741329

Heteroscedasticity Test Results (Regression Equation 1)

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.919201	Prob. F(4,135)	0.4548
Obs*R-squared	3.711886	Prob. Chi-Square(4)	0.4464
Scaled explained SS	5.146536	Prob. Chi-Square(4)	0.2726

Heteroscedasticity Test Results (Regression Equation 2)

Heteroskedasticity Test: Harvey

F-statistic	1.872333	Prob. F(5,134)	0.1033
Obs*R-squared	9.142144	Prob. Chi-Square(5)	0.1035
Scaled explained SS	6.778227	Prob. Chi-Square(5)	0.2377

Chow Test Results (Regression Equation 1)

Redundant Fixed Effects Tests

Equation: Untitled

Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	10.045888	(34,65)	0.0000

Chow Test Results (Regression Equation 2)

Redundant Fixed Effects Tests

Equation: Untitled

Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	13.894874	(34,64)	0.0000

Hausman Test Results (Regression Equation 1)

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	29.535726	4	0.0000

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
UE	0.011013	0.018078	0.000237	0.6462
ROA	5.728214	1.186330	0.723103	0.0000
AT	-0.055092	-0.008866	0.000363	0.0152
UE_NOACC	-0.001279	-0.007131	0.000679	0.8223

Hausman Test Results (Regression Equation 2)

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	24.654236	5	0.0002

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
UE	0.063736	0.099209	0.000565	0.1354
ROA	5.229619	0.940091	0.794233	0.0000
AT	0.057507	0.012983	0.000358	0.0186
UE_EQ_CG	0.068200	0.109129	0.000464	0.0574
UE_NOACC	-0.023202	-0.034096	0.000769	0.6944

Regression Equation Analysis Results 1 (Fixed Effect Model)

Dependent Variable: CAR
 Method: Panel EGLS (Cross-section weights)
 Date: 12/09/22 Time: 13:03
 Sample (adjusted): 2016 2018
 Periods included: 3
 Cross-sections included: 35
 Total panel (balanced) observations: 105
 Iterate coefficients after one-step weighting matrix
 Convergence achieved after 16 total coef iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.282859	0.039603	7.142375	0.0000
UE	0.066357	0.015648	4.240650	0.0001
ROA	4.987888	0.774328	6.441575	0.0000
AT	-0.180981	0.028819	-6.279931	0.0000
UE_NOACC	-0.210660	0.048247	-4.366305	0.0000
AR(1)	-0.271082	0.054791	-4.947566	0.0000

Effects Specification

Cross-section fixed (dummy variables)

Weighted Statistics

R-squared	0.898092	Mean dependent var	0.532630
Adjusted R-squared	0.836947	S.D. dependent var	1.108266
S.E. of regression	0.382000	Sum squared resid	9.485054
F-statistic	14.68788	Durbin-Watson stat	2.549029
Prob(F-statistic)	0.000000		

Unweighted Statistics

R-squared	0.570591	Mean dependent var	0.242441
Sum squared resid	10.90182	Durbin-Watson stat	2.366441

Inverted AR Roots -0.27

Regression Equation Analysis Results 2 (Fixed Effect Model)

Dependent Variable: CAR
 Method: Panel EGLS (Cross-section weights)
 Date: 12/06/22 Time: 14:49
 Sample (adjusted): 2016 2018
 Periods included: 3
 Cross-sections included: 35
 Total panel (balanced) observations: 105
 Iterate coefficients after one-step weighting matrix
 Convergence achieved after 20 total coef iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.285170	0.041331	6.899607	0.0000
UE	0.153732	0.024700	6.223838	0.0000
ROA	4.734611	0.861450	5.496097	0.0000
AT	-0.207221	0.031250	-6.631163	0.0000
UE_EQ_CG	0.181940	0.041443	4.390099	0.0000
UE_NOACC	-0.254300	0.052848	-4.811885	0.0000
AR(1)	-0.204094	0.051685	-3.948789	0.0002

Effects Specification

Cross-section fixed (dummy variables)

Weighted Statistics

R-squared	0.919020	Mean dependent var	0.511095
Adjusted R-squared	0.868407	S.D. dependent var	1.101968
S.E. of regression	0.371432	Sum squared resid	8.829572
F-statistic	18.15794	Durbin-Watson stat	2.776883
Prob(F-statistic)	0.000000		

Unweighted Statistics

R-squared	0.624181	Mean dependent var	0.242441
Sum squared resid	9.541282	Durbin-Watson stat	2.518166

Inverted AR Roots -0.20