CHAPTER I
INTRODUCTION

1.1 Background of The Study

Rapid development of Indonesian business can be seen from the emergence of various companies competing with their respective advantages to make reformation. It makes competition in the market to move and experience dynamic changes. Companies will continue to compete to increase and maximize their profits and advantages.

Maximizing company profits or advantages has always been the main goal of most companies. Company’s profit is one form of a company's financial performance. If the profit is high, the company will be assumed have good quality financial performance. Furthermore, if the profit is maximal, it will result in an increase in company value (Brigham and Houston, 2011). Based on the definition above, it can be concluded that the main objective of the company is to create good corporate value.

Based on explanations above, company’s value is related to profit. In a study conducted by Sulia and Rice (2013), it is explained that good profits will provide a good stock return, and vice versa. If the company gets negative profits, it will have an impact on bad stock returns. The study explains that company profits will have an impact on the returns on company shares.

It also explains that company’s profits will have an impact on the company's share price. Profits are listed in the financial report, and the company cannot be separated from earnings management.

Earnings management is a management intervention activity in the preparation of financial reports that will be used by external parties, this activity can be in the form of even profit distribution, increase or decrease in profits with a specific purpose (Muid and Rahmawati, 2012). Another opinion states that earnings management is the process of directing the company's profit report which is carried out deliberately and with financial accounting standards for certain purposes (Wirakusuma, 2016).

Incorrect practice in earnings management can reduce the credibility of the company's financial report. In addition, it can also add bias to financial reports and can make users of financial reports make wrong decisions because they believe in the numbers stated in the financial reports. It can decrease in the quality of the company's financial reports.

Agency theory explains that there is a misalignment of interests between management and shareholders, shareholders make contracts with management with the aim of welfare themselves, while management will try to meet their own economic needs through salaries and compensation (Baridwan, 2000). This can incorrect practice in earnings management carried out by management.

Incorrect earnings management practices can cause various problems, such as earnings management problems that occur in the United

States, namely the case of Enron and Worldcom companies, where management collaborates with KAP Arthur Anderson & Co. This is a form of financial reporting violations (Sulistyanto, 2008).

In addition to this case, in 2015 PT Inovisi Infracom Tbk carried out falsified financial reports which made the company's financial reports look odd and questioned by users of the company's financial reports. The impact of PT. Inovisi Infracom Tbk was suspended (suspended).

Basically earnings management does not always have a negative connotation, or something that is detrimental to other parties, but earnings management practice is the selection of the accounting method chosen by management to form good profits for the company, wise earnings management practices will have a positive impact on the company. For example, giving a positive impression to the company's users so that the company's value also increases.

Research conducted by (Farouk & Bashir, 2017) found that the company's ownership structure has a significant impact on earnings management practices in a company. Likewise, research conducted by (Perdana, 2019) found that the company's ownership structure has a significant impact on earnings management.

Signal theory is also the main basis that explains why companies have a motive to inform financial and non-financial reports to outsiders, because of the asymmetry of information between external parties and the company

(Fahmi, 2016). Meanwhile, the company's internal information is a signal for investors in the market to invest and as an indicator that affects the company's future prospects.

Wolk et al. (2000) found that one of the alternatives to minimize information gaps is through providing signals to external parties, namely through disclosing company information. Good implementation of Good Corporate Governance in a company will give a positive signal to stakeholders, because stakeholders feel that their interests will be better protected.

According to Jensen and Meckling (1976) in Tamba (2011), corporate ownership structures such as managerial ownership and institutional ownership are the two main corporate governance mechanisms that help agency problems. Institutional ownership has the ability to control the management through the monitoring process effectively, thereby reducing management actions to carry out earnings management.

A certain percentage of shares owned by an institution may affect the process of preparing financial reports which does not preclude accrualization in the interests of management. With the percentage of institutional ownership, it is hoped that it can guarantee the implementation of the basic principles of Good Corporate Governance, namely transparency, accountability, responsibility, independence, fairness and equality. According to Sutedi (2009: 54), the principle of Good Corporate Governance that is most relevant to the development of the company's internal systems and mechanisms is accountability.

One of the industry in Indonesia which is currently increasing is the manufacturing industry. According to the Ministry of Industry of the Republic of Indonesia, in 2016 Indonesia's manufacturing industry was ranked fourth in the world out of 15 countries whose manufacturing industries contributed to Gross Domestic Product (GDP) above 10%, at which time Indonesia could contribute to GDP by 22% after South Korea (29%), China (27%) and Germany (23%). Furthermore, in 2017 the manufacturing industry noted that the export value throughout 2017 reached USD125 billion or 76% of the total export value of Indonesia. This shows that there is an increase of 13.14% from 2016 which only reached USD 110.50 billion (Kemenperin.go.id). more clearly can be seen in table 1.1 below:

Table 1.1

GDP growth for the first quarter in year 2017

Sectors	2011	2012	2013	2014	2015	2016	2017*	Share 2016
Manufacturing industry	6.26	5.62	4.37	4.64	4.33	4.29	4.21	20.51
Agriculture, forestry, & fishery	3.96	4.59	4.20	4.24	3.77	3.25	7.12	13.45
Wholesale & retail trade, cars & motorcycles reparations	9.66	5.40	4.81	5.18	2.59	3.93	4.77	13.19
Construction	9.02	6.56	6.11	6.97	6.36	5.22	6.26	10.38
Mining and Quarrying	4.29	3.02	2.53	0.43	-3.42	1.06	-0.49	7.20
Transportation and warehousing	8.31	7.11	6.97	7.36	6.68	7.74	7.65	5.22
Finance and insurance	6.97	9.54	8.76	4.68	8.59	8.90	5.73	4.20
Public adm, defense, and compulsory social security	6.43	2.13	2.56	2.38	4.63	3.19	0.58	3.86
Information and communication	10.02	12.28	10.39	10.12	9.69	8.87	9.10	3.62
Education	6.68	8.22	7.44	5.47	7.33	3.84	4.11	3.37
Accommodation, food and beverages	6.86	6.64	6.80	5.77	4.31	4.94	4.68	2.92
Real estate	7.68	7.41	6.54	5.00	4.11	4.30	3.67	2.81
Other services	8.22	5.76	6.40	8.93	8.08	7.80	8.01	1.71
Business services	9.24	7.44	7.91	9.81	7.69	7.36	6.80	1.70
Electricity and gas	5.69	10.06	5.23	5.90	0.90	5.39	1.60	1.15
Health and social activities	9.00	7.97	7.96	7.96	6.68	5.00	7.13	1.07
Water, Waste management, cesspit, and recycling	4.73	3.34	3.32	5.90	0.90	5.39	1.60	0.07
Gross Domestic Product	**6.17**	**6.03**	**5.56**	**5.01**	**4.88**	**5.02**	**5.01**	**100.00**

Source: Statistics Indonesia (2017)

Table 1.2

Phenomena Table

Company Name	Year	Case
Enron	2001	Enron was cited as the biggest audit failure. By the use of accounting loopholes, special entities, and poor financial reporting, they were able to hide billions of dollars in debt from failed deals and projects.
WorldCom	2002	Orchestrated a scheme to inflate earnings in order to maintain WorldCom's stock price. It was discovered over $3.8 billion of fraudulent balance sheet entries and was forced to admit that it had overstated its assets by over $11 billion. At the time, it was the largest accounting fraud in American history.
PT Inovisi Infracom Tbk	2015	Falsified financial reports which made the reports look odd and questioned by users, causing it to be suspended.

Source: Prepared by Writer (2021)

The large contribution of the manufacturing industry makes this industry one as something very influential economy in Indonesia. But in fact, in table 1.1, it can be seen that the actual manufacturing industry has continued to decline from 2011 to 2017. Therefore, increasing the manufacturing industry is one of the instant ways the government can improve the economy nationally. Because with an increase in the GDP of the manufacturing industry by just 1, it will increase 0.2% of Indonesia's economic growth. In order to assist the government in increasing economic growth, research on the influence of the financial performance of the manufacturing industry listed on the Indonesian stock exchange is an obligation for researchers.

Based on the research background above, the researcher is interested in conducting research with the title **"The Impact of Ownership Structure on Earnings Management in Manufacturing Companies Listed in IDX year 2017-2019"**

1.1 Problem Limitation

Limiting a problem is used to avoid irregularities or widening of the subject matter so that the research is more focused and makes it easier to discuss so that the research objectives will be achieved. Some of the limitations of the problem in this study are as follows:

1. The broad scope only includes information about earnings management, and ownership structure
2. The object in this study is limited to manufacturing companies listed on the Indonesia Stock Exchange in 2017-2019

1.2 Problem Formulation

Based on the background above, the writer determine the formulation of the problem as follows:

1. Does the company's ownership structure have impact on earnings management?

1.3 Objective of The Research

The objectives of this study are to:

1. To understand the impact of ownership structure on earnings management.

1.4 Benefit of the Research

Regarding the background and the objectives of the research, the researcher expects that the research will contribute a great benefits both theoretically and practically. The result of this research will give some benefits for certain parties:

1.5.1 Theoretical Benefit

The results of this study are expected to be input and further development for other researchers interested in the theme of corporate earnings management.

1.5.2 Practical Benefit

Practically, this research is expected to be input to increase the insight of researchers and readers about corporate earnings management practices. In addition, this research is also expected to be useful for investors and the public so that they can get an overview of the factors.