CHAPTER I

INTRODUCTION

1.1 Background of the Study

Financial Statements are reports that provide information related to financial position, financial performance and changes in financial position in company. The financial statements should be reliable so that the data can be used in order to make predictions about the future direction of the company. Not only investors but also future investors, creditors, government and shareholders use financial statements in making the decision to the company.

As an investor, it is very important to analyze which company will give a large profit. Financial statements include many informations but the mostly watched out is income statement, which will be given information about earnings that have been achieved in certain periods. Investor and future investor will take decision after analyzing the income statement especially the earnings. Investor and future investor wants the information of the company which is real, no understatement or overstatement. Every company has a different quality of earnings. Earning Response Coefficient (ERC) is the measurement of how market reacts on stocks when the profit of company is published (Kusuma, 2015).

Earning Response Coefficient (ERC) is a measurement that can be used to measure the relationship between earnings and stock returns (Anggreni, 2016). The value of ERC is strongly affected by the profit as the profits carry out stock returns for investors and automatically it affects the expected return. From financial statements, investors can predict how the company is going in the future, earning response coefficient will be predicted higher if the profit is getting better in the future. Earning response coefficient is also affected by the news of the companies which can be good or bad. The example of good news is company has high profit, automatically investors will get higher dividends.

Research on ERC is helpful for investors in fundamental analysis to determine market reaction on the earnings information of a company. Investors are expected to be skillful to forecast the stock price of the earnings information to have an understanding of the factors that influence on ERC. According to Kristiyanti (2019), there are several factors that affect the earning response coefficient which is size, growth and profitability. Based on the theory of capital market efficiency, the present asset price or the size of the company accurately reflects the current information in the marketplace. The bigger company is usually easier to increase the performance as investor feels more secure investing in big companies than small companies. Hence, when it is time for earning announcement, a big company will get more responses from the investors.

In big companies, information is not only obtained from financial statements but there is also much non-accounting news around the year. The combination of accounting and non-accounting information is very useful for investors to predict how the company is going on in the future. At the moment of the earnings announcement, the investor will respond positively towards the earnings information. The growth of a company can affect the earning response coefficient. A high growth opportunity from an investment will attract investors. It will be responded as good news at the moment of earnings announcements, therefore there will be also high investor response to the earning announcement.

Profitability is used to assess the capability of company to create profits. It is clearly stated that profits are the main criteria for investors. The capability of company to create profits is affected by sales and investment. Profit can also use to interpret the financial performance. When the company generates more profits, automatically company will have better financial performance. Earning response coefficient with higher profitability is proofed higher than the companies with lower profitability. Company with profit is company that succeeds to generate the company resources in their present operation. Hence, the better financial performance will have high earnings response coefficient and vice versa.

There is one interesting industry which is consumer goods industry. Unlike other companies that might suffer from recession and have high rapid growth, consumer goods industry might not suffer from the recession but this industry cannot have rapid growth also. Consumer goods sector is a manufacturing company that sells common products that are mostly consumed by the public as daily used products. Not only snacks or food products, consumer goods products also include beverages, cosmetics, body care, electronics and automobile. In Indonesia, consumer goods sector grows rapidly. The target market of the consumer goods is more to family not industries.

The table below shows the condition of several consumer goods companies.

Table 1.1
Firm Size, Growth Opportunity, Profitability and Earnings Response Coefficient in Year 2017-2019

Company	Year	Size	Growth	Profitability	Earning Response Coefficient
Gudang Garam	2017	31.83	9%	12%	-0.1915
	2018	31.87	15%	11%	-0.1180
	2019	32.00	14%	14%	0.1100
Indofood Sukses Makmur	2017	32.11	5%	6%	-12.8697
	2018	32.20	5%	5%	-0.1803
	2019	32.20	4%	6%	0.0273
Kimia Farma	2017	29.44	5%	5%	-0.0922
	2018	30.06	38%	5%	0.1760
	2019	30.54	11%	0.1%	0.1448

Source: Prepared by the Writer (2021)

Out of several consumer goods companies that are listed in the Indonesia Stock Exchange, the writer chose Gudang Garam, Tbk. (GGRM), Indofood Sukses Makmur, Tbk. (INDF), Kimia Farma (Persero), Tbk. (KAEF) to show the comparison of each ratio. These ratios are summarized based on the writer's calculation where data and numbers are collected from the company's financial statements from year 2017-2019.

Based on the data on Table 1.1, it can be seen that the pattern of the relationship shows no consistency. As it has been mentioned above, the firm size of the company has the effect to the Earnings Response Coefficient (ERC), the bigger the companies then the companies are easier to increase performance and companies will get better response from the investor. When Gudang Garam Tbk. (GGRM) is compared to the Kimia Farma (Persero), Tbk. (KAEF) in 2017, the firm size of the KAEF is smaller than GGRM which are 29.44 and 31.83 respectively. It is not appropriate with the stated theory.

While for growth opportunity, the higher growth, the better response that the companies will get. It has the same theory as the firm size. In the table, it is not same with the theory suggested. In INDF 2017 and 2018, it has the same growth which is 5% but the ERC is has a big gap, -12.8697 and -0.1803 respectively. Another inconsistency is both on the GGRM 2018 and 2019. The growth of 2019 is smaller than 2018 but ERC in 2019 is higher.

High profitability will result in high ERC. There is also inconsistency based on the table. Based on the KAEF in year 2018 and 2019, the profitability is respectively 5% and 0.1%, but there is only a slightly different in ERC.

Thus, the comparison has shown very different results of some theories have suggested. According to the stated background, the writer is motivated to research an in-depth study and analysis about Firm Size, Growth Opportunity and Profitability as how these variables would affect Earning Response Coefficient in the consumer goods sector listed in Indonesia Stock Exchange with the period of 2017-2019. Hence the title of this research is **"The Influence of Firm Size, Growth and Profitability toward Earning Response Coefficient with Income Smoothing as Moderating Variable in Consumer Goods Industry Companies Listed in Indonesia Stock Exchange."**

1.2 Problem Limitation

The research uses Earning Response Coefficient (ERC) as the dependent variable while size, growth and profitability are the independent variables. The indicator of firm size is natural logarithm of total assets. Sales growth rate is used to determine growth. Return on Assets (ROA) is used to determine profitability. There is also moderating variable which is income smoothing. The companies that will be used in the research are listed in the Consumer Goods Industry on Indonesia Stock Exchange (IDX) period 2017-2019.

1.3 Problem Formulation

The research focuses on evaluating the influence of size, growth and profitability towards Earnings Response Coefficient (ERC) with income smoothing as the moderating variable. There are several questions that need to be analyzed in order to reach the objective of the research:

1. Does Firm Size have any significant influence towards Earning Response Coefficient (ERC) in consumer goods companies listed in Indonesia Stock Exchange?
2. Does Growth have any significant influence towards Earning Response Coefficient (ERC) in consumer goods companies listed in Indonesia Stock Exchange?
3. Does Profitability have any significant influence towards Earning Response Coefficient (ERC) in consumer goods companies listed in Indonesia Stock Exchange?

4. Do Firm Size, Growth and Profitability have any significant influence toward Earning Response Coefficient (ERC) simultaneously in consumer goods companies listed in Indonesia Stock Exchange?
5. Do Firm Size, Growth and Profitability have any significant influence toward Earning Response Coefficient (ERC) with Income Smoothing as moderating variable in consumer goods companies listed in Indonesia Stock Exchange?

1.4 Objective of the Research

As the description of the formulation of problems that have been mentioned above, this research is conducted with the aim of the following list:

1. To analyze whether Firm Size has significant influence towards Earning Response Coefficient (ERC) in consumer goods companies listed in Indonesia Stock Exchange.
2. To analyze whether Growth has significant influence towards Earning Response Coefficient (ERC) in consumer goods companies listed in Indonesia Stock Exchange.
3. To analyze whether Profitability has significant influence towards Earning Response Coefficient (ERC) in consumer goods companies listed in Indonesia Stock Exchange.
4. To analyze whether Firm Size, Growth and Profitability have significant influence toward Earning Response Coefficient (ERC) simultaneously in consumer goods companies listed in Indonesia Stock Exchange.

5. To analyze whether Firm Size, Growth and Profitability have significant influence toward Earning Response Coefficient (ERC) with Income Smoothing as moderating variable in consumer goods companies listed in Indonesia Stock Exchange.

1.5 Benefit of the Research

The research is conducted as it would be beneficial for several parties such as the management of the companies as the subject of the research, investors, the writer and future academicians in different aspects.

1.5.1 Theoretical Benefit

1. For the writer, this research is expected to be a medium of understanding and application of the theories obtained during lectures in the financial accounting major, mainly about factors affecting earning response coefficient.
2. For future academicians, this research is looked forward to be a reference for similar research in the future, to complement the existing research, and to expand the knowledge.

1.5.2 Practical Benefit

1. For the management of the company, this research is expected to be an information and consideration regarding decisions of improving company's performance.
2. For investors, this research is looked forward to be information or guidance in determining the decision of future investment regarding factors that affect earning response coefficient.