

# CHAPTER I

## INTRODUCTION

### 1.1 Background of Study

The development of globalization has significantly affected the economic order in these last decades. Along with that, the globalization era has encouraged the interest of both domestic and foreign investors to invest in Indonesia. According to Indonesia Central Securities Depository (KSEI), the capital market Single Investor Identification (SID) reached 6,100,525 investors as of August 2021. This number was increased significantly from 2017, which was 1,122,668 investors. The growing number of investors in Indonesia demonstrates that a large number of individuals have realized the value of investing.

According to Financial Service Authority (OJK), investment is the commitment to acquiring complete assets or purchasing shares and other securities for profit over a long-term period. Along with the increasing interest in investment in Indonesia, the need for information about the company as a place to invest becomes essential. A rational investor will preliminary conduct analysis in the investment decision-making process inseparable from financial statements.

Financial statements are the final output of the accounting process that can be used as an indicator to measure and assess the company's performance. Financial statements are also a form of accountability of the management toward the related parties, including the shareholders, managers, creditors, bankers, investors, government, and other parties (Putra & Subowo, 2016). Through financial

statements, its user can get a lot of useful information, one of which is earnings information. The earning information on the income statement has become the main focus for investors. This is due to an income statement containing information on a company's profitability over a period of time. Investors believe that a company's performance can be measured by looking at the level of earnings (Rizal, 2020).

Companies with good earnings quality are companies that have stable and continuing earnings. According to Penman (2001), stated that earnings quality of a company should reflect the sustainability of future earnings, which are determined by the accrual components and cash flow. In practice, companies with qualified earnings quality will publish their financial reports transparently without any manipulation (Risdawaty & Subowo, 2015). A qualified earning will indicate the company's actual profit, which can predict future earnings. Therefore, earnings quality can be a reflection of the company's performance whether they have shown actual economic conditions (Sugianto & Sjarief, 2018).

Investors' expectations of the company's potential to create profits in the future will be influenced by the release of financial statements in the form of earnings information collected in a certain period. The earnings information is used by investors as a basis for making a well-informed investment decision on whether to purchase, hold, or sell a company's shares. A company's earnings information is one of the aspects that might influence an investor's decision to invest. However, the earnings information released by a company does not guarantee that earnings are qualified enough for users' decision-making. Hence, it is crucial for an investor

to consider about company's earnings quality before deciding to invest in one company (Kurniawan & Suryaningsih, 2018).

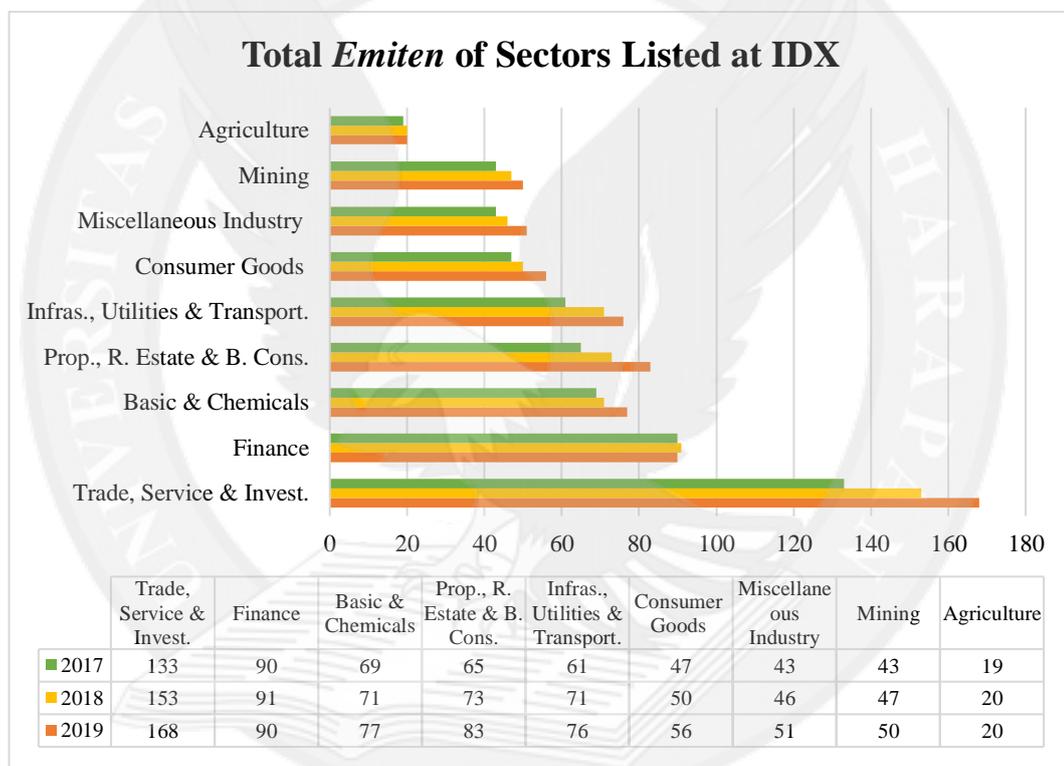
Consumer goods is one of the sectors listed at the Indonesia Stock Exchange in which its business is related to products purchased by individuals and households rather than by manufacturers and businesses. This sector has attracted many investors to invest since the profits obtained are quite numerous through selling consumer needs. Besides, the consumer goods sector is relatively stable compared to other sectors, which makes it suitable for long-term investment. Due to this reason, the consumer goods sector has become one of the most promising sectors in the capital market.

There are several subsectors in the consumer goods industry: cosmetic and household, food and beverage (F&B), houseware, pharmaceuticals, tobacco manufacturers, and others. Currently, this sector consists of 67 companies that contribute to producing consumer goods, including foodstuffs, household complementary materials, as well as medicines. It can be said that the consumer goods sector has become a pillar of the manufacturing industry, as it indicates a strong growth rate in comparison to basic industry and chemical as well as various industries (Indonesia Stock Exchange, 2021).

In practice, the consumer goods sector plays an essential role in supplying the daily needs of the Indonesian people. A high level of consumption of Indonesian people has made the consumer goods company's products are more often used by numerous people every day. Products that continue to be in demand by Indonesian people will make the consumer goods companies able to carry out their business

activities in a sustainable manner. Thus, this sector is expected to experience growth continuously in the future.

Based on the number of the issuer, or is known as *emiten*, the consumer goods' index has a relatively more minor number of publicly traded companies compared to other sectors listed at Indonesia Stock Exchange. The figure below shows the comparison of total *emiten* in each sector listed at Indonesia Stock Exchange for the year 2017-2019:



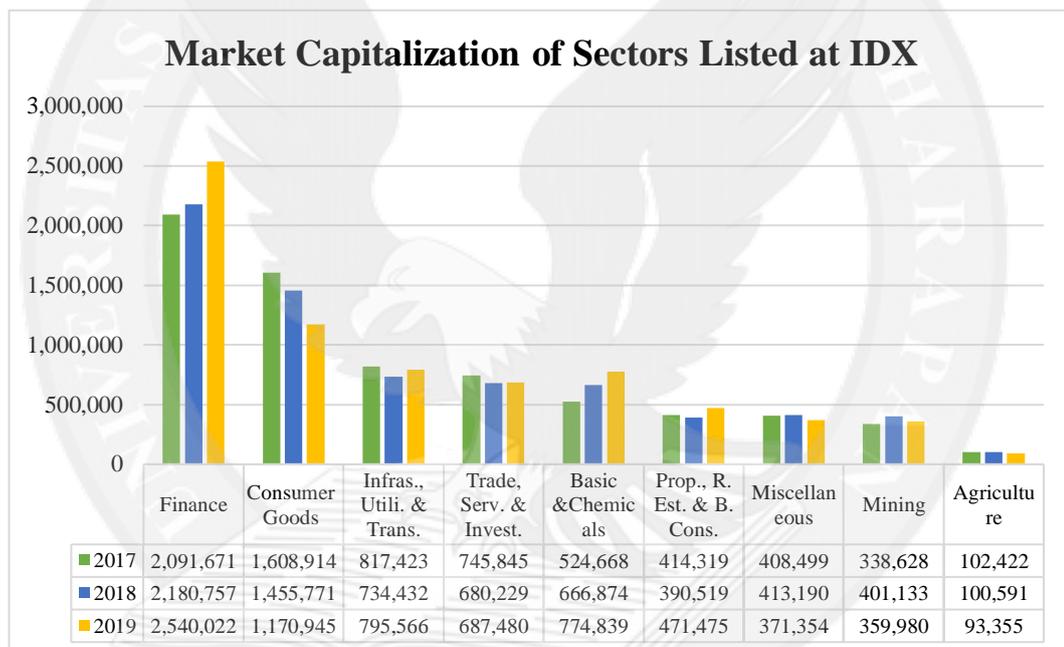
**Figure 1.1 Total *Emiten* of Sectors Listed at Indonesia Stock Exchange 2017-2019**

Source: Prepared by the writer from Indonesia Stock Exchange (2021)

From Figure 1.1 above, it can be seen that the total number of *emiten* in the consumer goods sector ranked sixth from nine sectors listed at Indonesia Stock Exchange during 2017-2019. Indeed, the total number of *emiten* in the consumer goods sector keep increasing from year to year. As of 31 December 2019, the total number of companies that publicly traded under the consumer goods sector are 56

companies. This indicates that the consumer goods sector offers a lot of opportunities for investors to invest in the publicly traded companies that they desire.

Although the total number of publicly traded companies under the consumer goods sector is smaller than other sectors, however, it is undeniable that consumer goods are one of the sectors with high market capitalization. The figure below shows the comparison of the market capitalization of each sector listed at Indonesia Stock Exchange for the year 2017-2019:



**Figure 1.2 Market Capitalization of Sectors Listed at Indonesia Stock Exchange 2017-2019**  
Source: Prepared by the writer from Indonesia Stock Exchange (2021)

From Figure 1.2 above, it can be seen that the market capitalization of the consumer goods sectors ranked second from nine sectors listed at Indonesia Stock Exchange during 2017-2019. Despite its total *emiten*, the consumer goods sector succeed in achieving the highest market capitalization after the finance sector, with an average of market capitalization Rp 1,411,877 billion. Indeed, the high market

capitalization achieved by this sector indicates the high level of profit and existence of consumer goods companies. Even some consumer goods companies also dominate the ranks of the top ten stocks with the largest market capitalization in Indonesia. The top three *emiten* from consumer goods sectors, namely PT HM Sampoerna Tbk (HMSP) with an average of market capitalization Rp 408,664,177 million, PT Unilever Indonesia Tbk (UNVR) with an average of the market capitalization of Rp 364,458,667 million, and PT Indofood CBP Sukses Makmur Tbk (ICBP) with an average of market capitalization Rp 118,562,731 million.

Based on supporting data above, it would be undeniable that investors will consider several things in making investment decisions, including the size of the company's market capitalization as well as the *emiten* who publicly traded the shares. Investors tend to seek a company with high market capitalization to invest because it reflects the level of success of the public company. However, it is undeniable that earnings information in financial statements is one aspect that significantly affects investors' investment decisions. The earnings information that is used in decision-making will also be influenced by several factors. Some of the factors are accounting conservatism, company size, as well as profitability. In this research, the writer will focus on describing the variables above and their relationship to earnings quality.

Accounting conservatism is one of the accounting principles which report accounting information with the lowest of several possible values for assets and income and the highest of several possible values for liabilities and expenses (Sugianto & Sjarief, 2018). One of the indicators to measure accounting

conservatism is by using CONACC. This ratio compares both net incomes to total assets and cash flow from operations to total assets. If the company's earnings are more released in the form of cash, it means the company has sufficient cash (actual profit) to support its operational activities, which makes its earnings stable and sustainable. Hence, the higher the CONACC ratio, the higher the earnings quality of the company's financial statements for investment decision-making.

Company size is a scale that shows the size of the company. A company's earnings quality is closely related to company size. One of the indicators to measure company size is by using Ln (Total Assets). A relatively larger company will have higher business continuity in improving its performance. Hence the company is able to maximize the company's earnings. So the higher the Ln (Total Assets) of a company, the higher the earnings quality because a large company tends to consider its earnings quality before releasing the financial statements to the public (Syawaluddin et al., 2019).

Profitability is a company's ability to generate profit which indirectly reflects a company's performance. One of the indicators to measure profitability is Return on Assets (ROA). This financial ratio is used to measure company effectiveness in generating a profit and utilizing the company's assets. It is believed that a company with high profitability will utilize its total assets for company operations effectively so that it can produce high earnings quality for the company. So the higher the ROA, the higher the company's earnings quality.

Earnings quality is a basis to determine whether the earnings generated by a company reflect the actual financial performance or not. A company's earnings

can be considered useful for user decision-making if it is stable and continuing so that it can be a basis to predict future earnings. One of the indicators to measure earnings quality is the Quality of Earnings Ratio (QER). This financial ratio indicates the sustainability of the company's future earnings, which is determined by the accrual from the company's net income and cash components from the company's cash flow from operations so that it can reflect the actual financial performance of the company. The higher the Quality of Earnings Ratio (QER) means that the company's earnings information is qualified enough for investment decisions because it shows the actual profit of the company, which is on a cash basis.

The previous research conducted by Putra & Subowo (2016) claimed that accounting conservatism (CONACC) significantly affected earnings quality (QER). Research conducted by Andriani et al. (2021) also claimed that company size (Ln (Total Assets)) and profitability (ROA) significantly affected earnings quality (QER). On the contrary, research conducted by Murniati (2019) claimed that accounting conservatism did not significantly influence earnings quality. Research conducted by Hakim & Abbas (2019) also claimed that company size (Ln (Total Assets)) and profitability (ROA) did not significantly influence earnings quality.

Based on the background above and previous researches that have been done in this sector, the writer is motivated to conduct research to know whether accounting conservatism, company size, and profitability affect a company's earnings quality. The writer is interested in conducting research under consumer goods companies because it is one of the most popular sectors that has attracted a lot of investors to invest. Thus, it has stimulated the writer to do research on whether

the earnings information of consumer goods companies are qualified enough for investment decision-making or not. On this basis, the writer will conduct the research with the title **“The Effect of Accounting Conservatism, Company Size, and Profitability on Earnings Quality in Consumer Goods Companies Listed at Indonesia Stock Exchange”**.

### **1.2 Problem Limitation**

The problem limitations set by the writer can be seen as follows:

1. The object of this research is manufacturing companies categorized as Consumer Goods at Indonesia Stock Exchange (IDX) from 2017 to 2019.
2. The independent variables of this research are accounting conservatism, company size, and profitability, while the dependent variable is earnings quality.
3. In this research, accounting conservatism is measured by using CONACC, company size is measured by using Ln (Total Assets), profitability is measured by using Return on Assets (ROA), and Earnings Quality is measured by using Quality of Earnings Ratio (QER).

### **1.3 Problem Formulation**

The problem formulation made by the writer can be seen as follows:

1. Does accounting conservatism partially affect earnings quality in consumer goods companies listed on Indonesia Stock Exchange?

2. Does company size partially affect earnings quality in consumer goods companies listed on Indonesia Stock Exchange?
3. Does profitability partially affect earnings quality in consumer goods companies listed on Indonesia Stock Exchange?
4. Do accounting conservatism, company size, and profitability simultaneously affect earnings quality in consumer goods companies listed on Indonesia Stock Exchange?

#### **1.4 Research Objective**

The research objective made by the writer can be seen as follows:

1. To know whether accounting conservatism partially has a significant effect on earnings quality in consumer goods companies listed on Indonesia Stock Exchange.
2. To know whether company size partially has a significant effect on earnings quality in consumer goods companies listed at Indonesia Stock Exchange.
3. To know whether profitability partially has a significant effect on earnings quality in consumer goods companies listed at Indonesia Stock Exchange.
4. To know whether accounting conservatism, company size, and profitability simultaneously have a significant effect on earnings quality in consumer goods companies listed on Indonesia Stock Exchange.

#### **1.5 Benefit of Research**

The benefits from conducting this research can be seen as follows:

### **1.5.1 Theoretical Benefit**

Theoretically, the results of this research are expected can be used as the literature material for theoretical studies and references for other academics who want to conduct further research on earnings quality. The writer also hopes that this research results can improve insight and knowledge of the effect of accounting conservatism, company size, and profitability on earnings quality.

### **1.5.2 Practical Benefit**

Practically, this research is expected to provide benefits for some related parties, such as:

1. For Academic

The results of this research can be used as a means of information to gain a better understanding of the impact of accounting conservatism, company size, and profitability on earnings quality. In addition, it can be a reference for similar research.

2. For Investors

The results of this research are expected to be a recommendation for investors and potential investors in assessing earnings quality so that they can make appropriate investment and business decisions in the future.

3. For Companies

The results of this research are expected to be a consideration for companies to be aware of the earnings quality of their published financial statements. Especially, the factors that probably affect earnings quality, including accounting conservatism, company size, and profitability.