CHAPTER I

INTRODUCTION

1.1 Background of the Study

One of the most important objectives of a company establishment is to increase the firm value through increasing the prosperity of investors or stakeholders. In the process of increasing the value of the company, sometimes there will be a conflict between the manager (agent) and the company owners who are often referred to as agency problems. It is normal for a company manager to have a different interest that may cause a conflict with the main objectives.

Firm value is the perception of the shareholders to companies that are often associated with stock prices. The higher the stock price is, the higher the value of the firm. According to Hidayah (2014), the higher the firm value is it will increase the investors' interest to invest in the company because it can provide more dividends to the investors. And for the creditor, firm value has relation to the liquidity of the company, for example the company has the ability to repay the loan provided by the creditors. It will strongly reflects the firm value. Companies which have high value must have a better performance in generating the profit and market value. Financial performance has a significant positive influence on firm value (Putri and Suwitho, 2015). The better the performance of the company it can be resulting in a high firm value. But not in line with the research conducted by Ariyanto (2013) which shows that financial performance does not have significant influence on the firm value.

According to Healy and Wahlen (1999), earnings management is one of the management of the company's effort to change the financial statement with the focus of misleading the shareholders who wanted to know the performance of the company or to influence the contractual outcomes of the agreement that rely on the accounting numbers reported. But not all of the earnings management is trying to manipulate the data reported, but more likely to be related with the selection of the accounting methods which according to the company rules to set the fain that could be done because it is allowed according to the accounting regulation. Earnings management appeared as an effect of the agency problem, where there are differences in interests that happen between the principal and the agent or which can be called as agency conflict. As an agent, managers are usually be in charge to optimize the profit of the owners, but on the other side managers also have the right and interest in increasing the company's welfare, so that there is a possibility that the agents will not always act in the half of the interest of owners (Jensen and Meckling, 1976). If the performance of the company is not in a good condition, where the management could not fulfill the target goals set, then the manager can make a modification of the financial statement especially the profit where it's still in accordance with the applicable accounting standards. Management should be motivated to show a good performance in achieving the profit target for the company so the management tends to select and apply for the accounting method that can generate a better result in return information (Halim, et al; 2005).

There are some approaches that can be used to determine a firm value, and will not always be the same with other companies due to many purposes of running the business. However, most of the profit of the company tends to be a tool that can be a measurement of the firm value. To maximize the occurrence of earning management manipulation and improvisation of the quality of financial statement, the company needs to implement the mechanism of Good Corporate Governance in the management system and the control of the company. Good Corporate Governance is an effort made by all parties with the same interest in the company in doing the business well in accordance with the respective rights and obligations (Arifin, 2005).

Good corporate governance is a method used by a company to provide confidence to the suppliers of company funds which will get a return on their investment. According to Lunesco (2012), a firm can increase their value by implementing the good corporate governance mechanism. In order to increase the performance of the company, good corporate governance is used to control the effort by making it more focused on controlling the behavior of the manager, so that the manager's action are responsible to those who have the same interest in the company.

The implementation of the mechanism of good corporate governance, the board of directors can guarantee the company's strategy can operate well which will result in the increase the value of company (Ni Nyoman (2014). In addition to the board of directors who can support the good corporate governance activities, the audit committee also can influence the company's value. According to Ni Nyoman (2014), audit committee also can give a negative influence towards the firm value with an assumption the company should be able to place the committee based on the competence in order to work effectively.

During this period of time, there were a lot of researches about the influence of the earning management on firm value and good corporate governance, many of the researchers claim that there is a positive relationship between earnings management and firm value. On the other side, many studies have conclude that there is a negative relationship between the earnings management and firm value.

According to Fauzan Kamil (2014) with corporate governance as moderating variable, the impact of earnings management firm value. Earnings management has no effect on firm value, according to the author, however corporate governance mechanisms involving managerial ownership, and independent commissioners have a significant impact on firm value. Managerial ownership and institutional ownership are partially moderating variables in the influence of earnings management on firm value, but independent commissioners are nor moderating variables.

Hasnawati and Sawir (2015), the author stated that there are some variables that have been proven to have a consistently impact to firm value. Meanwhile, Susanto and Christiawan (2016), succeeded in proving that earnings management, firm size had a significant positive influence towards firm value. And the research from Subanidja, Rajasa, Eduardus, and Atmanto (2016), stated that the earnings management and the corporate governance mechanism have an impact on the firm value. Independent commissioners, managerial ownership, and audit quality can all be listed as reasons why this industry should make excellent corporate governance a requirement. However, the issue of corporate governance as an independent or moderating variable, on the other hand, is still up for debate. According to Yuniarti, Mukhtaruddin, and Hanim 2017), shows that earnings management has negative impact on the company's value, corporate governance has no influence on firm value, nevertheless, as moderating variable of corporate governance affect earnings management effect on firm value.

The table below shows the condition of two companies which is Astra International Tbk., and Wijaya Karya Tbk., during the period of 2017-2019 which is listed on LQ45. The writer uses the Tobin's Q ratio which represents a firm's investment or growth opportunities. The calculation of the Earning Management is done by measuring discretionary total accruals using the Modified Jones' Models. The calculation of the Firm Value is by dividing the market value equity plus the debt with total assets of the company. When the value 0 – 1, means that replacing a company's assets costs more than the company is worth. When the ratio exceeds one, the company is worth more than the costs of its assets. The Earning Management is done by measuring discretionary total accruals that are calculated using Modified Jones' Models. If the value of the discretionary total accrual shows a positive result it indicates low quality of earnings, while the negative value of discretionary accruals indicates high quality of earnings.

Table 1.1 Discretionary Total Accrual and Firm Value (Tobin's Q) of 2 companies listed on LQ45 Companies Period2017-2019

No.	Company	Year	Earning Management	Firm Value (Tobin's Q)
1	**Astra International Tbk. (ASII)**	2017	-0.0344	1.16178
		2018	-0.0684	1.07958
		2019	0.2005	0.89921
2	**Wijaya Karya Tbk (WIKA)**	2017	-0.5578	0.21989
		2018	-0.1098	0.22462
		2019	0.3282	0.287361

Source: Prepared by the Writer (2021)

As shown on the table above, it shows inconsistencies of the result, as you can see year 2017 and year 2018 for both companies have negative results for the earning management and for the year 2019 shows a positive result. And for the firm value result for the Astra International shows that on year 2017 and 2018 are above 1, while for the year 2019 it shows below 1. On the other hand, firm value for Wijaya Karya shows a consistent result.

Therefore, as a result of the above-mentioned study, the author interested to examine the relationship between earnings management, firm value and corporate governance. The purpose of this study is to see if earnings management has positive or negative influence towards firm value and good corporate governance. As a result, the title of this study will be **"THE INFLUENCE OF EARNINGS MANAGEMENT ON FIRM VALUE AND GOOD CORPORATE**

GOVERNANCE AS MODERATING VARIABLE OF COMPANIES LISTED ON LQ45 INDEX IN INDONESIA STOCK EXCHANGE".

1.2 Problem Limitation

In line with the discussion about the problems, the focus of this study was to assess the influence of the independent variables on dependent variable with the help of moderating variable. Due to the limited use of alternative, this research was based on the quantitative method and there will be a limitation of the explanation about the influence of earnings management towards the firm value and corporate governance as moderating variable, this study was on companies which listed on LQ45 Index in Indonesia Stock Exchange within the period of 2015-2019. Corporate governance proxies by independent commissioners, managerial ownership, institutional ownership, and firm value measured by Tobin's Q ratio.

1.3 Problem Formulation

Based on the description, there is a potential that the role of good corporate governance as a reliever of earnings management practiced by management. According to the description, the research questions for this research are:

1 Does earnings management have significant influence towards firm value?

2 Does earnings management have significant influence towards the firm

value with managerial ownership as moderating variable?

3 Does earnings management have significant influence towards the firm value with institutional ownership as moderating variable?

4 Does earnings management have significant influence towards the firm value with independent commissioners as moderating variable?

1.4 Objective of the Research

The Purpose of this study was to determine the influence of earnings management on firm value and corporate governance as moderating variable of among companies listed on LQ45 Index in Indonesia Stock Exchange are:

1 To examine whether earnings management has significant influence towards firm value.

2 To determine whether earnings management has significant influence towards the firm value with managerial ownership as moderating variable.

3 To determine whether earnings management has significant influence towards the firm value with institutional ownership as moderating variable.

4 To determine whether earnings management has significant influence towards the firm value with independent commissioners as moderating variable.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

The writer expected that the result of this research can be used for other researchers as a reference to develop more and the writer also hope that it can support accounting analysis knowledge so that it can be a useful research for the concerned parties and can be an additional information or suggestion source for some companies in the future about the influence of earning management on firm value and good corporate governance.

1.5.2 Practical Benefit

The implementation of this study is expected to provide some of the following benefits:

1. For writers, this research can provide extra knowledge and expertise on the influence of earnings management on firm value and the role of corporate governance as moderating variable.
2. For companies, this research can provide additional information that can help them establish a better understanding for the influence of earnings management on firm value and good corporate governance as moderating variable.
3. For future researchers, the author expected that this study would be useful

for those who want to use this research as a reference for next researchers with similar topics.