CHAPTER I

INTRODUCTION

1.1 Background of the Study

Indonesia has a relatively stable economic growth, which contributes to increasing people's purchasing power. Increasing per capita income allows consumers to spend more money on food and beverage products. With a large population and increasing urbanization rates, the demand for food and beverage products continues to grow, thus changing the lifestyle of busy urban communities that encourage the consumption of ready-to-eat food and beverage products. The lifestyle of society that continues to advance triggers this tight Economic competitors, encouraging firm management to compete for superior financial performance in the company. These efforts are maximized in order to take various ways, one of which is through profit management activities. The selection of managers for various projects with the greatest potential to increase investor welfare and maximize the agreed-upon standards or principles is one of the primary means by which the firm aspires to increase its value.

Therefore, this study may offer a comprehensive understanding of how earnings management effects Indonesian non-cyclical consumer firms' financial performance from 2019 to 2023. It is anticipated that this study will offer valuable insights for industry stakeholders, such as investors and company management, by identifying and evaluating the effects of different Industry stakeholders, including investors and corporate management, can expect useful insights from this study since it will identify and evaluate the effects of various earnings management tactics on financial results, market responses, and drive variables. Increasing the company's worth is crucial for management in order to ensure the owners' well-being.

Company performance in the short term can be evaluated through financial reports. Those of financial reports user typically concentrate on the firm's profit level since it can demonstrate management's accomplishments in managing the company and serve as an indication in assessing management performance. If the desired profit level cannot be achieved, there is a possibility of earnings management actions. Basically, earnings management is the use of accrual accounts aimed at obtaining personal gain. The application of earnings management is unethical, but it is not prohibited as long as it is in complies with the accounting rules and Financial Accounting Standards (SAK) applicable in Indonesia (Yuliani 2021).

Accrual-based earnings management is carried out because of the flexibility of management policy in determining an accounting practice. This accrual component is used in recording and preparing financial reports, the behaviour of earnings management can be proven in various ways, one of which is measured by discretionary accrual and revenue discretionary (Muljadi 2012). Earnings management refers to adjustments created during the production of financial statements that can alter the reported profit levels. The purpose is to present a favourable financial performance to rating agencies, encouraging them to assign higher ratings. Such positive ratings can boost stakeholder confidence and optimize the inflow of funds into the company.

Discretionary accruals are accrual actions taken by managers because management can choose the policies to be used which consist of total accruals, receivables, revenues and plans, property and equipment (PPE). Total accruals, the difference between operating cash flow and profit, are the starting point for any accrual calculation. Total accruals can be classified into two categories: normal or non- discretionary accruals, which occur naturally during the compilation of financial statements, and abnormal or discretionary accruals, which come from accounting data manipulation (Ayu Furry Adryanti 2019). Discretionary accruals are accruals influenced by management's decisions, as they have the authority to establish policies regarding accounting methods and estimates. A drawback of the accrual basis is that it allows managers the flexibility to engage in practices that serve specific interests.

Several issues related to earnings management, especially in the center of the Covid-19 pandemic, are interesting to study because they describe the behavior and motivation of managers as financial reporters to report company performance amid economic instability in order to maintain high profitability ratios and attract investors, thus company managers often carry out their duties to generate the desired profit within the limits permitted by applicable general principles, so that they can increase investment activities in the Company. Earnings management is not always regarded negatively because it does not necessarily imply that managers manipulate the earnings (Susanto, Pradipta, and Cecilia 2019). Thus, Earnings management has become a common practice in financial reporting, especially when companies fail to meet investor expectations, turning it into a part of corporate culture. This approach is adopted to manipulate profit and loss figures in financial statements, aiming to showcase strong financial performance and position, thereby attracting potential investors.

Looking at the existing phenomenon, it is clear that the practice of earnings management in altering financial reports is not new. The increasing competition in the business world can cause companies to compete to show good performance to investors, one of which is by implementing earnings management. Companies can enact earnings management, seen from the positive side, it means that management wants to secure profits for reports in the coming period, while on the negative side for investment owners they want to have large profits in each financial report period. With this, the management will carry out earnings management to regulate financial reports, so that both internal and external parties are not harmed.

Investors consider a number of things when deciding whether or not to purchase a company's stock, including the company's financial success. For a company, maintaining and improving financial performance is a must so that the stock continues to exist and remains in demand by investors

(Septiana 2022). Company performance should be a quantifiable outcome that reflects the actual condition of the company based on various agreed-upon metrics. To assess a company's performance level, a series of evaluations are conducted, focusing on the results achieved over a specific period. These outcomes may include goods or services that serve as indicators of the organization's success (Haposan Banjarnahor, Agus Defri Yando 2018). Assessing performance is crucial for understanding the company's achievements and overall effectiveness, providing valuable insights for both management and shareholders. This information serves as a foundation for strategic decision-making, enabling the company to excel in domestic and international markets. Investors, particularly external stakeholders, tend to favor companies with strong financial performance. Education financial accounts will help them understand the current and future state of the company's finances.

In practice, the increasing competition among business entities has led to a rise in profit manipulation, particularly through income smoothing, to present favorable performance to stakeholders. This intense competition has driven significant industrial growth, particularly in the consumer goods sector.

One area where profit management is common is in the food and beverage industry. This include:

According to an examination undertaken by PT Ernst & Young Indonesia (EY) on AISA's financial report for the year 2017, PT Tiga Pilar

Sejahtera Food Tbk (AISA) found that accounting items were inflated by An audit of PT Tiga Pilar Sejahtera Food Tbk's (AISA) 2017 financial report by PT Ernst & Young Indonesia (EY) revealed IDR 4 trillion in overstated accounting items, IDR 662 billion in income, and an extra IDR 329 billion in the EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) account. In addition, according to the EY investigation, the AISA Group funneled a total of 1.78 trillion IDR to parties thought to have links to the former administration via a number of different schemes. The goal is to make PT Tiga Pilar Sejahtera Food Tbk's (AISA) financial report look good so that the bank will be interested in lending money and so that investors would be interested in buying AISA shares at a good price. Based on the incidents mentioned earlier, it is clear that numerous individuals are trying to influence the company's success for their own financial gain. Furthermore, because internal and external stakeholders alike can suffer losses due to company collapse caused by profit management practices that do not adhere to relevant norms. Research on the effects of earnings management on non-cyclical consumer sector financial performance is shown below using a number of corporations as examples.

Table 1.1 List of DAC and ROA

COMPANY NAME	CODE	YEAR	EARNING MANAGEMENT (DAC)	FINANCIAL PERFORMANCE (ROA)
PT. Budi Starch & Sweetener Tbk.	BUDI	2019	0.4429	0.0204
		2020	0.4170	0.0211
		2021	0.4954	0.0278
		2022	0.4794	0.0280
		2023	0.4354	0.0303

PT. Astra Agro Lestari Tbk.	AALI	2019	1.8244	0.0078
		2020	1.8846	0.0300
		2021	2.0321	0.0648
		2022	1.5956	0.0590
		2023	1.6866	0.0366
PT. Indofood Sukses Makmur Tbk.	INDF	2019	-0.4817	0.0510
		2020	-0.5101	0.0396
		2021	-0.3261	0.0427
		2022	-0.2938	0.0352
		2023	-0.2901	0.0437

Source : Organized by Writer (2024)

Based on the table above shows the total DAC and ROA of the three companies during the period 2019 - 2023, which is taken from the total observation. Where BUDI is consistent in its DAC ratio, in 2019 - 2023 the DAC ratio value experienced a stable decline and increase where this is adjusted to the value of its ROA ratio. Companies are good at managing their financial performance if their profit management and ratio levels are steady.

It reveals that AALI Company's DAC ratio remained stable in 2019 and 2020, but saw a substantial increase in 2021 as compared to the prior year. When viewed from the ROA ratio value in 2021, it did increase but was not balanced with the DAC ratio value which increased quite significantly, where this shows the influence of profit management and the lack of management of its financial performance in that year, although in that year the ROA ratio value experienced a small increase. However, in 2022-2023, the DAC ratio value decreased and was balanced with the ROA ratio value. In other words, in 2021, AALI took advantage of its increasing ROA value by increasing its DAC value so that the Company could attract investors by showing good profits and financial reports, but considering that the ROA value has a small increase, the company is considered to be less concerned about the ratio level. Where it must be balanced with the ROA value owned in order to reflect more realistic performance.

Meanwhile, INDF Company shows its DAC ratio value is minus in 2019 to 2023. This shows that the Company may be carrying out conservative profit management. Where the Company reduces reported profits, maybe the Company is trying to maintain the stability of financial reports in the future. Because in 2020 to 2023 the company increased its profit management ratio in order to adjust the stability of its ROA ratio value. In other words, the Company creates Profit Reserves to deal with potential losses, but in this case it may affect investor or auditor confidence.

In light of the foregoing, it is reasonable to assume that return on assets (ROA) is a financial ratio that measures the efficiency with which an organization generates net profit from its assets. A higher return on assets (ROA) shows that assets are being used more productively to generate profit. Return on Assets (ROA) analysis helps us figure out if a business is making good use of its assets in its operations to generate profits. Return on assets (ROA) is a useful metric for evaluating financially stable businesses because net profit is a measure of overall profitability. You can position your firm within its industry with the use of this metric, which assesses the effective use of capital and gives you a full view of the elements influencing the company's financial state. Furthermore, financial performance can be evaluated by comparing financial ratios with standard benchmarks or analyzing trends over multiple years. Such comparisons reveal progress or decline in performance based on the specific purposes of each ratio.

Companies trading on the Indonesian Stock Exchange that are not part of cyclical consumer sectors are the subject of this study. Distinctions in meaning, sectors, years, and the use of up-to-date and pertinent data are highlighted in this study as opposed to earlier research that used different data, time periods, and methodology. This study focuses on the non-cyclical consumer sector and how earnings management affects financial performance, rather than previous research that has looked at factors like managerial control, social responsibility, and capital structure

The author selected this subject for study because it is a fascinating study area connected to the fiercely competitive food industry, which means that non-cyclical consumer businesses are likely to experience earnings management. Because there are specific motivations that drive managers to manipulate financial data, particularly reported company profits, the phenomenon of earnings management is extremely fascinating to research since it can provide a picture or description of how managers behave while reporting their business actions over a specific period. Specifically, managers may manipulate earnings by engineering their company's earnings may grow, decline, or stay stable over time. As 2019-2023 is the most current year that permits its use as a study population in relation to the availability and completeness of research data, this time frame was selected.

Several supporting variables that impact the financial performance of organizations in the customer-facing non-cyclicals industry can be used to back up and understand the research on this topic. These include current ratios, firm size, earnings management variables, debt to asset ratios, and sales growth. In light of this, the findings of this study can inform the formulation of better corporate strategies, leading to enhanced financial results for the organization. Research with the following title is of interest to the author, as described above: "**The Effect of Earnings Management towards Financial Performance**".

1.2 Problem Formulation

The problem formulation of this study has one main variable used in the study, so the entire process until the end will only be focused on:

1. Does Earning Management impact Financial Performance ?

1.3 Objectives of Research

This study examines whether Earning Management effect the Financial Performance of consumer non cyclicals companies listed on Indonesian Stock Exchange in the period 2019 – 2023.

1.4 Benefits of the Research

The outcomes of this research are anticipated to be beneficial and useful to all levels of society. The various benefits that are expected include:

1.4.1 Theoritical Benefit

Theoretical benefits are expected to enrich theories related to financial performance and can be used as a reference for more study related to the variables studied in this study.

1.4.2 Partical Benefit

a. For Researchers

   This research is useful for researchers, to add insight or additional contributions to future research literature and knowledge regarding several factors that can influence financial performance.

b. For Related Management

   When making decisions, this study is helpful for management because it provides information that can help them maximize the company's financial performance.

c. For Investors

   The value of a firm might be affected by this research since it can give a picture of the business's financial health.

1.5. Problem Limitation

The limitations of the problem in this study are:

1. The companies that have already been listed on the Indonesian Stock Exchange and are considered non-cyclical consumers are the primary subject of this study.
2. This analysis utilizes research data spanning from 2019 to 2023.

3. Earnings management, liquidity, leverage, company size, and sales growth are the variables that are autonomous in this study, with financial performance serving as the dependent variable.