Institutional Ownership, Managerial Ownership And Earning Management

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***Abstract* -** The purpose of this study is to examine the effect of institutional ownership and managerial ownership on earnings management. By taking the population of manufacturing companies that listed in Indonesia Stock Exchange (IDX) in 2017-2018, this research is conducted using quantitative method with regression analysis. This research showed that institutional ownership and managerial ownership had no effect on corporate earnings management.

***Index term*:** Institutional ownership, Managerial ownership, Earnings management, Good corporate governance

I. INTRODUCTION

The separation of ownership and control in corporate organizations creates an asymmetric information problem between shareholders (principals) and managers (agents) that is show the existence of an agency risk. Asymmetry information creates a moral hazard problem when managers have an incentive to pursue their own profits with costs incurred by shareholders (Scott, 2012), this condition shows that difference information content will causes agency problems. The existence of this agency problem made management tends to present information that is not true to the shareholders, especially if the information is related to the management performance measurements and will be affect the level of investment in the company. To ensure that their bonus performance and investment in the company is still obtained, management will conduct earnings management so that the company's performance is good.

Earnings management is the selection of accounting policies from existing accounting standards by managers that can be used to maximize their profits and or the market value of the company (Scott, 2012). The problem of earnings management can be overcome by having good corporate governance so that agency risk can be reduced. By increasing supervision of management actions, limiting managerial opportunistic behavior, and improving the quality of the company in the flow of earnings management information in the company can be minimized. Herawaty (2008) revealed that one way to suppress earnings management is by a mechanism of good corporate governance. Good corporate governance through internal mechanisms such as the composition of the board of directors or commissioners, managerial ownership and executive compensation as well as external mechanisms such as market control and levels of financial debt can help reduce earnings management. Good corporate governance with its mechanism provides a way for companies to suppress earnings management by offering shares that can be owned by internal and external parties, such as managerial ownership and institutional ownership

Sujono and Soebiantoro (2007) in Sabrina (2010) explained that managerial ownership is the ownership of shares by company management as measured by the percentage of the number of shares owned by the management. The managerial ownership structure can be explained through two points of view, namely the agency approach and the imbalance approach. The agency approach considers the managerial ownership structure as an instrument or tool used to reduce agency conflict between several claims against a company. The information imbalance approach views the mechanism of managerial ownership structure as a way to reduce information imbalance between insider and outsider through information disclosure within the company. Increasing managerial ownership is a way to overcome the problems that exist in the company because with increasing managerial ownership, managers will be motivated to improve their performance so that in this case will have a good impact on the company and meet the wishes of shareholders. The larger managerial ownership in the company will drive the management to be more active to improve their performance because management has the responsibility to meet the wishes of shareholders who are none other than himself. Management will be more careful in making a decision, because management will share the benefits directly from the decisions taken. In addition, management also bears losses if the decisions taken by them are wrong.

Institutional ownership is ownership of shares by the government, financial institutions, legal entity institutions, foreign institutions, trust funds and other institutions at the end of the year (Shien, et. al. 2006 in Winanda, 2009). One factor that can affect company performance is institutional ownership. The existence of institutional ownership in a company will increase the supervision of management performance, because ownership of shares represents a source of power that can be used to support or vice versa on the performance of management. Supervision by an institutional investor is very dependent on the amount of investment made. Cornet et al. (2006) conclude that the supervision of company by the institutional investors can encourage managers to giving more attention on company performance so that it will reduce manager selfish behavior so the financial statements produced by management will have more integrity. Based on that background we compiled research questions as follows:

- Does managerial ownership affect earnings management?
- Does institutional ownership affect earnings management?

This research tries to answer the research question above and give a new understanding on how the typical of ownership will affect the earning management practices in Indonesia’s manufacturing companies. This research is arranged by quantitative method with regression analysis. The population used in this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2017-2018.

The result of this research concludes that institutional ownership influences earnings management, whereas managerial ownership does not affect earnings management in the manufacturing companies in 2017-2018. This research is arranged in introduction, theory and hypotheses development, research method, analysis and discussion, and conclusion.

II. THEORY AND HYPOTESIS DEVELOPMENT

Agency Theory

When there is a separation between the owner (principal) and the manager (agent) in a company, then there is a possibility that the owner's wishes are ignored. When the owner or manager delegates the decision-making authority to the other party, there is an agency relationship between the two parties. This agency relationship, such as between shareholder relations with managers, will be effective as long as managers make investment decisions that are consistent with the interests of shareholders. However, when the manager's interests differ from those of the owner, then the decisions taken by the manager will most likely reflect the preferences of the manager compared to the owner.

In accordance with the agency theory, a selfish manager will act in ways that improve their own well-being without regard to the interests of shareholders, therefore owners who have delegated decision-making authority to their managers can lose their potential benefits that should be derived from strategies that are optimize the desires of the owner (Leventis and Dimitropoulos 2012).

In general, the owners want to maximize the value of shares. When managers also own a large number of shares of the company, they will definitely choose a strategy that generates an appreciation of the value of shares. However, when a manager acts more as a hired person than as a partner and owner, the manager will prefer a strategy that can increase their personal compensation and not a strategy that focuses on returning to the owner (Pearce and Robinson 2008).

Agency theory is a theory that discusses the relationship between principal and agent. Agency theory is a sacrifice that arises from any agency relationship, including relationships in employment contracts between shareholders and company managers (Mishkin 2008). This agency theory emphasizes the importance of handing over company operations from owners (pricipals) to other parties who have the ability to better manage the company (agents) (Irfan 2002).

Positive Accounting Theory

Opportunistic actions that underlie earnings management can be explained through positive accounting theory as well as the three hypotheses formulated by Watts and Zimmerman (1986). First, the bonus plan hypothesis explains how incentives in the form of bonuses offered to management to achieve certain targets can motivate the selection of accounting procedures that allow a shift in the future earnings to current periods. Second, the debt covenant hypothesis explains that companies that have a large ratio between debt and equity tend to choose and use accounting methods with higher income statements and tend to violate debt agreements if there are benefits to the company, such as profit play so that debt obligations can be delayed for the next period. Third, the political cost hypothesis explains how these costs affect management in choosing accounting procedures that can keep the company from being noticeable so as to avoid government intervention and regulators such as the imposition of higher taxes or other demands (Sulistyanto, 2008).

Earning Management

Earning management can be explain as the choice of accounting policy by the manager to increase or decrease the amount of income reported with the managerial efforts to change, conceal, and delay information in financial statements by achieving certain objectives (Sulistyanto 2008). Reporting interventions in the external financial reporting process with the intention that users have a false information of the economic performance of the company so that the decisions taken by its users are in line with management's expectations to increase the value of the company (Schipper 1989).

Based on previous research conducted by Roychowdhury (2006) the measurements of earnings management are as follow:

a. Abnormal cash flow operations (CFO)
   Abnormal CFO is a profit manipulation that is done by a company through cash flow operations that will have cash flow lower than its normal level.
b. Abnormal production cost (PROD)
   Abnormal production costs are real earnings management which is done through manipulation of production costs, where the company will have higher production costs than the normal level.
c. Abnormal discretionary expenses (DISC)
   Abnormal discretionary expenses are profit manipulations carried out through research and development costs, advertising costs, sales costs, administration, other general costs.

Effect of Managerial Ownership on Earnings Management

Managerial ownership is ownership of share by the management of the company. From the standpoint of accounting theory, earnings management is largely determined by the motivation of company managers. Managerial ownership has a significant effect on earnings management. With the ownership of shares owned by the manager, the manager will act in harmony with the interests of shareholders so as to minimize the manager's opportunist behavior. In a low share ownership, the incentives for the possibility of opportunistic behavior of managers will increase.

Managerial ownership is considered as an important internal monitoring tool to resolve agency conflicts between external stockholders and company management. Managerial ownership is one factor that can reduce agency problems because it will align the interests of managers and shareholders. Putri and Yuyetta (2013) research found that managerial ownership had a negative effect on earnings management. Its explaines that the larger the managerial ownership, the smaller the percentage of earnings management. Conversely, the smaller managerial ownership, the larger the percentage of earnings management. High share ownership makes company managers feel the benefits directly from economic decisions taken and bear the consequences of making wrong decisions. This shows that there is a greater responsibility for managers in managing the company and presenting financial statements with honest and candid information because the results of the financial statements are also for themselves. Managerial ownership will encourage managers to produce optimal company performance and motivate managers on their accounting activities because they will share the consequences of their actions.

But on the other-hand there are studies that find different results which conducetd by Agustia (2013) and Guna and Herawaty (2010). They found that managerial ownership has no effect on earnings management. This is because managers who participate in owning shares in the company will tend to take policies to manage the company's profits in accordance with the views desired by investors. For example, managers are thought that by increasing profits reported in a company's financial statements many investors will be interested in buying the company's shares or investing in the company and thus will increase the company's stock price. It was also due to the fact that managers who also own company shares only have relatively very small shares when compared to the overall capital in the company. Upon developing this hypothesis, the hypotheses of this study are:
H1: Managerial ownership affects earnings management

Effect of Institutional Ownership on Earnings Management

Institutional ownership is ownership of shares owned by other institutions. This is one way to monitor the manager's performance in managing the company so that ownership of other institutions is expected to reduce the earnings management behavior of managers. Institutional ownership has the ability to control management through an effective monitoring process. Evidence that the supervisory actions taken by a company and institutional investors may limit the behavior of managers. Institutional investors are parties who can monitor agents with a large ownership, so that the motivation of managers to manage profits is reduced.

Institutional ownership has the ability to control management through effective monitoring processes so that managers will be careful if they want to do earnings management. Institutional ownership is considered a way to oversee managers because an increase in institutional ownership will be able to reduce agency cost on debt and insider ownership because the greater institutional ownership will further reduce conflicts between creditors and managers and ultimately will reduce agency costs and earnings management.

Research by Guna and Herawaty (2010); Agustia (2013); and Putri and Yuyetta (2013) found that institutional ownership had no effect on earnings management. So, in this case institutional ownership is not an effective and efficient thing in reducing or hindering earnings management carried out by company management. So whether or not there is institutional ownership in this case is not an important thing for the company. Upon the development of this hypothesis, the hypothesis of this study is:
H2: Institutional ownership influences earnings management

III. RESEARCH METHODS

The research is using a quantitative approach by testing hypotheses. The operational definition of variables in this study is :

1. Managerial Ownership
   Managerial ownership is the proportion of shares owned by the directors, management, commissioners as well as every party directly involved in the decision making of the company concerned. Managerial ownership measured by the percentage of share ownership of the board of directors and board of commissioners divided by the number of shares outstanding (Rustiarini, 2010).
2. Institutional Ownership
   Institutional share ownership is a presentation of ownership rights of shares owned by other parties or institutions. Institutional ownership can be calculated by a percentage of the value of the number of shares of companies owned by the institution divided by the total number of shares outstanding. Here are the measurements:
3. Earning Management
   Earnings management is the manager's effort to intervene or influence the information in the financial statements, to trick the principal who wants to know the performance or condition of the company. The accrual-based model is one of the models that uses discretionary accruals as a proxy.

Earnings management in this study is proxied by discretionary accruals. Discretionary accruals are a component of managerial engineering accruals by utilizing freedom and discretion in estimating and using accounting standards. Earnings management uses modified Jones by assuming that all changes in credit sales in the event period are the object of earnings management. This is based on the idea that it is easier to manage discretionary profits on the recognition of income on credit sales. Then to measure discretionary accruals, the Jones model is defined as the residual regression of total accruals from changes in sales and fixed assets, where the variable income changes adjusted for the variable changes in receivables that occurred in the period concerned. (Dechow *et al.*, 1995).

a. Calculates the total value of accruals (TACC):

$$TACC_{it} = NI_{it} - CFO_{it}$$

b. Calculate parameter values α, β1, β2, and β3 as follows:

$$\frac{TACC_{it}}{A_{it-1}} = \alpha(\frac{1}{A_{it-1}}) + \beta_1 \frac{(\Delta REV_{it} - \Delta REC_{it})}{A_{it-1}} + \beta_2(\frac{PPE_{it}}{A_{it-1}}) + \beta_3(\frac{\Delta CFO_{it}}{A_{it-1}}) + \varepsilon_{it}$$

c. Calculate non-discretionary accruals by entering the calculation results of the parameter values α, β1, β2, and β3 from equation to value α, b1, b2, and b3 on the equation below:

$$NDACC_{it} = a(\frac{1}{A_{it-1}}) + b_1 \frac{(\Delta REV_{it} - \Delta REC_{it})}{A_{it-1}} + b_2(\frac{PPE_{it}}{A_{it-1}}) + b_3(\frac{\Delta CFO_{it}}{A_{it-1}})$$

d. Calculate the value of discretionary accruals by subtracting TA from NDACC as follows:

$$DACC_{it} = \frac{TACC_{it}}{A_{it-1}} - NDACC_{it}$$

Explanation:

$TACC_{it}$ = Total company Accruals i in period t
$DACC_{it}$ = Company Discretionary Accruals i in period t
$NDACC_{it}$ = *Non Discretionary Accruals of the company i in period t*
NI_{it} = *Net Income of company i in period t*
ΔCFO_{it} = Change in Cash Flow from Operating company i in period t
A_{it-1} = Company assets i in period t-1 (beginning of the year)
ΔREV_{it} = Changes in company income i in period t
ΔREC_{it} = Changes in company receivables i in period t
PPE_{it} = Company fixed assets i in period t
ε = *Error*

Population and Sample

The population used in this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2017-2018. Samples taken from the population must be truly representative. The sampling method that is used in this study is the judgment sampling method, which is one form of purposive sampling by taking a predetermined sample based on the aims and objectives of the study. The criteria used in this study are:

1. Manufacturing companies listed on the Indonesia Stock Exchange during 2017-2018.
2. Manufacturing companies that publish financial reports or annual reports in a row during the 2017-2018.

IV. ANALYSIS AND DISCUSSION

Classic assumption test

Regression testing conducted on the regression equation will be tested on classical assumptions consisting of normality test, muticolinierity test, heterokedasticity test and autocorrelation test. Following are the test results from the SPSS :

a. Normality test

The results of the normality test can be seen in the following table:

Tabel 1
The results of the normality test

Model	*Asymp. Sig (2-tailed)*

1	0,000

Source: SPSS Processed Results, 2020.

From the classical assumption test table it can be seen that the level of significance of the Kolmogorov-Smirnov one sample shows the number 0.00 which means it is smaller than 0.05 so it can be concluded that the data is normally distributed. This is supported by Gujarati (2004: 109) stating that "... it can be shown that if there is a large number of independent and identically distributed random variables, then with a few exceptions the distribution of their sums tends to a normal distribution ...". The statement shows that large amounts of data will cause the data to become normally distributed by themselves. In addition Gujarati (1995: 782) states that if the data amounted to> 25, including a large sample, so this study is normally distributed because it includes a large category that is amounted to 312.

b. Multicollinearity Test

Multicollinearity test aims to test whether the regression model found a correlation between independent variables (independent) (Ghozali, 2012). Multicollinearity can be seen from the value of tolerance and its opponents as well as the variance inflation factor (VIF). Both of these measurements indicate which of each independent variable is explained by other independent variables. From the multicollinearity test table it can be seen that the VIF value for variables is less than 10 for variables in the regression model 1. It was concluded that the regression model 1 does not have multicollinearity between the independent variables in the regression model, because the VIF value <10 and tolerance value> 0.1 are meaning that there is no multicollinearity. Multicollinearity test results can be seen in the following table:

Tabel 2

Multicollinearity Test Result

Variabel	Tolerance	VIF	Result
KINTS	0,810	1,234	Free of Multicollinearity
KM	0,949	1,054	Free of Multicollinearity

Source: SPSS Processed Results, 2020.

c. Heteroscedasticity Test

From the heteroscedasticity graph produced from SPSS, it can be seen that the plot graph is between the predicted value that is ZPRED with the residual value SRESID. There is no specific pattern, and the pattern of dots spread on the scatterplot graph so that it can be concluded that heterocedasticity does not occur.

d. Autocorrelation Test

The autocorrelation test aims to test whether in the linear regression model there is a correlation between the error of the intruder in the t period and the error of the intruder in the t-1 period (before). The method that can be used to detect the presence or absence of autocorrelation is the Durbin Watson test (DW Test). DW tests are only used for first-order autocorrelation and require a constant (intercept) in the regression model and there are no more variables between independent variables. The autocorrelation test aims to test whether in the linear regression model there is a correlation between the error of the intruder in the t period and the error of the intruder in the t-1 period (before). To find out whether or not there is autocorrelation, you can do a statistical test from Durbin Watson (DW test). To test the presence or absence of autocorrelation, the Durbin Watson criteria is located -2 to +2. In this study the results of the Durbin Watson test resulted in a value of 1.808, so that the regression model did not occur autocorrelation.

Effect of Institutional Ownership on Earnings Management

This study found that institutional ownership had no effect on earnings management. Chung *et al.* (2002) stating that ownership of shares is in a large amount, tends not to be actively traded in the market and is usually owned in a long term period. When there is a tendency to own shares in the long run, institutional ownership will be concerned with the underlying profitability of the company and will be very concerned with the use of discretionary accruals to manipulate earnings, which is a form of camouflage of management performance. Soloman (2007) in Sabrina (2013) states that institutional investors represent a strong mechanism of corporate governance that can monitor and align management interests with the interests of shareholders. Huang et al. (2011) states that the majority of investors' voting power is related to the low discretionary accruals. Gumilang et al. (2015), Chung et al. (2001), Bushee (1998) states institutional ownership has a significant negative effect on earnings management, because the majority owner prevents management from taking advantage of their discretion in choosing policies to increase or reduce reported profits with the aim of obtaining personal profit. In the case of PT Ades Alfindo 2004, the entry of new institutional investors managed to find inconsistencies in sales for the 2001-2004 period by earnings management. In accordance with ISA 260 paragraphs A1-A8, institutional investors can become Those Charged with Governance (TCWG) as an organization with responsibility for overall oversight of the strategic direction of the entity and accountability obligations, including overall oversight of the financial reporting process.

Effect of Managerial Ownership on Earnings Management

This study found that managerial ownership has no effect on earnings management. A very small proportion of ownership does not become an instrument of equality of interests with shareholders and has not formed a sense of belonging to the company (Maksum, 2005). That is why managerial ownership has no effect on earnings management. Scholer's study (2005) states that management discretionary controls reported profits using accrual policies and no matter how stringent accounting regulations, managers will use their influence to intervene reported earnings. Giving shares to management should be an incentive for management to reject interventions that want to interfere in managerial matters, especially if done will harm the public. Huang et al. (2011) precisely managers use their ownership as a protector of themselves from disciplinary actions by shareholders, consequently management is free or free to improve earnings management.

Zaki (2014) and Sudjatna and Muid (2015) explained that shares given to company managers that are relatively very small have not been able to influence earnings management activities carried out by company managers. With the authority as a company owner and manager of operational activities, managers will be more flexible in managing earnings because they have information that is not owned by external investors, so they can take advantage of this information. In this condition, giving ownership to management would lead to higher earnings management. It could be said whether or not the shares owned by management did not affect the pattern of earnings management. Sulistyanto (2008) added, the compilers of financial statements chose to use accounting methods or estimated values according to specific objectives either to increase share prices for the value of the company or to optimize their personal well-being both as managers and owners.

V. CONCLUSIONS

This research concludes that institutional ownership influences earnings management, because the majority owner prevents management from using their discretion in choosing policies to increase or reduce reported profits with the aim of obtaining personal profit.

Whereas managerial ownership and the suitability of the characteristics of the audit committee with corporate governance guidelines do not affect earnings management, because compliance with regulations is carried out only because it is mandatory, not yet fully determined. Then, the existence of authority as a company owner and operational manager, will make managers more flexible in managing earnings because they have information that is not owned by external investors.

The advice contributed in this research is that there is a need for cooperation and synergy from various business actors, regulators, accountants, board of commissioners, etc. to provide socialization of benefits, and the importance of corporate governance so that ethical awareness arises about the importance of good corporate governance practices for improving business performance and sustainability in Indonesia, which will reduce negative earnings management practices.

For regulators and governments, it must strengthen the rules in the form of guidelines for implementing aspects of corporate governance to match those applied at the international level, so that users of financial statements have a balanced level of perspective and assessment.

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