Influence of the Internal Corporate Governance, Leverage Ratio, and Earnings Management to the Stock Share Return

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ABSTRACT

The aim of this paper was to study and to know the empirical evidence about the influence of internal corporate governance, leverage ratio, and earnings management due to the stock share return. The internal corporate governance included the managerial property and the independent board of director. This study was as a basic research by using quantitative approach. Secondary data was used in this study and it included the finance report and the asset market of Manufacture Company which was registered in Bursa Efek Indonesia (BEI) during the year of 2006 to 2009. The kind of company was selected as go public emitted manufacture in Bursa Efek Jakarta (BEJ). In addition, this study used stock share value data of Indonesia Securities Market Directory (ISMD) from the Asset Market Data Centre (Pusat Data Pasar Modal, PDPD), Faculty of Economy, University of Airlangga, and Surabaya of Indonesia. Result showed that the internal corporate governance, leverage ratio, and earnings management influenced the stock share return. This result could be used to contribute on the development of theory especially the study of financial accounting about the agency theory and corporate governance which had relation to earnings management. In addition, this result could be used as a consideration of the investor in making decision on the infestation.

Keywords: managerial property, board of director, earnings management, leverage ratio, stock share return

INTRODUCTION

The action of earnings management has caused some cases of scandal on the financial report in business world like Enron, Merck, World Com, and the other majority of companies in USA [1]. There is the same case occurred in Indonesia like involving the financial report which begins from the detection of earnings manipulation [2]. The scandal will cause the loss which has to be mutual liability by some sides as the reason of the earnings management. It does not only harm the stakeholder but indirectly it has to be mutual liability by the public which do not have the direct relation to the company. If this case is carried out in a long time, it will influence economical of a country. Therefore it is necessary to implement good corporate governance to eliminate the earnings management in the business world management and to balance some interest [3].

Corporate governance is one of the key elements in increasing the economic efficiency. It included a relation series between the company management, the board of director, the stock share holder, and the other stakeholders. The system of corporate governance gives the effective protection for the stock share holder and creditor so that they believe will really obtain the return of their infestation. According to Scheifer and Vishny [4], corporate governance is a mechanism which is used to make certainty that the finance supplier like stock share holders and bond holders of a company have return of the activity carried out by manager. In addition, how the finance supplier of a company carry out the control to the manager which includes the internal factor like proportional independent board of director, structure on the board of director, managerial property, and the external factor like institutional property [5].

A manager has the possibility to carry out the earnings management due to the increasing of stock share rate. Hence, the motivation of manager intends to increase the stock share trade and the riches of stock share holder by maximizing the stock share rate [6]. The pattern of earnings management which is increased will get the positive response from the investor because the more increasing of emitted earnings growth will reflect the higher return. Qiang et.al. [7] studied the earnings management to stock share return on the business sector and the result indicated that total discretionary accruals which was used in earnings management practice that had positive and strong influence to stock share return. Ardiati [8] also studied the same research with the study of Qiang et.al. [7]. Ardiati [8] has added the variable of audit quality as the moderating variable and the result indicated that earnings management and stock share return was bigger for the company which was audited by KAP Big 5 than by KAP non-Big 5.

The relation between leverage ratio and stock share return has been carried out by Ulupui [8]. The result showed that debt to asset ratio could be used to measure the leverage and produce the negative result to stock share return. It was due to the higher leverage ratio which would cause the higher credit and it meant that the interest load would higher and it would decrease the profit and the lower return was as the further reason.
MATERIALS AND METHODS

This study used 2 kinds of data. Data of this study included the data of finance report and the data of asset market of Manufacture Company which was registered in Bursa Efek Indonesia (BEI) during the year of 2006 until 2009 on the manufacture emitting which go public in Bursa Efek Jakarta (BEJ). There was selected the emitting which was moving in the manufacture because the finance report on the manufacture emitting had the item with more complex and perfect of discretionary accrual than the non manufacture emitting. The samples were selected using purposive and judgment sampling with the criteria as follow:

1. The companies were on the group of Manufacture Company which had finance report from the year of 2006 until 2009.
2. The companies were registered in Bursa Efek Indonesia (BEI) from the year of 2006 until 2009.
3. The manufacture company had not published the finance report at the end of June 2010.

The conceptual framework was presented as in Figure 1.

The relation between institutional property, managerial property, proportional independent board of director, and standard board of director with the stock share return

The application system of corporate governance is believed to be going to give the effective protection to the stock share holder and creditor for giving back the growing infestation. Therefore, the corporate governance can be described as series rules which organize the relation among stock shareholders, company manager,
creditor, government, employer, and the other interest side as the intern as well as the extern which is related to their duty and responsibility. This expression was suitable with the research of Aman and Pascal [9] which found that company management with the variables of the structure on the board of director and the lower ranking of holder characteristic would give the lower return because the risk was higher. Hence, company with the higher ranking of company management would produce the higher profit because the risk was lower.

The other motivation in earnings management was to synchronize the expectation of investor earning [10]. Some managers had a strong incentive to make certainty that the expectation of income could be reached especially they had the other compensations which was still related to the stock share rate. One of the manners was to carry out the earnings management by increasing the number of them. This case was researched by Ardiati [8] and Qiang et.al. [7] They found that the action of earning management had the influence to stock share return. Corporate governance with the lower ranking will give the lower return because the risk is higher. Aman and Pascal [9] presented that institutional property had the influence to stock share return.

Based on the theory and results of previous researchers as above, institutional property influenced the stock share return which was mediated by earnings management. Institutional investor which has the access of information source with more accurate time and relevant can know the existence of earning management is faster and easier because the stock share property is more than the personal investor. The institutional investor can monitor the activity which is carried out by manager (agent). Therefore the performance of company will influence stock share rate due to the trust of investor, so that the company can produce return for investor. This case is occurred if it is mediated by an action which can minimize the behavior of earnings management.

The relation between earnings management and stock share return

Earning management is one of some motivations for synchronizing the expectation of investor earning [10]. The managers had a strong incentive to make certainty that the expectation of income could be reached mainly if they had the other compensations which was still related to the stock share rate. One of the manners was to carry out the earnings management by increasing the number of them. If the expectation was not reached, so the reason was when the manager could not find more earning management to pursue the deficit, the incoming company profit was poor and the company was not well managed because the company could not be predicted the incoming profit itself. The impact was the reputation of manager would be bad and the company became weak.

Ardiati [8] evaluated the relation between the earnings management and the pattern of income increasing and decreasing to the stock share return (response of investor). It indicated that there was not the influence difference of earnings management to stock share return between the emitter which carried out the earnings management with the pattern of income decreasing. In addition, the market response to the income increasing obtained the empirical proof that the influence of earnings management to the stock share return was not bigger for the emitter which had accrual discretionary caused the income decreasing that was compared with the emitter which had accrual discretionary caused income increasing.

The pattern of earnings management which was measured using the accrual discretionary was due to the manager motivation to reach the certain aim. The manager motivation for increasing the stock share rate stimulates them to inform that the earnings were always increasing. Therefore, the investors will be interesting to invest in the company with the idea that the infestation will produce return.

The relation between leverage ratio and stock share return

The more credit of a company causes the more possibility of company failure and it was not to be able to pay the credit, so it has the risk of bankrupt. The impact was the stock share market will react negatively such as the decreasing of stock share trading volume and stock share rate which caused the decreasing of stock shareholder [11]. In addition, there was an impression that the more credit indicated the company had difficulty in funding through stock share selling in market and there was an assumption that the more credit would cause the company was not been interested by the investors or candidates investor in stock share market.

Ulupui [12] presented that debt to asset ratio did not influence the stock share return. This result was not the same as the study of Sunarto [13]. He expressed that debt to asset ratio had the influence to stock share return. It indicated that company with low debt asset ratio would have the finance risk less when the economic condition decreased and it had the chance to obtain profit lower when the economy was good.

Based on the theory and the results of previous researchers as above, it could be described that the leverage ratio influenced the stock share return and it was mediated by earnings management. Company with high leverage ratio would cause the stock share rate of company became low so that the return was also low. This condition caused the manager making effort to increase the stock share return of company. This case was carried out with mediating by an action of earnings management which could increase the company profit.
The influence of leverage ratio to the stock share return mediated by earnings management

Debt covenant hypothesis of positive accounting theory presented that the closer a company with the violation of credit agreement based on accounting was more allowed the company manager to select the accounting procedure which moved the reported profit from the next period to now [14]. This case had been observed by Mammedova [15] and Astuti [16] that found the leverage ratio influenced earnings management.

Stock share return

Return was the result from infestation [17]. This expression was also supported by Gitman [18]. Gitman presented that return was the profit total of the harmless on the infestation during the certain period. Return total of infestation in certain period included the capital gain (loss) and yield. Capital gain (loss) is the difference between the relative infestation rate at present and the rate at the period before. Yield is the percentage of periodical cash accepting due to investment rate of the certain period of an infestation. The formula is as follow

\[ \text{Return} = \text{capital gain (loss)} + \text{yield} \]

\[ \text{Capital gain (loss)} = \frac{P_n - P_{n-1}}{P_{n-1}} \]

\[ \text{Yield} = \frac{D_t}{P_{n-1}} \]

Note:

- \( P_n \) = stock share rate at present
- \( P_{n-1} \) = stock share rate at the period before
- \( D_t \) = dividend at present

Fisher and Jordan [20] also presented that return included two components such as yield and capital gain. Capital gain is the difference between the relative stock share rate at present and at the period before, but dividend yield is the division result of dividend at present and stock share rate at the period before [20].

RESULTS AND DISCUSSION

Table 1 Line analysis coefficient of direct, indirect, and total influence

<table>
<thead>
<tr>
<th>Variable</th>
<th>Direct influence</th>
<th>Line coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>institutional property</td>
<td>-0.0361</td>
<td>Stock share return</td>
</tr>
<tr>
<td>managerial property</td>
<td>-0.1932</td>
<td></td>
</tr>
<tr>
<td>proportional independent board of director</td>
<td>-0.2282</td>
<td></td>
</tr>
<tr>
<td>standard board of director</td>
<td>0.0494</td>
<td></td>
</tr>
<tr>
<td>Leverage ratio</td>
<td>0.0203</td>
<td></td>
</tr>
<tr>
<td>Earnings management</td>
<td>-0.197</td>
<td></td>
</tr>
<tr>
<td>Institutional property</td>
<td>0.0145</td>
<td>Stock share return</td>
</tr>
<tr>
<td>Managerial property</td>
<td>0.0263</td>
<td>(+0.0164 x -0.1597)</td>
</tr>
<tr>
<td>Proportional independent board of director</td>
<td>0.0172</td>
<td>(+0.1080 x -0.1597)</td>
</tr>
<tr>
<td>Standard board of director</td>
<td>0.0048</td>
<td>(-0.0298 x -0.1597)</td>
</tr>
<tr>
<td>Leverage ratio</td>
<td>-0.0877</td>
<td>(0.5943 x -0.1597)</td>
</tr>
<tr>
<td>Earnings management</td>
<td>-0.0216</td>
<td>(-0.0361 + 0.0145)</td>
</tr>
<tr>
<td></td>
<td>-0.1669</td>
<td>(-0.1932 + 0.0263)</td>
</tr>
<tr>
<td></td>
<td>-0.211</td>
<td>(-0.2282 + 0.0172)</td>
</tr>
<tr>
<td></td>
<td>0.0542</td>
<td>(0.0494 + 0.0048)</td>
</tr>
<tr>
<td></td>
<td>-0.0674</td>
<td>(0.0203 + -0.0877)</td>
</tr>
</tbody>
</table>

Direct influence

Based on the result as in Table 1 the direct influence could be described as follow

1. The determination coefficient \( R^2 \) was 0.3735. It indicated that the institutional property (X1), managerial property (X2), proportional independent board of director (X3), and standard board of director (X4) described the stock share return of 37.35%.
2. Direct line coefficient of institutional property to stock share return was -0.0361. The negative value indicated that the institutional property had negative influence to the stock share return. Therefore, if
the institutional property increased, so the stock share return would decrease, and if the institutional property decreased, so the stock share return would increase of 0.0361.

3. Direct line coefficient of managerial property to the stock share return was -0.1932. The negative value indicated that managerial property had the negative influence to the stock share return. Therefore, if the managerial property increased, so the stock share return would decrease, and if the managerial property decreased, so the stock share return would increase of 0.1932

4. Direct line coefficient of proportional dependent board of director to the stock share return was -0.2282. The negative value indicated that proportional independent board of director had the negative influence to the stock share return. Therefore, if the proportional dependent board of director increased, so the stock share return would decrease, and if the proportional dependent board of director decreased, so the stock share return would increase of 0.2282

5. Direct line coefficient of standard board of director to the stock share return was 0.0494. The positive value indicated that standard board of director had the positive influence to the stock share return. Therefore, if the standard board of director increased, so the stock share return would increase, and if the standard board of director decreased, so the stock share return would decrease of 0.0494.

Indirect Influence

Based on the result as in Table 1 the direct influence could be described as follow

1. Direct line influence of line coefficient was the influence of institutional property to the stock share return which was mediated by the earnings management of 0.0145 (-0.0906 x -0.1597). It indicated that the influence of institutional property to the stock share return which was mediated by earnings management was 0.0145

2. Direct line influence of line coefficient was the influence of managerial property to the stock share return which was mediated by the earnings management of -0.0263 (-0.1644 x -0.1597). It indicated that the influence of managerial property to the stock share return which was mediated by earnings management was 0.0263

3. Direct line influence of line coefficient was the influence of proportional independent board of director to the stock share return which was mediated by the earnings management of 0.0172 (-0.1080 x -0.1597). It indicated that the influence of proportional independent board of director to the stock share return which was mediated by earnings management was 0.0172

4. Direct line influence of the standard board of director to the stock share return which was mediated by the earnings management was 0.0048 (-0.0298 x -0.1597). It indicated that the influence of standard board of director to the stock share return which was mediated by the earnings management of -0.0048

5. Direct line influence of line coefficient was the influence of leverage ratio to the stock share return which was mediated by the earnings management was -0.0877. It indicated that the influence of leverage ratio to the stock share return which was mediated by the earnings management was -0.0877

The influence of earnings management to the stock share return

Based on the recapitulation of result as above, the earnings management influenced the stock share return with the significant value of 0.0211 (<0.05). Line coefficient for the variable of earnings management to the stock share return was -0.1597. If the earnings management increased, so the stock share return would decrease, and if the earnings management decreased, so the stock share return would increase with the value of 0.1597.

The result as above supported the research of Qiang et.al. [7]. He presented that the total of discretionary accrual has the positive relation with the stock share return. The other motivation of earnings management was to unite the profit expectation of investor [10]. Managers had a strong incentive to make certainty the expectation to their income that could be reached, especially if they had the other compensations which was still related to the stock share rate. One of the manners to carry out the case was the earnings management by increasing the number of them. If the expectation did not reached, so the market would present the reason that if the manager could not find enough of earnings management to go away from the deficit, so the incoming income of the company would be faded and the company did not be well managed because they could not predict their future themselves. The consequence was reputation of the manager would be bad and stock share of the company became weak too.

Ardiati [8] had studied the relation between earnings management with the pattern of income increasing and decreasing to the stock share return (response of investor). It indicated that there was no difference on the influence of earnings management to the stock share return on the emitting which carried out the income between the increasing and decreasing of earnings management. Study on the market response to income increasing produced the empirical proof that the influence of earnings management to the stock share return was not bigger for the emitting of discretionary accrual with income decreasing than income increasing. The patterns of earnings management which were measured using the discretionary accrual was not relieved from the manager motivation for reaching the certain aim. The manager motivation for increasing the stock share rate...
could push them to inform the increasing earnings. Therefore the investors would be interested to invest on the company with the expectation that the infestation would produce the expected stock share return.

The influence of institutional, managerial property, proportional independent board of director, standard board of director to the stock share return

Based on the result of statistical analysis, the corporate governance influenced the stock share return with the significant value of 0.000 (<0.05). Coefficient determination ($R^2$) was 0.3736. It indicated that the institutional property, managerial property, proportional independent board of director, and standard board of director described the stock share return with the percentage of 37.6% but the rest of 62.64% could be described by the other variables. This result supported the research of Aman and Pascal [9], and Drobetz et.al.[20]. They expressed that the company management with the lower ranking would give the lower return because there was the higher risk, but the company management with the higher ranking would produce the higher profit because there was the lower risk.

The better corporate governance of a company would give influence to the process of finance reporting so that the report had the responsive strength which could give the positive reaction for the interest sides like stock share holder that hoped to get the return of their infestation. System of corporate governance gave the effective protection for the stock shareholder and the creditor so that they believed to be going to get really the return of their infestation [21].

The influence of leverage ratio to stock share return

Based on the statistical analysis, the leverage ratio did not influence the stock share return with the significant value of 0.7336 (>0.05). The line coefficient of leverage ratio to the stock share return was 0.0203. If the leverage ratio increased, the stock share return would increase too, on the other hand if the leverage ratio decreased, the stock share return would decrease with the value of 0.0203.

This result supported the research of Ulupui [12]. He found that the leverage ratio which was measured using debt asset ratio did not influence the stock share return, but this result did not support the research of Sunarto [12]. It indicated that debt to asset ratio had the influence to the stock share return because the more credit of a company, so the bigger possibility of company failure not to be able to pay the credit, so that it had the risk of bankrupt. The consequences was stock share market would react negatively such as the decreasing of stock share trading volume and the stock share rate. It gave impact to the decreasing on the stock shareholder [11].

In addition, result of this study indicated that leverage ratio did not cause the change of stock share return. This result was not significant, by no mean that the investor could ignore the credit ratio of a company. The higher proportional credit caused the higher fixed payment and it would cause the risk of bankrupt.

The influence of institutional property to the stock share return mediated by earnings management

Based on the result of statistical analysis, the institutional property did not influence the earnings management with the significant value of 0.1651 and the earnings management influenced the stock share return with the significant value of 0.022. The line analysis showed that the indirect influence coefficient of institutional property to the stock share return mediated by earnings management was 0.0145. This value was smaller than the direct influence with the value of 0.0361, so that the earnings management as intervening variable gave the weak influence.

Result of this study was suitable with the research of Aman and Pascal [9]. They presented that the institutional property influenced the stock share return. Institutional investor which had the access of information source with accurate time and relevant could detect the existence of earnings management more quickly and easily because the stock share property belonged to him was bigger then personal investor so that could decrease the earnings management. Therefore the institutional investor was as the side which could monitor the activity that was carried out by manager (agent). The consequence was the company performance would influence the stock share rate because there was the trust of investor so that the company could produce the return for investor.

The influence of managerial property to the stock share return mediated by earnings management

Based on the result of statistical analysis, the managerial property influenced the earnings management with the significant value of 0.0032 and earnings management influenced the stock share return with the significant value of 0.0220. Analysis of line showed that the indirect influence on the coefficient of managerial property to the stock share return mediated by earnings management was 0.0263. This value was smaller than the direct influence with the value of 0.01932, so that the earnings management as intervening variable was still weak because the direct influence coefficient was bigger the indirect influence.

This result was fitted to the research of Aman and Pascal [9]. They presented that the managerial property influenced the stock share return Manager as the decision maker in the company had to be able to work well and
maximal, so that could produce well company performance as well as influence the stock share rate. Therefore stock share property of manager was necessary to more increasing in order to decrease the earnings management. If the company performance was good, so there was the investor trust and it was certainly get the return.

The influence of proportional independent board of director to the stock share return mediated by earnings management

Based on the result of statistical analysis, the proportional independent board of director influenced the earnings management with the significant value of 0.0328 and the earnings management influenced the stock share return with the significant value of 0.0220. Line analysis showed that the coefficient of indirect influence on the proportional independent board of director to the stock share return mediated by earnings management was 0.0172. This value was lower than the direct influence with the value of 0.2282, so that the earnings management as intervening variable was still weak because the direct influence coefficient was higher than the indirect influence.

This result was fitted to the research of Aman and Pascal [9] and Drobetz et.al. [20]. They presented that the proportional independent board of director influenced the stock share return. The more meeting on the board of director would cause the quality of financial report could be more trusted because there was well monitoring and the company performance was also good so that could increase the earnings management. Hence, it would give trust for the investors to invest which would produce the return to them.

The influence of standard board of director to the stock share return mediated by earnings management

Based on the result of statistical analysis, the proportional independent board of director did not influence the earnings management with the significant value of 0.6290 and the earnings management influenced the stock share return with the significant value of 0.0220. Line analysis showed that the coefficient of indirect influence on the standard board of director to the stock share return mediated by earnings management was 0.0048. This value was smaller than the coefficient of direct influence with the value of 0.0494, so that earnings management as the intervening variable was still weak because the coefficient of direct influence was higher than the indirect influence.

This result was fitted to the research of Drobbetz et.al. [20]. He expressed that the standard board of director influenced the stock share return. The more number of board of director would cause the quality of financial report could be trusted because there was the better monitoring so that could show the company performance was also good and it could decrease the earnings management. Hence, it would give impact to the stock share return so that investors had a trust to invest which would produce the return to them.

The influence of leverage ratio to the stock share return mediated by earnings management

Based on the result of statistical analysis, the leverage ratio influenced the earnings management with the significant value of 0.0000 and the earnings management influenced the stock share return with the significant value of 0.0220. Line analysis showed that the coefficient of indirect influence on the leverage ratio to the stock share return mediated by earnings management was -0.0877. This value was higher than the direct influence with the value of 0.0203. Therefore earnings management as the intervening variable had the strong influence because the coefficient of direct influence was smaller than the indirect one.

Company with high leverage ratio would cause the stock share rate of the company became low so that the return was also low. This condition caused the manager made an effort to increase the stock share rate of the company. It was carried out with being mediated by earnings management which was able to increase the company profit.

CONCLUSION

Based on the analysis and result as above, it was concluded as follow:

1. The earnings management influenced the stock share return. This result indicated that the motivation of manager for increasing the stock share rate could stimulate them to inform the continuous increasing of earnings.
2. The institutional property, managerial property, proportional independent board of director, and standard board of director which were as the determining factors of corporate governance gave the positive signal on the well response market of stock share rate increasing for producing the returns. Therefore, management with lower ranking would give the lower return because there was the higher risk and on the contrary management with higher ranking would give the higher return.
3. The direct influence of institutional property, managerial property, proportional independent board of director, and standard board of director to the stock share return had the coefficient value higher that
the indirect influence which was mediated by earnings management. Therefore the earnings management which was functioned as the intervening variable gave the weak influence.

4. The direct influence of leverage ratio to the stock share return had the coefficient value lower than the indirect influence which was mediated by earnings management. Therefore the earnings management which was functioned as the intervening variable gave the strong influence.

REFERENCES


