EARNING RESPONCE ANALYSIS OF COMPANIES IN THE INDONESIA STOCK EXCHANGE REVIEWING FROM COMPANY SIZE AND INCOME SMOOTHING

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**Abstract:**

The capital market is a meeting place for investors as owners of funds with issuers as companies seeking funds. Issuers offer shares to investors to meet the company's funding needs. Varied stock prices provide investors with a choice to invest their capital. Investors seek profits by investing their funds in issuers, so that the issuers provide returns to investors. In making a decision to invest, an investor needs a financial report to find out information and be taken into consideration if investors want to invest. The financial report itself is a tool to obtain financial information and the performance of a company. The approach used in this research is a quantitative approach. The sampling technique used in this study is a non-probability technique. The test results show that size has no significant effect on earning response. This negative relationship is because the amount of information available throughout the year on large companies will cause investors to react less when the earnings announcements are announced. The test results for the income smoothing variable are known that the regression coefficient is positive at 2.242. The t-statistical test for the Income Management variable obtained the t-count value of 2.242, which is greater than the t-table value of 1.668. The significance value obtained is 0.029, which is smaller than the predetermined significance value of 0.05. This shows that income smoothing has an effect on the market reaction of the company.

***Keywords:***  *Company Size, Income Smoothing, Earning Response,*

# Introduction

The capital market is a meeting place for investors as owners of funds with issuers as companies seeking funds. Issuers offer shares to investors to meet the company's funding needs. Varied stock prices provide investors with a choice to invest their capital. Investors seek profits by investing their funds in issuers, so that the issuers provide returns to investors. Return is a return or return on funds that have been invested.

Investment in the capital market contains an element of uncertainty or risk, because investors do not know with certainty the results that will be obtained from their investments. Investors only estimate the expected profit from their investment and how far it is likely that the actual results will deviate from the expected results (Edwantiar, 2016). Investors estimate the return of their preferred stock before buying it. Investors assess the performance prospects of issuers so that investors have an idea of the expected return on the funds that have been or will be invested. Expected return is an estimate of the return on the funds invested.

The market reaction is indicated by a change in the price of the securities in question (Alwiyah, & Solihin, 2015). Changes in share prices are due to actions by investors or potential investors regarding the company in question. The action can be in the form of buying, holding, or selling shares. Investors make decisions to buy or sell shares because they get information on an event. Only the buy or sell decision can make the stock price change. This is because there is a demand for the number of shares with an offer for the number of shares available. Investors or potential investors who make purchases will increase the number of requests for the shares in question. Meanwhile, investors who sell their shares will increase the number of offerings. The large number of requests for shares that exceed the supply of the number of shares available makes the stock price move up. On the other hand, the higher the number of shares sold by the shareholder than the demand for the purchase of the shares, the price will decrease.

In making a decision to invest, an investor needs a financial report to find out information and be taken into consideration if investors want to invest. The financial report itself is a tool to obtain financial information and the performance of a company.

The financial statements in question are commercial financial reports. According to Kasmir, "financial statements are reports that show the current financial condition of the company or at a certain time" (Kasmir, 2017). Thus, the financial statements should be complete, accurate and can be justified because they are used as a reference in making decisions for investors and potential investors.

In addition, financial reports are also expected to be a means to attract potential investors. Earning Response Coefficient (ERC) is a form of measuring information in earnings (Herdirinandasari, Sherla Sherlia, 2016). Does the earnings information reflect the actual situation, so that it can be used in decision making, and can also increase the benefits of decisions in making financial reporting. Therefore, it is not uncommon for managements to engineer their financial statements or we are familiar with the term creative accounting. One way of creative accounting is by doing earnings management, especially the practice of income smoothing. Income smoothing is the satisfaction of shareholders increasing along with the stability of the company's profits (Herdirinandasari, Sherla Sherlia, 2016).

The practice of income smoothing shows managers' efforts to use their reporting policies with the intention of reducing the surge in company profits (Sanjaya, W., & Suryadi, 2018). Another way that can be done is to stabilize the position of assets or debts they have. This is expected to make investors feel quite safe and risk-free, because if the position of assets and debt is too volatile, it is feared that it will create a risk of anxiety about guaranteeing business continuity in the future. Therefore, the sensitivity of investors to profit growth, asset growth and debt growth are seen as triggers and reasons for the practice of income smoothing. All of this is done only to maintain the good name of the company in the eyes of the public, especially stakeholders so that it is expected to provide a positive response to market reactions (earnings response) (Fauzan, M., & Purwanto, 2017).

In reality, the beauty of the financial statements published by issuers in reality does not necessarily make investors interested and willing to invest so that it does not cause investors to be interested and willing to invest which does not result in the stock price of a company going up, instead experiencing a downward trend even though the financial statements are quite good. . This proves that the phenomenon of increasing profits and good financial performance does not always increase profits and good financial performance is not always directly proportional to stock prices also occurs in the ranks of issuers with high liquidity (blue chips). Therefore, the researchers were inspired to conduct research on the factors that influence the market reaction (earnings response) with asset growth, debt growth (liabilities growth), and income smoothing practices as independent variables.

# Research Method

The approach used in this research is a quantitative approach. The quantitative approach emphasizes testing theories through measuring research variables with numbers and analyzing data with statistical procedures (Indriantoro, 1999). Based on the research explanation, this research is in the form of associative research with causality type. Sugiyono said that associative research with the type of causality is research that explains the influence of independent variables on the dependent variable (Sugiyono, 2019).

The sampling technique used in this study is a non-probability technique. According to Sugiyono, non-probability sampling is a sampling technique that does not provide equal opportunities or opportunities for each element or member of the population to be selected as a sample (Sugiyono, 2019). While the method used in this sampling is purposive sampling. The samples used in this study were 12 manufacturing companies listed on the Indonesia Stock Exchange.

Quantitative analysis using simple linear regression statistics. Simple regression analysis is a regression analysis between one variable Y and one variable X which measures the effect between variable X (income smoothing and firm size) and variable Y (earnings response). This simple regression analysis method is carried out with the help of the SPSS 25 program which is one of the computer program packages that process statistical data (Atmaja, 2009).

# Results and Discussion

# Results

**Impact of Covid-19 on Retail Growth in Indonesia**

Simple linear regression analysis was used to determine the effect of the independent variable individually (partial) on the dependent variable. This study examines the effect of income smoothing on market reaction, the effect of firm size on market reaction, the effect of income smoothing and firm size on market reaction. This analysis was processed using a computer program for statistical data processing.

**Table 1. Partial Test Results (t test)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Coefficientsa** | | | | | | |
| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
| B | Std. Error | Beta |
| 1 | (Constant) | 25.905 | 1.969 |  | 13.159 | .000 |
| Company Size | .032 | .023 | .169 | 1.353 | .181 |
| Income Smoothing | 1.834 | .818 | .281 | 2.242 | .029 |

Based on the table above, the regression model used is as follows.

Y = 25,905 + 0,032X1 +1,834X2

Based on the regression model and the table above, the results of simple linear regression can be explained as follows:

1. Constant of 25.905, meaning that if the Earning Response and income smoothing variables are assumed to be constant, the Earning Response is 25.905
2. The variable size of the company is 0.032, meaning that every time there is an increase in the size of the company by 1 point, there will be an increase in Earning Response of 0.032.
3. Variable income response is 1.834, meaning that every time there is an increase in Income Smoothing by 1 point, there will be an increase in Earning Response of 1.834

Based on the coefficients table above, it can be explained partially the relationship between variables as follows:

1. The Effect of Firm Size on Earning Response

Company size has an effect on Earning Response. Based on the t value: It is known that the calculated t value is 1.353 t table 1.668 and the significant value is 0.181> 0.05, then Ho is accepted (rejected Ha) so it can be concluded that the firm size variable has no effect on earning response

1. The Effect of Income Smoothing on Earning Response

Income Smoothing has an effect on Earning Response. Based on the t value: It is known that the calculated t value is 2.242 t table 1.668 and a significant value of 0.028 <0.05, then Ho is rejected (accepted Ha) so it can be concluded that the income smoothing variable has a positive effect on the earning response variable.

Multiple linear regression analysis was used to determine the effect of income smoothing and firm size simultaneously (simultaneously) on the market reaction. This analysis was processed using a computer program for statistical data processing and the following results were obtained:

**Table 2. Simultaneous Test Results (F Test)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **ANOVAa** | | | | | | |
| Model | | Sum of Squares | df | Mean Square | F | Sig. |
| 1 | Regression | 362.301 | 2 | 181.151 | 3.423 | .039b |
| Residual | 3016.847 | 57 | 52.927 |  |  |
| Total | 3379.148 | 59 |  |  |  |

Based on the table above, it can be seen the effect of all independent variables consisting of company size and income smoothing together (simultaneously) on the dependent variable earning response. In the results of the simultaneous significance test, the calculated F value was 3.423 with a significance level of 0.039. This value is smaller than 0.05, so it can be said that company size and income smoothing together (simultaneously) have an influence on Market Reaction in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2016-2019 period.

**Table 3. Results of the Coefficient of Determination**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Model Summary** | | | | |
| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
| 1 | .327a | .107 | .076 | 7.27510 |

Based on the table above, the value of R square which is a symbol of the correlation coefficient shows the value of 0.107. This value can be interpreted that the relationship between the three variables, namely company size, income smoothing and earning response in this study is in the weak category. Through this table also obtained the value of R square or Coefficient of Determination which shows a value of 0.107, which means that the variable company size and Income Smoothing have a contribution of 10.7% to the Y variable or Earning Response. while 89.3% is influenced by other variables.

# Discussion

1. **The Effect of Firm Size on Earning Response**

Based on the partial test results presented in the table above, it can be seen that the t count is 1.353 < 1.668 with a significance level of 0.181 > 0.05. This shows that the variable size partially has a positive and insignificant effect on earnings response in manufacturing companies listed on the Indonesia Stock Exchange for the 2016-2019 period.

The test results show that size has no significant effect on earning response. The results of this study are in line with research conducted by Chaney and Jeter (1991) who argue that size has no effect on earning response. This negative relationship is because the amount of information available throughout the year on large companies will cause investors to react less when the earnings announcements are made.

Company size is a variable to measure how big or small the sample company is. The size of the company can be expressed in terms of total assets, sales, and market capitalization. Company size is one of the factors that affect ERC (Naimah and Utama, 2008). The greater the total assets, sales and market capitalization of a company, the greater the size of the company. Large companies provide a lot of non-accounting information throughout the year. This information is used by shareholders as a tool to better interpret financial statements, so that it can be used as a tool to predict cash flows and reduce uncertainty. The amount of information available throughout the year on large companies has an impact on the market being less responsive to earnings announcements.

Firm size is used as a proxy for share price informativeness to examine the relationship between firm size and earnings response in the long term (long window). The more sources of information in large companies, the lower the earning response value. The size of the company that affects the earning response, causes every investor to know all the information related to the company's data in detail.

1. **Effect of Income Smoothing on Earning Response**

Income Smoothing is income smoothing which is an action in which managers intentionally reduce fluctuations in reported earnings in order to achieve the desired profit level. As well as earnings management, the smoothing concept is motivated by agency theory, it is assumed that owners and management both have an interest in maximizing the respective utility of the information they have.

Testing this hypothesis is done by simple linear regression analysis and statistical t test. The test results for the income smoothing variable are known that the regression coefficient is positive at 2.242. The t-statistical test for the Income Management variable obtained the t-count value of 2.242, which is greater than the t-table value of 1.668. The significance value obtained is 0.029, which is smaller than the predetermined significance value of 0.05. This shows that income smoothing has an effect on market reactions in manufacturing companies listed on the Indonesia Stock Exchange for the 2016-2019 period. Thus, it can be said that the hypothesis that income smoothing has a positive effect on market reactions in manufacturing companies listed on the Indonesia Stock Exchange for the 2016-2019 period is accepted.

Companies that perform Income Smoothing tend to make the market react. The market that reacts can be seen in the abnormal return. Stable profits will attract investors to buy shares of related companies. The smaller the income smoothing index, the higher the market reaction. Based on the results of research that has been carried out, Income Smoothing has an effect on Market Reaction, meaning that the company performs income smoothing to change market response. This shows that income smoothing is appropriate if it is used as a basis for making decisions for investors to buy shares.

These results are in line with the results of previous research by Amrie Firmansyah (2019) with the title "The Effect of Income Smoothing, Dividend Leverage Policy and Company Size on Earning Response Coefficent and Future Earnings Response Coefficient". The results of the study found that Income Smoothing has a positive effect on ERC, investors are under the action of income Smoothing by managers in the company will increase the informativeness of current earnings because investors consider income smoothing is an act of efficiency of managers in generating profits.

1. **The Effect of Firm Size and Income Smoothing Variables Together on Earning Response**

From the results of simultaneous testing between the variables of Company Size and Income Smoothing on Earning Response, it is obtained a significance value of 0.039 <0.05, so these results show that together the variables of firm size and income smoothing have an effect on earning response. The magnitude of the effect based on the coefficient of determination of 10.7%. The rest there are 89.3% of other factors that influence the unknown.

The magnitude of the influence of the three variables that have been tested can be assumed to affect the three variables in the low category which is less than 50% of the magnitude of the effect. of the three variables that have been analyzed, it can be seen that the income smoothing variable is the most influencing factor among the other variables. However, this can be indicated that there are still many other factors or variables that can cause an increase or growth in earning response or market reaction that can stimulate consumer and investor interest. The results of this study have answered the third hypothesis that together when tested will have a significant influence on market response.

# Conclusion

Based on the results of data analysis and discussion in the previous chapter, it can be concluded as follows:

The test results show that size has no significant effect on earning response. This negative relationship is because the amount of information available throughout the year on large companies will cause investors to react less when the earnings announcements are announced.

The test results for the income smoothing variable are known that the regression coefficient is positive at 2.242. The t-statistical test for the Income Management variable obtained the t-count value of 2.242, which is greater than the t-table value of 1.668. The significance value obtained is 0.029, which is smaller than the predetermined significance value of 0.05. This shows that income smoothing has an effect on market reactions in manufacturing companies listed on the Indonesia Stock Exchange for the 2016-2019 period. Thus, it can be said that the hypothesis that income smoothing has a positive effect on market reactions in manufacturing companies listed on the Indonesia Stock Exchange for the 2016-2019 period is accepted.

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