The Influence of Real Earning Management toward to Stock Returns

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Abstract: This study uses the independent t test which shows that there is no significant difference between real earnings management and non-real earnings management in returning stock returns. While the dummy regression test results show the correlation between Real Earnings Management and Stock Return shows a very low relationship, there is a positive but insignificant relationship between stock returns based on real earnings management actions.

Keywords: Real Management, Stock Returns

1. Introduction

The phenomenon of fraud in reporting financial conditions has occurred in large companies such as Xerox, Eron, Worldcom, Adelphia, Microstrategy, and others (Stice et al. 2007). Earning case management by means of illegal (financial fraud) which received public attention, mostly carried out by large companies, such as Enron Co.,, Xerox Co.,, WordCom, and the Walt Disney Co.,. Enron Co., was proven to have manipulated profits, namely manipulating Enron executives through its auditors so as to increase profits of USD 1 billion, WordCom was proven to have manipulated accounting for USD 4 billion on the expense side. This scandal allegedly involved Arthur Andersen and the Walt Disney Company who were proven to have performed accounting revenue manipulation, namely manipulating accounting data for two fiscal years by reporting false earnings (Rama, 2010).

Indonesia Corruption Watch (ICW) reported the predicted to manipulate of reports on the sale of three coal mining companies belonging to the Bakrie Group to the Directorate General of Taxes. ICW engineering reporting carried out by PT Bumi Resources Tbk., Along with its branch offices during 2003-2008 has cost the state US $ 620.49 million. ICW Budget Monitoring and Analysis Division Coordinator, Firdaus Ilyas, predicted manipulation of the sales report occurred by PT Kaltim Prima Coal (KPC), PT Arutmin Indonesia and PT. Bumi. Tbk. The results of ICW calculations through primary data and audited financial reports show that the sales report of Bumi during 2003-2008 was US $ 1.06 B lower than the actual value so that it was estimated that the state suffered losses due to the receipt of coal production funds or royalties of US $ 143.18 million so that Land tax underpaid of US $ 477.29 million.

McNichols, M. (1989) found that stock prices display information beyond management's earnings estimates because investors access some information that managers don't have. Bansal, and Choudhary. (2021) find that investors perceive the decline in REM as an element of risk; hence, they discount the share price at a higher rate. The increase in REM brings positive things because it can suppress the rate of return on shares. Dela Cruz, A. L. C. (1999) show that earnings management does not have a significant effect on stock returns in the short term. Tabassum, N., Kaleem, A., & Nazir, MS (2013 found that the effect of Real Earnings Management on the resulting financial performance is negative. Lasdi, L. (2013) examined the effect of SarbOx on earnings management behavior, which shows earnings management has shifted from Accrual management to real account management. Rachmawati (2020) shows that intellectual capital has a negative effect on real earnings management. Likewise,

profitability strengthens the effect of intellectual capital on real earnings management, income growth as a control variable has a significant effect on real earnings management.

Farichah Farichah (2017) stated that management compensation and auditor reputation motivate to carry out earnings management, and have a negative effect on earnings management and company stock returns. Weerathung et.al. (2020) show that earnings management as a whole does not decline following the convergence of IFRS. However, post-IFRS earnings management varies downwardly among large firms to keep pace with the convergence of IFRS earnings management. Salehi et.al (2018) shows a significant and positive relationship between company earnings quality and stock returns, meaning that earnings management and disclosure quality (DQ) are not significantly related to company stock returns. Firdiansjah et.al (2020) show that the duality of CEO and CSR has a significant effect on ROA and CSR. ROE if the company does earnings management. Simultaneously, it shows that CEO Duality has a negative and significant effect, but CSR has a positive and insignificant effect on earnings management, while earnings management has a significant effect on ROA and ROE. Lock et.al (2019) analyzed various scenarios of exchange rate movements which found that exchange rate movements did contribute to earnings management by companies when the exchange rate weakened. However, earnings management does not have a significant relationship with the strengthening of foreign currency exchange rates. In addition, management earnings have a positive effect on annual stock returns in Malaysia. Dechow et.al (1995) stated that it is important to control financial performance when finding earnings management to be simultaneously correlated with financial performance.

Jessica, V. (2020) found that firm characteristics can highlight earnings management behavior significantly. Li, X. (2010) found that real earnings management (REM) actions are related to stock returns. There is a relationship between the company that is greater than the occurrence of earnings management actions in normal operating cash flows and production costs. The reason we chose to conduct research on Infrastructure, Utility and Transportation Sector Companies listed on IDX is because these companies have an important role in driving the economic sector in Indonesia in the traffic of goods and community activities in Indonesia. Based on the phenomena and previous research, the authors are interested in conducting research with the aim of:

1. To test the difference in the mean unpaired samples in performing earnings management.
2. To see the effect of real earnings management on stock returns.

This phenomenon and previous research motivated us to conduct a scientific study entitled: **"The Influence of Real Earning Management toward to Stock Returns".**

2. Literature Review

Jaworski and Young (1992) define dysfunctional behavior as the behavior of a subordinate who tries to manipulate the control system et. for personal purposes intentionally meddling with or violating rules and procedures. In this regard, there are 2 (two) things that are related, namely: 1) Gaming Performance Indicator. (Ridgway 1956; Binberg et.al 1983; Kerr 1974); 2) Strategic Information Manipulation (Binberg et al. 1983). Scientific study related to dysfunctional behavior show a strong relationship between locus of control and an individual's willingness to manipulate and cheat (Gable and Dangello 1994; Comer 1985; Solar and Bruehl 1971).

According to Roychowdhury (2006: 337), earnings management through real activities manipulation is a management action that ignores the company's normal business practices to achieve profit targets as the main goal. However, the profit target achieved does not always contribute to company value even though the target has been achieved. Management of earnings through manipulation of real activities is carried out by management through the daily operations of the company in the current period. Meanwhile, earnings management through accrual manipulation can be done during the company's current accounting period. According to Roychowdhury (2006: 340), earnings management through real activities manipulation is carried out through cash flow from operations, production costs, and discretionary spending.

Manipulation of real activities can be detected through cash flows from operations using abnormal operating cash flows (ABN_CFO) obtained from the difference between actual cash flows from operations (measured by total assets in the previous period) and cash flows from normal operating activities using the estimated coefficient of the following regression equation.

$$CFOt / At\text{-}1 = \alpha 0 + \alpha 1\ (1 / At\text{-}1) + \alpha 2\ (St / At\text{-}1) + \alpha 3\ (\Delta St / At\text{-}1) + \varepsilon t \quad (1)$$ (Roychowdhury, 2006: 344)

Real activity manipulation can be detected through discretionary expenditure using abnormal discretionary expenditure (ABN_DISEXP) which is obtained from the difference between actual discretionary expenditure (scaled to total assets in the previous period) and normal discretionary expenditure using the estimation coefficient of the regression equation model as follows:

DISEXPt / At-1 = a0 + a1 (1 / At-1) + β (St / At-1) + et (2) (Roychowdhury, 2006: 345)

Real activity manipulation can be detected from production costs by using abnormal production costs (ABN_PROD) which can be obtained by looking at the difference between actual production costs (measured by total assets in the previous period) and abnormal production costs using the coefficient estimation of the following regression equation models:

PRODt / At-1 = a0 + a1 (1 / At-1) + β1 (St / At-1) + β2 (DSt / At-1) + β3 (DSt-1 / At-1) + et (3) (Roychowdhury, 2006: 345). For details, see the following formulas:

EMR (Real Income Management) = AbnCFO * (- 1) + AbnDISEXP * (- 1) + AbnPRO

According to Tandelilin (2010), stock returns consist of: a. Capital Gain (Loss), namely an increase (decrease) in the price of a share which can provide profit (loss) for investors; and B. Yield is a component of return that reflects cash flow or income obtained periodically from a stock investment. Jogiyanto (2013: 235) states that stock returns are the results obtained from stock investments. Returns can be in the form of realized returns that have occurred or expected returns that have not occurred but are expected to occur in the future. The definition of stock return from Brigham and Houston (2019) is the difference between the amount received and the amount invested divided by the amount invested. Total return consists of capital gains (losses) and returns. Capital gain (loss) is the difference from the current investment price relative to the price in the previous period. If the current investment price (Pt) is lower than the investment price in the previous period (Pt-1), it means there is no capital gain and vice versa, there is a capital gain. Total returns are often called returns. Jogiyanto (2013: 236) Return is obtained by the sum of capital gain (loss) and yield. Capital gain or capital loss is the difference from the current investment price relative to the price of a certain period. The amount of capital gain or loss can be calculated with the following formula: $\boldsymbol{R = Pt - Pt - 1\ Pt - 1}$ If the current investment price (Pt) is lower than the investment price in the previous period (Pt-1), it means there is no capital gain and on the contrary, there is a capital gain. Yield is the percentage of periodic cash receipts against the stock investment price in a certain period and is the percentage of loan interest earned against the bond price of the previous period. Thus the total return can be stated as follows: $\boldsymbol{R = Pt - Pt - 1\ Pt - 1 + yield}$ 29 However, considering that companies do not always pay periodic cash dividends to their shareholders, stock returns can be calculated as follows:

$\boldsymbol{R = Pt - Pt - 1 / Pt - 1}$

Information: R = stock return; Pt = current period share price; Pt-1 = previous period stock price.

3. Research methods

This type of research is a quantitative research which is theoretical explanation. The data used is secondary data in the form of annual financial reports from 29 companies from 2016 to 2018 which are called panel data. The population in this study are infrastructure, utility and transportation sector companies listed on the Indonesia Stock Exchange (BEI). The sample was selected using a purposive sampling method that is by using certain criteria. The criteria used are as follows:

1) Infrastructure, utility and transportation sector companies listed on the IDX

2) The companies that were the research samples were companies that were not delisted during the research year, namely 2016-2018.

The number of samples in this study were 87 samples. The independent variable used in this study consists of real management. While the dependent variable is the stock return. In this study, answering the research objectives to be carried out, namely using the independent sample t-test method and dummy regression test using SPSS Version 26.0. This model is used because the independent variable used is a dummy variable with 2 categories, namely: not doing real earnings management (coded = 0), doing real earnings management (coded = 1). This study uses the assumption that the multivariate normal distribution cannot be fulfilled by discriminant analysis because the independent variable is a categorical variable (non-metric) and the dependent variable is a continuous variable (metric). This dummy regression data does not need to be tested for normality because the data is non-metric and metric. Dummy regression testing is not different from OLS testing but to test the dummy coefficient it can be seen from the value of R Square Adjusted or R Square which describes the correlation or relationship between the independent variable and the dependent variable. R Square explains the fit model (Goodness of Fit), which means that changes that occur in the dependent variable can be explained by the independent variable (Edison, 2018).

The regression equation in this study is : $Yi = \beta_0 + \beta_1 X_{+} \in i$

Information: Yi = Stock Return; β_0 = Constant; X = Real Management; β_1 = Regression Coefficient; $\in$ = Error

4. Results and Discussion

IV.1. Test the difference of the independent sample t test

If the value of sig 2 tailed > 0.05, there is no a significant difference in results between real earnings management and non-real earnings management and vice versa. The significance value was obtained 0.131.

Table 1. Independent Samples Test

		Levene's Test for Equality of Var.		t-test for Equality of Means					
								95% Confidence Interval of the Diff	
		F	Sig.	t	df	Sig. (2-tailed)	Mean Diff	Std. Error Diff	Lower	Upper
RS	Equal variances assumed	2,253	,145	-1,559	27	,131	-,21558	,13828	-,49930	,06814
	Equal variances not assumed			-1,662	23,036	,110	-,21558	,12974	-,48395	,05278

Source : SPSS Versi 26.0 (2021)

IV.2. Test Seeing the Effect of X on Y

Hypothesis testing for Real Management variables, on Stock Return. Using a partial regression test (t test). The hypothesis to be tested in this study is formulated as follows:

1. Goodness of Fit. The coefficient of determination essentially measures how much the model's ability to explain the variation in the dependent variable. The coefficient of determination is between zero and one. The small value of R2 means that the ability of the independent variables to explain the variation in the dependent variable is very limited. A value close to one means that the independent variables provide almost all the information needed to predict the variation in the dependent variable. The formed model or the independent variable in explaining the percentage variation in the dependent variable is very limited. If the value of R2 is close to 1, then the model formed or the independent variable used is able to explain the percentage of variation in the dependent variable perfectly (Ghozali, 2013: 59). The Model Fit Test (Goodness of Fit Test) looks at the R Square to see how much influence X has on Y.

2. Hypothesis Testing

a. H0: $bi = 0$.

This means whether an independent variable is not a significant explanation for the dependent variable.

b. Ha: $bi \neq 0$.

This means that these variables are significant explanations for the dependent variable.

3. Testing Criteria

T count > T table then we accept the alternative hypothesis, namely variable X individually (partially) has a significant effect on variable Y. H0 is rejected if the degree of confidence is smaller than $\alpha = 5\%$. The hypothesis formula partially in this study is:

H0: Real Management has no influence on Stock Return.

Ha: Real Management has an influence on Stock Return.

Table 2. Model of Summary

Model	R	R Squ	Adj R Squ	Std. Error of the Est
1	,287[a]	,083	,049	,37033

a. Predictors: (Constant), MLAR_2

Source : SPSS Versi 26.0 (2021)

Table 3. Anova

Model		Sum of Squ	Df	Mean Squa	F	Sig.
1	Regression	,333	1	,333	2,431	,131[b]
	Residual	3,703	27	,137		
	Total	4,036	28			

a. Dependent Var : RS

b. Predictors: (Constant), MLAR_2

Source : SPSS Versi 26.0 (2021)

Table 4. Coefficients

		Unstandardized Coeff.		Standardized Coeff.		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	-,019	,103		-,183	,856
	MLAR_2	,216	,138	,287	1,559	,131

a. Dependent Var : RS

Source : SPSS Versi 26.0 (2021)

Result Interpretation of this study are :

1. The value of R Square shows the relation between Real Earnings Management and Stock Return, which shows a value of 28.70 according to Ghozali (2011) which has a very low relationship.
2. Anova test to see the degrees of freedom (df) when looking for t count of 1.559.
3. The coefficient test shows the regression equation, the value of significance and the value of t count.

Decision-making of this study are : :

1. The results show a significance of 0.131 this value is greater than 0.05, it means that there is no influence real earnings management toward to stock returns.
2. T count is smaller than T table so that there is no influence between real earnings management on stock returns.We can see of t count with t table, namely t count 1.559 while t table with df 28 at 0.025 is at 2.048.
3. The dummy regression test results shows there is no significant effect on the size of stock returns based on real earnings management actions.
4. There is a positive influence between the amount of stock returns based on real earnings management actions with the Regression Equation is obtained : Yi = -0.019 + 0.216 X1 + 0.138

5. Conclusions and Suggestions

The conclusions of this study:

1. There is no significant difference between real earnings management and non-real earnings management in returning stock returns.
2. The correlation between Real Earnings Management and Stock Return shows a value of 28.70 which has a very low relationship.
3. There is no significant effect between the amount of stock returns toward real earnings management actions.

Suggestion :

1. Advanced researchers can add other variables to test the stock returns obtained.
2. There needs to be control from investors over the stock returns that are obtained, although not significant but shows a positive relationship.

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