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Impact of Company Size, Profitability, Leverage, and Firm Value on Earnings Smoothing

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ABSTRACT

The purpose of this study is to examine the effects of firm valuation, profitability, size, and financial leverage on earnings smoothing in companies that are listed on the Indonesia Stock Exchange (IDX) MNC36 Index between 2017 and 2022. The study utilised a quantitative methodology, utilising secondary data obtained from the annual reports of MNC36 Index companies. 36 businesses were included in the study; these were chosen based on three criteria: they used Rupiah currency, had consecutive yearly financial reports available, and were consistently included on the MNC36 Index. Using SPSS software, a logistic regression analysis was performed to assess the model's fit using the Hosmer and Lemeshow Goodness of Fit Test. These theories are refuted by the data, which show that firm size and profitability have no discernible effects on earnings smoothing. On the other hand, financial leverage and company value play a crucial role, since they stimulate management to employ earnings smoothing as a risk mitigation strategy and improve investor perception.

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INTRODUCTION

The capital market serves as a mechanism that allows corporations to fulfill their financing requirements by issuing equity and debt securities, such as stocks and bonds. These financial instruments are utilized for multiple strategic purposes, including business expansion, increasing working capital, and debt management(Hadi Cahyadi, 2020). Additionally, the capital market offers a platform for the public to engage in investment activities across a variety of financial assets, such as equities, bonds, and mutual funds(Putri et al., 2023). Nevertheless, investments in the capital market are inherently associated with risks stemming from the uncertainty of returns. Investment decisions are typically guided by the financial disclosures released by companies, as these financial statements provide critical insights into the organization's economic health and operational performance(Musyafa & Kholilah, 2023).

Making the right investment decisions requires relevant and accurate information, which is often influenced by earnings management practices. As noted by Schipper (1989) and Scott

(2015), earnings management involves intentional interventions in financial reporting that can affect the quality of information available to investors. This can lead to distortions in financial reports due to internal and external factors, including economic conditions and political situations (Rizqia et al., 2013). This information impacts stock prices, and uncertainty in the information can cause price fluctuations. Therefore, companies strive to present good performance through financial reports, especially in terms of profits, to attract investor interest(Saputri & Suwarno, 2023).

In addition to financial performance, external factors such as macroeconomic indicators, government policies, and global market trends also influence investment decisions. These external variables can create fluctuations in the capital market, affecting both individual and institutional investors. Therefore, understanding not only the internal dynamics of corporate financial reports but also broader economic and political contexts is essential for making sound investment decisions and mitigating risks associated with market volatility(Widjaja & Diana, 2024).

Corporate profit is a crucial indicator used by management to assess performance and is often employed to stabilize profits to meet investor expectations and maintain a favorable company image(A. S. Indrawan & Damayanthi, 2020). As noted in the context of Indonesia's infrastructure projects, companies may engage in income smoothing practices to attract investors by presenting a less risky and more stable financial outlook, thereby influencing investor perceptions and potentially manipulating financial statements to their advantage (Nalarreason et al., 2019). Income smoothing may be encouraged by management's pressure to meet investor expectations and maintain a constant corporate image. Indrawan et al., (2018) define income smoothing as management's conscious attempts, within the bounds of accounting standards, to reduce erratic changes in reported earnings.This approach is employed to present a more stable financial performance, thereby minimizing scrutiny related to profit volatility and aligning the company's reported outcomes with investor expectations (Kosasih et al., 2021).

Income smoothing techniques are influenced by a number of variables, such as firm valuation, profitability, size, and financial leverage. As noted by Wijaya et al., (2023), management's awareness of the importance of earnings information can lead to income smoothing practices. Large companies, in particular, are often associated with heightened investor attention and may engage in income smoothing to mitigate profit fluctuations that could impact investor evaluations (Widjaja & Diana, 2024). Decisions for income smoothing heavily depend on profitability, which is a gauge of a business's capacity to generate profits over the long term. As noted by Arhinful et al., (2024), companies use income smoothing practices to stabilize earnings and enhance financial performance, even when profitability is not exceptionally high. This practice can help management in masking profit volatility and maintaining investor confidence (Prasetyoningrum et al., 2021).

Financial leverage, or the degree of debt usage in a company's capital structure, can impact income smoothing practices. According to Ghofir & Yusuf, (2020), companies exhibiting high leverage are more inclined to employ income smoothing techniques as a strategy to stabilize profit fluctuations and mitigate perceived financial risk. This practice aims to present a stable financial position despite the underlying volatility, thereby mitigating the risk of default and enhancing the company's financial stability(Obeidat, 2021). Moreover, firm value, indicative of investors' assessments of a company's performance, can be affected by a range of corporate policies, including dividend policy. Research within the manufacturing sector indicates that firm value is significantly linked to management decisions, such as dividend distribution, which can communicate stability and potential for growth to investors (Weston & Copeland, 1992; Chen & Steiner, 1999). Companies with higher firm value often engage in income smoothing and maintain a consistent dividend policy to uphold investor trust and enhance shareholder value (Sitompul et al., 2024).

This research looks at companies that are listed on the Indonesia Stock Exchange's MNC36 Index, which consists of 36 carefully chosen businesses that meet strict standards. This index provides a useful sample to assess how income smoothing techniques are influenced by variables including firm valuation, profitability, size, and financial leverage, which in turn affects capital market investment decisions.

Financial statements are a source of information on a company's financial condition, including profit, which plays a crucial role in attracting investors (Sivaram et al., 2019). Companies may engage in income smoothing techniques to reduce fluctuations in profit across periods, making profit levels appear more stable and potentially influencing investor perceptions and investment decisions (Rosli et al., 2018). In order to address variations in periodic profit, companies frequently adopt income smoothing techniques to portray a more consistent financial performance. This approach can enhance investor appeal and mitigate perceived risk (Putra et al., 2023).

Based on the above background, this research will examine "The Influence of Company Size, Profitability, Financial Leverage, and Firm Value on Income Smoothing: An Empirical Study on MNC 36 Companies Listed on the Indonesia Stock Exchange for the Period 2017 – 2022.

Jensen and Meckling (1976) created agency theory, which describes the contractual arrangement in which the principle (owner) assigns decision-making responsibility to the agent (manager). Due to varying goals and information asymmetry, this delegation frequently results in conflicts of interest since agents may put their own interests ahead of the principals (Fitriani, 2018). Financial statements play a critical role in resolving these conflicts by providing transparent information essential for stakeholder decision-making(Widyastuti et al., 2022). In line with agency theory, earnings smoothing emerges as a practice in which management seeks to align reported earnings with market expectations, ensuring financial consistency and mitigating potential conflicts. This can be achieved through real or artificial methods, which manipulate the timing of transactions or employ accounting techniques to stabilize reported earnings (Nugroho et al., 2021).

Profitability, business value, financial leverage, and company size are important variables that affect earnings smoothing techniques. Larger businesses with significant assets and revenue levels frequently work to keep consistent results and superior financial reporting, which may entail the use of earnings smoothing techniques. Profitability is a crucial indicator of operational stability and efficiency that supports investor confidence and long-term sustainability. It is commonly quantified by Return on Assets (ROA) and other financial measures (Oktoriza, 2018). Financial leverage, as indicated by the Debt to Equity Ratio (DER), reveals a company's reliance on debt and can drive management to engage in earnings smoothing to manage financial risk and enhance the company's attractiveness to investors (Yulia, 2013). Similarly, firm value, as reflected by stock price, is closely linked to investor perception, with high-value companies often employing earnings smoothing to maintain profit stability and protect shareholder wealth (Butar & Sudarsi, 2012).

RESEARCH METHOD

To evaluate theories on how firm value, profitability, size, and financial leverage affect earnings smoothing in companies on the MNC36 Index, the study uses a quantitative methodology. This study makes use of secondary data that was gathered via documentation techniques. The information is taken from annual reports of businesses, which are available at www.idx.co.id, the official website of the Indonesia Stock Exchange (IDX).

The study's focus is on the 36 businesses that are listed on the Indonesia Stock Exchange's (IDX) MNC36 Index between 2017 and 2022. Firms who maintained their listing on the MNC36 Index for the duration of the study, consistently produced annual financial statements, and used the Rupiah currency in their financial reports were the criteria used to select the sample.

The dependent variable in this study is earnings smoothing, which is assessed using the Eckel Index. The firm value, financial leverage, profitability, and size of the corporation are the

independent factors. Price to Book Value (PBV) measures business value, Debt to Equity Ratio (DER) measures financial leverage, Return on Assets (ROA) measures profitability, and the logarithm of total sales measures company size.

Using SPSS software, logistic regression techniques binary logistic regression in particular will be used to the acquired data for analysis. The purpose of this analysis is to ascertain the effects of each independent variable on the dependent variable. The Hosmer and Lemeshow Goodness of Fit Test will also be used in this study to assess how well the regression model fits the data. Based on the significance values found, the results of the logistic regression will assist in determining the significance of the independent factors' impact on the dependent variable.

Although the data is taken from annual reports, it is still necessary to explain how to ensure that the data is valid, accurate, and reliable for use in the analysis. To achieve this, the study will employ several validation techniques. First, cross-referencing data from multiple years ensures consistency in financial reporting. Any discrepancies in the data will be addressed through reconciliation with audited statements. Second, only reports that have been verified by independent auditors will be used, ensuring that the financial figures presented are accurate. Third, the use of official sources such as the IDX and following strict selection criteria—such as maintaining consistent financial reporting in Rupiah further supports the reliability and credibility of the data used for analysis.

RESULTS AND DISCUSSIONS

Research Data Description

This research aims to examine how firm size, profitability, financial leverage, and firm value influence income smoothing practices among companies listed on the MNC 36 Index of the Indonesia Stock Exchange (IDX) during the period from 2017 to 2022. The study focuses on firms included in the MNC 36 Index within this period, with the sample selected using purposive sampling. Criteria for inclusion in the sample are firms that were part of the MNC 36 Index between 2017 and 2022, those that underwent changes in auditors, and companies that consistently reported their annual financial statements in Indonesian rupiah during these years. The sample selection process is outlined in Table 1 :

Table 1. Sample Selection Criteria

Desciption	Quantity
Companies listed on the MNC 36 Index IDX during the 2017-2022 period	36
Companies on the MNC 36 Index IDX that did not present complete annual reports	(3)
Number of observation years	6
Number of companies included in the research sample (33*6)	198
Outlier data	12
Net sample size	186

Source: Secondary data processed by the author, 2024

Data Analysis Results

Descriptive Statistical Analysis

T able 2. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Firm Size	186	28.98	35.23	31.5857	1.62060
Profitability	186	-0.01	0.47	0.0841	0.07933
Financial Leverage	186	0.04	23.35	1.7086	2.45373
Firm Value	186	0.56	82.44	4.2906	9.78604
Income Smoothing	186	0.00	1.00	0.2903	0.45514

Source: Secondary data processed by the author, 2024.

The descriptive statistical analysis of 186 samples across 33 companies listed on the MNC36 Index uncovers diverse attributes such as company size, profitability, financial leverage, firm value, and income smoothing. Company size ranged from 28.98 to 35.23, with an average of 31.59 and a standard deviation of 1.62. Profitability varied from -0.01 to 0.47, averaging 0.08 with a standard deviation of 0.08. Financial leverage varied from 0.04 to 23.35, averaging 1.71 with a standard deviation of 2.45. Firm value ranged from 0.56 to 82.44, with an average of 4.29 and a standard deviation of 9.79. Income smoothing values were between 0.00 and 1.00, with a mean of 0.29 and a standard deviation of 0.46. In 2018, PT Integra Indocabinet Tbk had the smallest firm size, while PT Bank Mandiri (Persero) Tbk had the largest. In terms of profitability, PT Aneka Tambang (Persero) Tbk experienced the lowest level in 2019, whereas PT Unilever Indonesia Tbk saw the highest profitability in 2018. For financial leverage, PT Puradelta Lestari Tbk had the lowest ratio in 2018, while PT Sawit Sumbermas Sarana Tbk exhibited the highest ratio in 2020. PT Bank CIMB Niaga Tbk recorded the lowest firm value in 2019, with PT Unilever Indonesia Tbk achieving the highest firm value in 2017. Regarding income smoothing, PT AKR Corporindo Tbk reported the lowest level in 2017, in contrast to PT Ace Hardware Indonesia Tbk, which reported the highest.

Model Analysis and Hypothesis Testing

Logistic Regression Analysis

This study seeks to illustrate the implementation of income smoothing and evaluate how firm size, profitability, financial leverage, and firm value affect income smoothing among companies on the MNC36 Index. To achieve this, a logistic regression analysis was performed using SPSS software. The analysis began by evaluating the overall fit of the model through the -2 Log Likelihood statistic. The hypothesis tested was whether the proposed model accurately represents the data (H0) or fails to do so (Ha). A decrease in the -2 Log Likelihood value from the initial model (which only included a constant) to the model with independent variables supports H0, suggesting that the proposed model fits the data well. The -2 Log Likelihood values for both the initial model and the model with independent variables are as follows:

Table 3. -2 Log Likelihood

-2Log Likelihood	-2Log Likelihood
242.910	208.253

Source: Processed Data by Author, 2024.

Table 3 shows a decrease in the -2 Log Likelihood value, which dropped from 242.910 in the initial model to 208.252 after adding the independent variables (block number=1). This result supports accepting H0 and rejecting Ha, suggesting that the proposed model fits the data well.

Assessing the Feasibility of the Logistic Regression Model

The Hosmer and Lemeshow Goodness of Fit Test was used to assess the logistic regression model's appropriateness. The following theories are investigated by this test: Ha contends that there is a meaningful difference between the model and the data, contrary to H0's assertion that there isn't. Ha is rejected and H0 is accepted if the Chi-Square significance value is higher than 0.05 (α=5%). This suggests that there isn't much of a difference between the data and the model, meaning the model predicts the study values with accuracy. Below are the specifics of the Hosmer and Lemeshow Goodness of Fit Test findings that were used to evaluate the efficacy of the logistic regression model:

Table 4. Hosmer and Lemeshow's Goodness of Fit Test

Chi-Square	Significance Value
8.950	0.347

Table 4 indicates that the Hosmer and Lemeshow Goodness of Fit Test yielded a Chi-Square statistic of 8.950 with a p-value of 0.347. These results suggest that the null hypothesis (H0) should be accepted and the alternative hypothesis (Ha) rejected, signifying that there is no significant difference between the model and the observed data. Consequently, the logistic model used in this study is considered effective in predicting the observed values, thereby validating its suitability.

Coefficient of Determination Test

The coefficient of determination test assesses the relationship between income smoothing and the MNC36 Index companies' size, profitability, financial leverage, and firm value. The Nagelkerke R Square, a variation of the Cox and Snell R Square that performs similarly to R Square in multiple linear regression, was employed in this investigation. The logistic regression model yielded values for the Cox and Snell R Square and Nagelkerke R Square, which are displayed in Table 5.

Table 5. Cox and Snell R Square and Nagelkerke R Square

Cox and Snell R Square	Nagelkerke R Square
0.342	0.488

Source: Processed Data by Author, 2024.

The Cox and Snell R Square is 0.342 and the Nagelkerke R Square is 0.488 based on the data in Table 5. This indicates that firm size, profitability, financial leverage, and firm value account for 48.8% of the probability that corporations included in the MNC36 Index will use income smoothing. Other factors not included in the analysis account for 51.2% of the variance that remains.

Hypothesis Testing

The impacts of firm size, profitability, financial leverage, and firm value on income smoothing practices among corporations listed on the MNC36 Index were examined through hypothesis testing using the Wald Test. Financial leverage and business value have a considerable impact on income smoothing, as indicated by a significance level of less than 0.05 (α=5%). Table 6 displays the Wald Test findings that were acquired using logistic regression analysis.

Table 6. Wald Test

Variable	Coefficient	Wald	Sig	Explanation
Firm Size	-0.180	0.822	0.365	Not Significant
Profitability	6.372	2.498	0.114	Not Significant
Financial Leverage	-2.176	11.397	0.001	Significant
Firm Value	0.189	6.783	0.009	Significant

Source: Processed Data by Author, 2024.

The data shown in the table suggests that there is no significant impact of firm size and profitability on income smoothing methods, as the p-values for these variables are greater than 0.05. On the other hand, the business valuation and financial leverage have p-values less than 0.05, indicating a substantial impact of these variables on income smoothing methods.

Formed Logistic Regression Model

In order to determine how the independent variables affect the dependent variable, the regression coefficients are evaluated during the testing process' last stage. The variables that are the focus of this study include firm value, financial leverage, profitability, and company size. If a variable's probability value in the "Sig" column of the "Variables in the Equation" table is less than 0.05 (5%), it is considered significant and supports the hypothesis. On the other hand, if the probability value is higher than 0.05 (5%) then the hypothesis is not supported, implying that the

variable has no meaningful impact. Table 7 provides a full breakdown of the results of the logistic regression study.

Table 7. Variables in the Equation

	B	S.E.	Wald	df	Sig	Exp(B)
Company Size	-0.180	0.199	0.822	1	0.365	0.835
Profitability	6.372	4.031	2.498	1	0.114	584.992
Financial Leverage	-2.176	0.644	11.397	1	0.001	0.114
Firm Value	0.189	0.073	6.783	1	0.009	1.208
Constant	5.138	6.141	0.700	1	0.403	170.326

Source: Processed Data by Author, 2024

The logistic regression coefficient test results in the following model:
PL: 5.138 – 0.180UP + 6.372P – 2.176FL + 0.189NP + e

Based on the logistic regression analysis, the coefficient for company size is -0.180, accompanied by a p-value of 0.365, which exceeds the 0.05 significance threshold. This result suggests that company size does not exert a statistically significant influence on earnings smoothing practices. Although the negative coefficient implies a slight decrease in the probability of earnings smoothing as company size increases, this relationship lacks statistical significance.

Profitability, with a coefficient of 6.372 and a p-value of 0.114, indicates a positive association with earnings smoothing. This suggests that firms with higher profitability are more likely to engage in such practices. However, as the p-value exceeds 0.05, the effect of profitability on earnings smoothing is not deemed statistically significant. Nevertheless, the odds ratio (Exp(B) = 584.992) implies that highly profitable firms are substantially more inclined toward earnings smoothing to present a stable financial outlook.

Conversely, financial leverage exhibits a statistically significant negative relationship with earnings smoothing, as evidenced by a coefficient of -2.176 and a p-value of 0.001. This indicates that firms with greater financial leverage are less likely to engage in earnings smoothing. The odds ratio (Exp(B) = 0.114) signifies that for each unit increase in financial leverage, the likelihood of earnings smoothing diminishes considerably, underscoring the importance of debt management in influencing such practices.

Firm value, reflected by a coefficient of 0.189 and a p-value of 0.009, demonstrates a statistically significant positive impact on earnings smoothing. This suggests that as firm value escalates, so does the propensity to engage in earnings smoothing, potentially as a strategy to maintain favorable perceptions among investors. The odds ratio (Exp(B) = 1.208) further supports the notion that firms with higher market valuations are more inclined to adopt earnings smoothing to ensure financial stability and investor confidence.

Finally, the constant value of 5.138 represents the baseline log-odds of engaging in earnings smoothing when all other variables are held at zero. However, with a p-value of 0.403, this constant is not statistically significant within the model, suggesting it does not contribute meaningfully to explaining the likelihood of earnings smoothing practices.

Discussion

a. The Effect of Company Size on Earnings Management Practices in Companies Listed on the MNC36 Index

The study's conclusions demonstrate that earnings management strategies are not substantially impacted by a company's size. Hypothesis 1 is not supported since the company size variable has a p-value of 0.365, which is higher than the 0.05 significance level. Typically, metrics such as total assets or total net sales are used to assess the size of a company. It was suggested that because they are under more scrutiny from investors, analysts, and regulators, larger corporations might manipulate their earnings more. It is expected that larger companies will control notable earnings swings in order to minimise tax obligations and avoid unfavourable investor views

(Segovia, 2014). The finding that a company's size has little bearing on earnings management raises the possibility that other factors may have greater sway. Maintaining impartial and open financial reporting may be encouraged by investor alertness and regulatory oversight. When making investment decisions, investors consider aspects other than firm size, such as profitability and possibilities for the future. As a result, management might not concentrate on managing earnings to enhance the public's opinion of the organisation.

This result is consistent with the study by Sophan Sophian and Ananda Atalia (2022), which also concluded that company size does not impact earnings management. Likewise, both Tjahjono et al. (2023) and Sophan Sophian & Ananda Atalia (2022) found no significant relationship between company size and earnings management.

b. The Effect of Profitability on Earnings Management Practices in Companies Listed on the MNC36 Index

The findings demonstrate that strategies for managing earnings are independent of profitability. Hypothesis 2 is rejected because the profitability variable has a significance level of 0.114, which is higher than the 0.05 cutoff. Investors frequently utilise profitability, which indicates a company's potential to produce future earnings, to evaluate financial health and make investment decisions. Because of its function as a performance metric, profitability and earnings management do not significantly correlate. Decisions made by creditors and investors are mostly based on profitability; however, changes in profitability do not always prompt businesses to manipulate their results, which could damage their reputation (Shabilla & Nugroho, 2020). High profitability, in accordance with signalling theory, provides a good message to investors and eliminates the need for management to manipulate results in order to draw in capital.

This finding is consistent with Shabilla & Nugroho (2020), which show that profitability does not affect earnings management. Other studies, such as Sugiari et al. (2022) and Utari et al. (2024), also report that profitability has no significant effect on earnings management.

c. The Effect of Financial Leverage on Earnings Management Practices in Companies Listed on the MNC36 Index

The results of the study imply that techniques for managing earnings are influenced by financial leverage. The financial leverage variable shows a significance level of 0.001, which is less than the 0.05 cutoff. Thus, Hypothesis 3 is confirmed. The amount of debt used to fund a company's operations is measured by financial leverage. High levels of leverage increase investor risk and may lead to methods for earnings management to offset perceived financial concerns (Hidayah & Adi, 2024). Excessive leverage might send the wrong signals to investors, which forces management to manage earnings in order to maintain investor interest and project a stronger financial position.

This finding is consistent with research by Sonadi (2018), which shows that financial leverage affects earnings management. Similarly, Joana & Abdi (2022) and Lestari & Nurhayati (2024) find that financial leverage has an effect on earnings management.

d. The Effect of Firm Value on Earnings Management Practices in Companies Listed on the MNC36 Index

According to the research, a company's worth significantly influences its methods for managing earnings. Acceptance of Hypothesis 4 is supported by the firm value variable's significance level of 0.009, which is below the 0.05 threshold. By indicating the possible rewards from investing in the company, firm value influences investor decisions. Stability and expansion are typically reflected in a high business value, which may draw in more investors and raise stock prices. In order to enhance the firm's value and draw in investment, management could use earnings management techniques to provide a more palatable financial picture.

This finding aligns with Sonadi (2018), which indicates that firm value affects earnings management. Similarly, Sellah & Herawaty (2019) and Gunawan & Wiyono (2024) report that firm value has an impact on earnings management.

CONCLUSION

An analysis of the impact of firm value, financial leverage, company size, and profitability on income smoothing practices across MNC36 Index companies from 2017 to 2022 reveals that income smoothing practices are not significantly impacted by either profitability or business size. As a result, the theories linked to these variables are disproved. On the other hand, it is demonstrated that business valuation and financial leverage have a major impact on income smoothing techniques, confirming the theories associated with these variables. Businesses that have greater levels of financial leverage and firm value are more likely to use income smoothing as a risk management tactic and to improve their standing in the marketplace.

One of the study's many shortcomings is that it only looks at businesses that are included in the MNC36 Index, which may make it difficult to compare the findings to the state of the capital markets as a whole. Furthermore, the analysis is limited because it takes into account only four independent variables, which might not account for all variables that potentially affect income smoothing. With an adjusted R square of 48.8%, the coefficient of determination indicates that 51.2% of the variation can be attributed to other factors. To get a more complete picture, future research should think about expanding the sample to include companies outside of the MNC36 Index, lengthening the study period, and adding or removing independent variables like cash holdings, ownership of public shares, liquidity, and managerial ownership.

The findings that financial leverage and firm value significantly influence income smoothing practices suggest important practical implications for companies, management, and investors. Companies with higher financial leverage or firm value may need to carefully monitor their risk management strategies, as excessive income smoothing can distort financial statements and potentially lead to regulatory scrutiny. Management should ensure that income smoothing is used responsibly and transparently, aligning with the company's long-term objectives and market expectations. Investors, on the other hand, should be vigilant when analyzing firms with high leverage or large market valuations, recognizing that these companies might engage in income smoothing to present a more favorable financial position than reality. Informed investors may need to dig deeper into the financial reports of such companies to assess the true health of the business beyond the smoothed figures.

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