
**POLITICAL CONNECTION AND EARNINGS MANAGEMENT:
EVIDENCE FROM INDONESIA**

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Abstract

The objective of the study is to examine the influence of ownership concentration and earnings management practice. This study also analyzes type ownership concentration (state-owned enterprises vs. privates) on earnings management practice. This study employs some control variables, such as corporate governance, political relations, sales, and leverage. This study's samples consist of listing companies (state-owned enterprises and private companies) in the Indonesia Stock Exchange from 2006-2014. The sampling technique is purposive sampling producing 232 listing companies consisting of 116 state-owned enterprises and 116 private companies. Data of this study is secondary data collected from annual reports. This study uses multiple regression analysis to examine the effect of ownership concentration on earnings management practice. The results show that the level of concentration of ownership has a positive and significant impact on Indonesia's earnings management practices. Besides, the type of relationship is inverted U-shaped. In contrast, the type of ownership does not significantly mediate the relationship between the concentration of ownership and earnings management. In terms of the control variables, only sales have a positive and significant association with earnings management.

Keywords: Earnings management, state-owned enterprises, political connection

1. Introduction

The financial statements are a structured presentation of the financial position and financial performance of an entity. The purpose of the financial statements is to provide information concerning the entity's financial position, entity performance, and entity cash flows that benefit most economic decision-making users (Financial Presentation and Financial Reporting Framework Paragraph 7, PSAK 2009). To achieve that goal, the information contained in the financial statements' elements should assist investors in making rational decisions. One of the

elements contained in the financial statements is earnings. The quality of earnings can be said to be of high quality if the reported earnings can be used by the users to make the best decisions and can be used to explain or predict stock prices and returns (Bernard and Stober, 1998).

The earnings quality aspect cannot be separated from agency conflict (Salno and Baridwan, 2000). Based on the agency theory (Jensen, M. & Meckling, 1976), when the owner (principal) delegates decision-making authority to management (agent), management, as a company manager, has broader access to private information and company prospects than shareholders. Such conditions lead to information asymmetry, which is a condition that reflects the imbalance of information acquisition between management as a provider of information with stakeholders and other stakeholders as users of information. When information asymmetries are high, stakeholders do not have sufficient resources, incentives, or access to relevant information to monitor manager actions (Richardson, 1998). This condition certainly provides an opportunity for earnings management. In short, earnings management is a management intervention in preparing financial statements to increase or decrease accounting profits according to their interests (Scott, 2009).

In the capital market, with the separation between ownership and management and a broad base of shareholders, earnings management is done because of the desire to support its stock price. Price is more often the key to managerial compensation included in stock options or other incentive plans. Top executives manage their revenues aggressively through actors of accounting manipulation and corporate policies designed to improve their companies' performance (Ding, Zhang, & Zhang, 2007). Healy and Wahlen (1999) state that earnings management occurs when executives of a business entity use policies in preparing financial statements and establish transactions to change financial statements. The objective is to manipulate the number of reported earnings to shareholders and influence the agreement's outcome depending on the accounting figures.

Previous research has shown that ownership structure plays a vital role in shaping corporate governance and corporate performance (Shleifer and Vishny, 1986; McGuinness and Ferguson, 2005). The existing literature indicates that state ownership has low governance quality than private ownership (Shleifer, 1998), so it has more motivation to manage earnings. The surprising result of state ownership is a significant cause of corporate inefficiency (Wang & Judge, 2012). For example, Chen and Yuan (2004) have found evidence that state-owned enterprises in China manage their revenues higher than private companies (Capalbo and Palumbo, 2013). They tend to do so primarily through non-operating transactions with related parties (tunneling). Other conflicting research finds evidence that state-owned enterprises tend to have lower earnings management levels than private companies (Ding et al., 2007; Wang and Yung, 2011). A study comparing earnings management practices in state-owned enterprises with private companies in China (Ding et al., 2007) shows evidence that the relationship between the concentration of stock ownership and earnings management shapes a reversed U-shaped pattern. Initially, large shareholders tend to maximize accounting profits to gain future benefits (entrenchment effects). When the concentration of ownership reaches a high level, the controlling owner's commitment builds a reputation for not taking over minority shareholders (Gomes, 2000), and more likely to seek to preserve its future growth potential by minimizing accounting earnings (alignment effects). In companies registered in China, the correlation between the concentration of

ownership and earnings management is positive at 55 percent - 60 percent ownership. In contrast, the high ownership level relates to earnings management being negative.

In Indonesia, state-owned enterprises with high private ownership have higher performance than wholly state-owned enterprises (Astami et al., 2010). The management of private companies is arguably strongly motivated for at least two reasons. First, they may have their funds and reputations at risk. Second, they are picked up and monitored by shareholders with considerable share ownership in the company. Other government funds will generally cover another case with companies with state ownership, accounting losses reported by state companies. State-owned enterprises tend to have inadequate monitoring mechanisms and low management pressures, leading to low performance (Astami et al., 2010). Other studies have shown different results. SOEs have an ever-increasing profit growth compared to private companies (Ula, 2011), among other telecommunication sectors (Christina, 2014), and pharmaceuticals (Wibowo, 2013). Therefore, there are different ownership structures to varying levels of agency conflict.

This study examines how ownership concentration on earnings management compares the influence of ownership concentration on earnings management on SOE and non-SOE firms listed on the Indonesia Stock Exchange. It looks at the pattern of concentration relationship of ownership to earnings management.

2. Brief Literature Review

2.1 Earnings Management

Schipper (1989) defines earnings management as an intervention with a specific purpose in the external financial reporting process to gain some private advantage (instead of facilitating the process's neutral operation). According to Scott (2009), earnings management is managers' actions to report earnings that maximize personal or corporate interests using accounting method policy. Healy and Wahlen (1999) state that earnings management occurs when executives of a business entity use policies in preparing financial statements and establish transactions to change financial statements. The objective is to manipulate the number of reported earnings to shareholders and influence the agreement's outcome depending on the accounting figures. Fischer and Rosenzweig (1995) view earnings management as a series of steps that managers undertake to increase or decrease the number of reported profits in the current year, which is their responsibility without causing a decrease or increase in profit achieved a business entity in the long run.

Manager behavior associated with the implementation of earnings management can also be started from the agency approach (Jensen and Meckling, 1976). In agency theory, profit management practices undertaken by the management of a business entity are influenced by a conflict of interest. Agents (management) that should carry out the principal's service function have a different purpose from the principal goal. As an agent, management tries to prioritize his interests first at the expense of the owner's interests as the principal reflects the management's opportunistic behavior. Conflicts of interest between both parties (management and owners) arise because each party seeks to maximize its utility. The agency theory explains that managers can act opportunistically when a company is in poor performance by raising accounting profits to conceal poor performance. Otherwise, when firms perform good performance, managers work

opportunistically by lowering their accounting earnings to postpone good performances. When it comes to agency relationships, managers have better, faster information than external parties such as investors and creditors. This means that management has information asymmetry so that they can control the information in a business entity. This information asymmetry provides management incentives for moral hazard in earnings management to maximize its prosperity.

2.2 Concentration of Ownership

The phenomenon of ownership of public companies in Indonesia is concentrated (Claessens et al., 2002). Concentrated ownership is the concentration of cash flow rights and family control rights, government, public financial institutions, wholly-owned companies, or others as controlling shareholders. Concentrated ownership may encourage controlling shareholders to make expropriation. Expropriation is a process of using a person's right of control to maximize his well-being with wealth distribution from others (Claessens et al., 2002). Expropriation is possible because the controlling shareholder can take advantage of the law's limitations in a country that embraces civil law, such as Indonesia. According to Johnson et al. (2000), countries adhere to civil law emphasizing predictable laws and trusting legislation to regulate personal interest behavior. The laws in the civil legal system are made by legislators (La Porta et al., 1999). This is an incentive for the controlling shareholder to creatively manage unfair transactions to fit the contents of the law. Increased expropriation by the controlling shareholder implies an entrenchment effect since the controlling shareholder has substantial control to use the company to fulfill its interests rather than all shareholders' interests (Bozec and Laurin, 2008). Entrenchment is the controlling shareholder's actions protected by its control right to expropriation (Fan and Wong, 2002). The entrenchment effect covers the expropriation of the company's earnings transferred to another company controlled by the controlling shareholder. The controlling shareholder may also expropriate the search for objectives that do not maximize the company's earnings. In short, the entrenchment effect controlling shareholders will encourage profit maximization practices, such as earnings management.

Contrary to the entrenchment effect, the controlling shareholder also has sufficient cash flow rights to prevent exploiting non-controlling shareholders. The higher the cash flow right lead the controlling shareholder to run better the company. This is known as the alignment effect. Alignment is the actions of the controlling shareholders in harmony with the interests of the non-controlling shareholder. La Porta et al. (1999) suggest that alignment effects on increasingly concentrated ownership structures often occur in countries where legal systems are still developing, such as in Southeast Asia. This is because the concentrated ownership structure occurs naturally in those countries, which means the relationship is positive. In state-owned companies, the alignment effect also applies, mostly when an Initial Public Offering (IPO) occurs. State-owned companies with a larger holding company will be used as the basis for calculating future cash flow prospects so that the maximum IPO price can be achieved. So the full IPO price can be reached. As ownership of the parent company increases, the drive for expropriation will decrease to create a so-called alignment effect (Ding et al., 2007).

2.3 Earnings Management in State-Owned and Non-State-Owned Enterprises

The practice of earnings management can happen to different types of companies that have gone public. Whether it is state-owned enterprises (SOEs) or private (Non-SOE), the motivation to

make earnings management can appear without distinguishing the company's ownership status. For example, in the case of bonus giving to both state-owned and non-state-owned enterprises, the bonus bonuses for managers are determined based on the company's achievements. This achievement, for example, can be measured through the achievement of corporate profits. Given that a profit-based bonus scheme is the most popular way of rewarding corporate executives, it is logical that managers whose remuneration is based on earnings levels will manipulate those earnings to maximize their remuneration (Watts and Zimmerman, 1986).

Earnings management practices can occur both in state-owned and non-state-owned enterprises, but the magnitude of potential events can be different. This phenomenon only appears in state-owned companies that have gone public (Givoly et al., 2010), so it cannot be generalized to all SOE companies. Ding et al. (2007) state that the motivation to make earnings management on SOE companies is smaller than non-SOE companies. This is due to differences in the quality of governance. According to him, state-owned companies have better quality governance practices than non-SOE companies, so that state-owned companies have smaller agency problems and consequently lower earnings management motivation (Beatty et al., 2002). This opinion is supported by Ball and Shivakumar (2005), who states that the motivation to do earnings management on SOE companies is lower than non-SOE companies. This is because state-owned companies have demands for greater transparency and financial reporting quality than non-SOE companies

3. Development of Hypotheses

3.1 Concentration of Ownership with Profit Management

Previous research has shown that ownership concentration plays a vital role in shaping corporate governance and corporate performance (Shleifer and Vishny, 1986; McGuinness and Ferguson, 2005). In the expanding capital market, with the separation between ownership and management and a broad base of shareholders, earnings management is done because of the desire to support its stock price. Top executives manage their revenues aggressively, through actors of accounting manipulation and through company policies designed to improve their companies' performance (Ding et al., 2007). Claessens et al. (2002) state that controls rights have implications for the expropriation of non-controlling shareholders. The controlling shareholder is interested in obtaining benefits not provided to non-controlling shareholders. La Porta et al. (1999) also affirm that the controlling shareholder effectively controls the company. The controlling shareholder tries to exploit his position and seek personal gain. To hide expropriation, the controlling shareholder is more likely to have earnings management since stakeholders do not readily detect this action (Haw et al., 2004). This is likely due to the increase in control rights facilitating the controlling shareholder actively to control preparing the financial statements.

This study assumes that control rights motivate controlling shareholders to manage earnings, so ownership concentration is directly proportional to earnings management (entrenchment effect). To test these allegations, the hypotheses that can be formulated are as follows.

H1a: Ownership concentration positively affects earnings management.

Although previous researchers have documented the positive relationship between ownership concentration and earnings management, it has not explicitly examined whether the positive

linear relationship is infinite. If the parent company's ownership increases, the impulse to expropriate will decrease to create the so-called alignment effect (Ding et al., 2007). Alignment is the actions of the controlling shareholders in harmony with the interests of the non-controlling shareholder. Based on the literature, the researchers present several possible reasons why the author believes that relationships may no longer be linear for companies with high earnings management, but rather curve. Morck et al. (1988) and McConnell and Servaes (1990) examined the insider shareholding relationship with firm value. They report the U shape pattern of the relationship. Their explanation is that, to a lesser extent than insider shareholding, the alignment effect dominates the entrenchment effect, but at some point, the entrenchment effect dominates the effect of alignment. As a result, the company's value first increases and decreases with the concentration of ownership. Similar U-shaped patterns are also obtained by Xu and Wang (1999) in testing performance with its listing structure in China. Initially, the effect of alignment dominates the relationship, then at some point a more dominant entrenchment effect.

On the other hand, Ding et al. (2007) prove an inverted U-shaped pattern in research on the relationship between the concentration of share ownership and earnings management. Initially, large shareholders tend to maximize accounting profits to gain future benefits (entrenchment effects). However, when the concentration of ownership reaches a high level, the controlling owner's commitment builds a reputation for not taking over minority shareholders (Gomes, 2000), and more likely to seek to preserve its future growth potential by minimizing accounting earnings (alignment effects). This study also predicts that the U pattern's appearance is reversed (Ding et al., 2007). At higher concentrations of ownership, there will be an alignment effect on earnings management. Then the hypothesis that can be formulated is as follows.

H1b: The relationship between the concentration of ownership and earnings management is a reversed U-shaped curve, where the highest earnings management occurs at the intermediate level of concentration of ownership

3.2 Earnings Management between State-Owned Enterprises and Non-SOEs

In agency theory, it assumes that each is solely motivated by their self-interest, thus generating a conflict of interest between the principal and the agent. Agency problems in each company are closely related to the quality of corporate governance. A wholly state-owned company tends to have better monitoring mechanisms (Beatty et al., 2002) so that state-owned enterprises' motivation performs lower earnings management (Ding et al., 2007; Wang and Yung, 2011).

The introduction of the concept of corporate governance in Indonesia was. Formally, it was initiated in 1999 when the government established the National Committee on Corporate Governance, which resulted in a corporate governance code that was subsequently revised in 2006. This code then became a reference for companies running their business activities in Indonesia, including SOE (Kamal, 2011). Implementation of this code seems to have more effect on SOEs than private listed companies. This is indicated by the many awards obtained by SOEs in the Indonesian Good Corporate Governance Awards. A total of 30 listed companies listed on the Indonesia Stock Exchange (IDX) were announced as the Top 30 issuers with the highest corporate governance score in 2013. The score is based on the Indonesian Institute for Corporate Directorship (IICD) assessment, which uses the ASEAN Corporate Governance Scorecard's

reference in assessing corporate practices. Two of the three companies with the highest corporate governance score (Top 3) are State-Owned Enterprises (SOEs).

This study argues that corporate governance in private-owned companies is lower than that of state-owned enterprises in Indonesia. Inadequate corporate governance can create opportunities and more motivate management to make earnings management. Based on the description, the hypothesis that can be formulated is as follows.

H2: The effect of ownership concentration on earnings management is stronger if the company is privately owned

4. Research Method

4.1 Population and Sample

This study's population was non-bank companies listed on the Indonesia Stock Exchange (go public) in 2006 - 2014. The sampling procedure is a purposive sampling method, a collection method that is limited to certain types that can provide the desired information. This research uses a matching sample method to divide the sample based on the similarity of specific characteristics. First, the researchers look for state-owned companies that go public between 2006 to 2014. Furthermore, to obtain private companies, researchers do a matching sample by matching (matching) state-owned and private companies with similar industries and have the same asset size.

4.2 Data

The data in this study is secondary data collected using the documentation method. Secondary data refers to information collected from existing sources (now, 2006). The reason for the use of secondary data in this study is that this data has the validity of data guaranteed by others so reliable for use in research. The data obtained from the company's financial statements sampled from 2006 to 2014. The data required in this study are data on earnings management, corporate ownership, corporate governance index scores, the profile of the composition of independent commissioners and president commissioners, net income of the company, number of corporate assets, company sales, and leverage.

4.3.1 Dependent Variable

The dependent variable in this research is earnings management. Measurement of earnings management uses total accruals. Accruals are the main components of profit-making compiled based on specific estimates. To find the total accruals in this study is done by calculating the difference between net income and cash flow from operating activities divided by the average total assets (Liu and Lu, 2007; Chia et al., 2015).

$$ACC_{it} = \frac{NI_{it} - CFO_{it}}{(TA_{it-1} + TA_{it})/2} \quad (1)$$

Information:

ACC_{it} = Total accruals of firm i in year t; NI_{it} = Net profit of company i in year t; CFO_{it} = Cash from the operating company i in year t; TA_{it} = Total assets of firm i in year t

4.3.2 Independent Variable

The independent variable in this study is the concentration of ownership. This study aims to examine whether and how the concentration of ownership affects earnings management. Ding et al. (2007) conducted a study to measure company ownership concentration by comparing the largest percentage of ownership in a company's ownership structure. The greater share ownership in the company means that its ownership structure is increasingly concentrated and vice versa.

$$\text{Ownership Structure (Top1)} = \% \text{ largest share ownership} \quad (2)$$

This study predicts the appearance of an inverted U pattern on the relationship between the concentration of ownership and earnings management. At higher concentrations of ownership, the level of earnings management will decrease. To measure the higher concentration of ownership is by squaring the Top1 variable (Ding et al., 2007). This study also compares the differences between state-owned enterprise ownership group and private company's shareholding group. Therefore, the researchers used dummy variables (Ding et al., 2007) to distinguish the stock ownership group, i.e., Private = 1 variable for private companies and 0 for state enterprises.

4.4 Empirical Model

This study used cross-sectional multivariate regression to examine the effect of ownership structure on earnings management as conducted in Ding et al. (2007). The regression is as follows:

$$ACCit = \alpha + \beta1 (Top1) + \beta2 (Top1)^2 + \beta3 (Private) + \beta4 (Private_Top1) + B3 (PC_PCom) + \beta4 (PC_IC) + \beta3 (CG) + B4 (ln_sales) + \beta4 (Lev) + \epsilon \quad (3)$$

Information: Top1 = largest shareholder; private = dummy variable (ie 0 = SOE, 1 = Non-SOE); PC_PCom = political relationship of the president commissioner (dummy, 1 = connected politically, 0 = not connected politically); PC_IC = political relations independent commissioner (dummy, 1 = connected politically, 0 = not connected politically);CG = Corporate Governance Index; Ln_sales = natural logarithm sales;Lev = Leverage.

5. Results and Discussion

5.1 Sample

This study's sample is 232 listed companies on the Indonesia Stock Exchange in the period 2006 to 2014. The sample results in this study can be seen in the following table.

Table 1. Sample

Criteria	Number
SOE	116
Private listed	116
	232
Incomplete data	0
Total Sample	232

5.2. Classic Assumption Test

5.2.1 Normality Test

This study used the Kolmogorov-Smirnov (K-S) non-parametric statistical test method for the residual distribution. If the significance value of KS is below 0.5, the residual is said to be not normal.

Table 2. Normality Test Results

	Model 1	Model 2	Model 3
Asymp. Sig Residual	0,062	0,140	0,095

Source: Processed Data, 2015

The normality test results in the table above show that the residual probability value in the three models is above 0.05, so that there is no indication of a normality problem.

5.2 Multicollinearity Test

Testing multicollinearity symptoms in the regression model can be seen from the Tolerance value (TOL) and Variance Inflation Factor (VIF). If the TOL value is less than 0.10 or the VIF value is greater than 10, there are multicollinearity symptoms and vice versa. Based on Table 3, the analysis results show that all variables are free from multi-linearity problems.

Table 3. Multicollinearity Test

	Model 1		Model 2		Model 2	
	TOL	VIF	TOL	VIF	TOL	VIF
Top1	0.171	5.860	0.166	6.037	0.149	6.723
Top1 ²	0.730	1.370	0.534	1.872	0.521	1.919
Private	0.716	1.397	0.684	1.461	0.409	2.446
Private*Top1	0.171	5.844	0.167	5.985	0.157	6.378
Leverage	-	-	0.908	1.101	0.906	1.104
LnSales	-	-	0.627	1.595	0.592	1.689
PC. Prescom	-	-	-	-	0.405	2.468
PC. IC	-	-	-	-	0.772	1.296
Corp. Gov	-	-	-	-	0.749	1.335

Note :

Top1 = The largest shareholder of the company; Private = BUMN vs. Private; Leverage = leverage; PC_Presscom = Commissioner president's political relations; PC_IC = Political relations of independent commissioners; Corp_Gov = Corporate governance; LnSales = Natural Logarithm of Sales.

Source: Processed Data, 2015.

5.3 Autocorrelation Test

This study, to detect autocorrelation, uses the Run Test.

Table 4. Autocorrelation Test

	Model 1	Model 2	Model 3
Asymp. Sig Residual	0,693	0,511	0,292

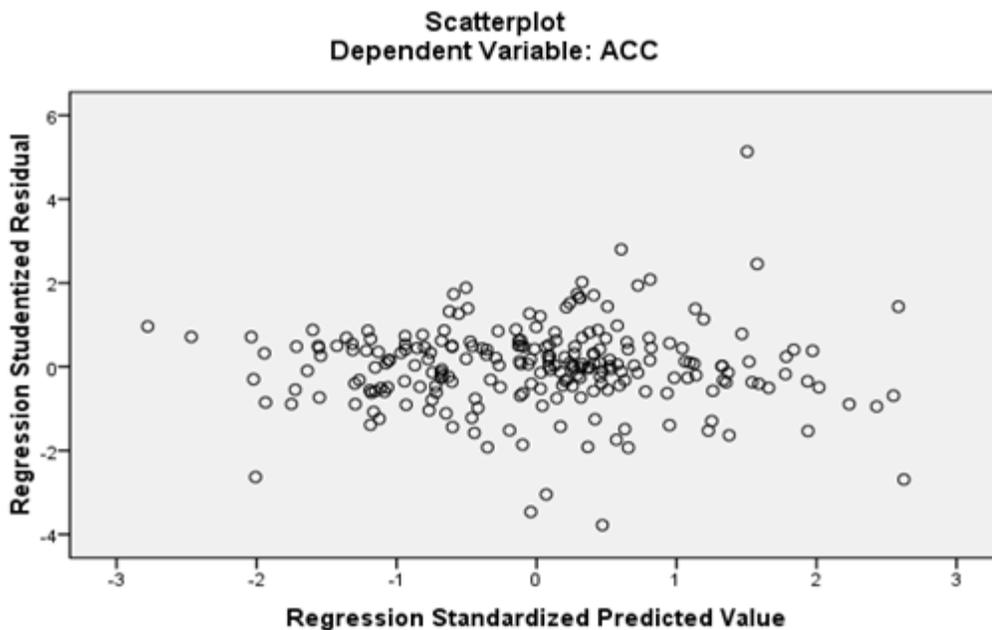
Source: Processed Data, 2015.

The table above shows that the residuals have an insignificant probability so that the three research models are declared not affected by autocorrelation problems.

5.4 Heteroscedasticity Test

In this study, the heteroscedasticity test was carried out by analyzing the graph plot between the predicted value of the dependent variable (ZPRED) and its residual (SRESID). This test shows the following results.

Figure. 1. Heteroscedasticity Test



Based on the figure above, the graph points are scattered (not forming a pattern), so there is no heteroscedasticity.

5.3 Hypotheses testing

Table 5 shows a summary of the results of the regression analysis of the three research models.

Table 5. Regression Results

	Model 1	Model 2	Model 3	Interpretation
Top1	0.360 (2.289*)	0.280 (1.788*)	0.193 (1.168)	H _{1a} supported
Top1 ²	-0.075 (-0.985)	-0.174 (-1.991**)	-0.167 (-1.890*)	H _{1b} supported
Private	-0.042 (-0.544)	-0.093 (-1.205)	-0.047 (-0.467)	
Private*Top1	-0.286 (-1.823*)	-0.227 (-1.451)	-0.177 (-1.097)	H ₂ supported
Leverage	-	0.091 (1.362)	0.089 (1.332)	
LnSales	-	-0.223 (-2.771***)	-0.202 (-2.431**)	
PC_PCom	-	-	0.081 (0.812)	
PC_IC	-	-	-0.005 (-0.069)	
CG	-	-	-0.114 (-1.549)	
<i>Turning Point</i>		80.46%		
Adj. R- Square	0.024	0.058	0.057	
F Statistic	2.440**	3.388***	2.561***	

Notes: * = Sig. 10%; ** = Sig. 5%; *** = Sig. 1%; Top1 = largest shareholder; private = dummy variable (ie 0 = SOE, 1 = Non-SOE); PC_PCom = political relationship of the president commissioner (dummy, 1 = connected politically, 0 = not connected politically); PC_IC = political relations independent commissioner (dummy, 1 = connected politically, 0 = not connected politically); CG = Corporate Governance Index (Hermawan, 2011); Ln_sales = natural logarithm sales; Lev = Leverage.

Table 2 shows that Top1, the concentration of ownership, has a significant positive coefficient on all three models. This means that ownership concentration positively affects earnings management and is robust despite added control variables. The squared Top1 variable (Top1²) is intended to detect a relationship between earnings management and a higher ownership concentration. In the second and third models, the Top1² variable has a significant negative coefficient. Meanwhile, the Top1 variable on the same model has a positive and significant coefficient. This shows a nonlinear relationship between earnings management and ownership concentration with an inverted U-shape. Inverted U-shapes show a lower ownership concentration positively affects earnings management, but this effect becomes negative at higher

ownership concentrations. Based on the regression coefficient of Model 2, a turning point of 80.46% is obtained.

The previous research finding showed that ownership concentration positively affected management, which showed more concentrated ownership. The higher the tendency of management practice to be done by the company. This finding is consistent with the results of previous studies by Claessens et al. (2002), Febrianto (2005), and Siregar et al. (2006) that the more concentrated the ownership, the higher the chance of earnings management in the controlled company. In developing countries such as Indonesia, earnings management occurs as a form of expropriation of controlling owners to minority owners through policies favoring majority owners. This action is then known as the entrenchment effect in which the controlling owner tends to take an approach that benefits himself and harms the minority owner. These results simultaneously prove that entrenchment effects occur in Indonesia. Significantly negative (negative) results in the quantified Top1 variable indicate an inverted U-shaped relationship (Ding et al., 2007). These results explain that on the left side curve slopes, starting from lower concentrations, increased ownership concentration will be followed by improved earnings management or an entrenchment effect occurs. After passing through the top point, the slope of the right-side curve, the lower the ownership concentration, the lower the earnings management or the alignment effect occurs. After passing through the 80.46% peak, the slope of the right-side curve, the lower the ownership concentration, the lower the earnings management or the alignment effect occurs.

Private ownership status has insignificant coefficients in all three models, so ownership status (BUMN vs. Non-SOE) does not affect earnings management. Private * Top1, which is the interaction between the concentration of ownership and ownership status, has a significant coefficient only in the first model. After added control variables in the second and third models, this variable is no longer significant. Among the five control variables, only sales variables (LnSales) have a significant coefficient, namely on the second and third models, and negatively. This means that the concentration of ownership affects earnings management practice without the influence of private ownership factors. This study does not support Wang and Yung (2011) and Ding et al. (2007), which states that ownership concentration on earnings management is more significant on private companies.

4. Conclusions

This research was conducted to analyze how entrenchment and the effect of alignment on the relationship between ownership structure on earnings management. This study also compared the effects of entrenchment and alignment effects on state-owned enterprises with privately-owned companies listed on the BEI. Other factors that are suspected to be influential in this study are control variables, including corporate governance, political relationships, sales, and leverage.

Based on the previous test results, it can be seen that ownership concentration has a positive effect on earnings management. This shows that the more concentrated the ownership, the higher the tendency of earnings management practices to be done by the company. This action is then known as the entrenchment effect in which the controlling owner tends to take a policy that benefits himself and harms the minority owner. After the entrenchment effect through the 80.46

percent peaks, the more ownership cause lower earnings management or the alignment effect. This shows that the level of ownership concentration positively influences Indonesia's earnings management practices, and the relationship is inverted U-shape. The peak point of 80.46 percent shows the limits of company ownership concentration, which earn earnings management. It implies that investors can utilize this figure to make investment decisions; namely, the level of ownership concentration above 80.46 percent indicates that companies tend not to make earnings management or profit minimization. Private ownership does not affect the effect of ownership concentration on earnings management. Companies with high ownership concentration levels tend to perform earnings management without being influenced by factors owned by private companies. In the control variable, only sales variables, which have significant coefficients. It implies that capital market regulators in Indonesia must supervise state-owned and private companies from possible earnings management practices

4. Limitations and Suggestion

There are two limitations in this study. Earnings management proxies only use the accrual method, while other management proxies such as accrual discretion and Eckel index are not used. Thus, this research cannot show the type of earnings management, which tends to be more often used, both at the company of SOE and non-SOE. Future researchers interested in researching similar topics should consider using other earnings management proxies, for example, discretionary accruals of the Jones model modified by Dechow (1995). Second, the period of observation of this study is from 2006 to 2014. Further research should cover a more extended period to reflect the current state.

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