
Article

The Effect of Financial Performance on Earnings Management Practices in Pharmaceutical Industry Health Companies Listed on the Indonesia Stock Exchange (IDX) for the Period 2014-2023

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Abstract: This study aims to analyze the effect of profitability, leverage, company size, and sales growth on earnings management practices in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) for the period 2014-2023. The data used is secondary data in the form of annual financial reports from 8 pharmaceutical issuers that meet purposive sampling criteria. The analysis was carried out with a non-linear panel data regression model using a quadratic polynomial function to capture complex relationship patterns. The results show that profitability and sales growth have a non-linear positive effect on earnings management, while leverage shows a significant negative effect. However, firm size has no significant effect on earnings management practices. The findings indicate that external pressures, such as creditor scrutiny and market expectations, play an important role in encouraging or limiting earnings management in pharmaceutical companies.

Keywords: *Earnings Management, Profitability, Leverage, Company Size, Sales Growth, Non-Linear Regression, Pharmaceutical Industry.*

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1. Introduction

The companies listed on the Bursa Efek Indonesia (BEI) have an obligation to present accurate and transparent financial statements as a basis for decision-making for investors, creditors, and other stakeholders. Financial statements not only serve as a tool to reflect the company's performance but are also used to assess the financial condition and future prospects of the company. Transparency and accuracy in financial reporting are crucial in maintaining the integrity of the capital market. However, in some cases, companies use

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earnings management practices to maintain a positive financial image. Although this may provide short-term benefits, these practices risk undermining the credibility of financial reports and public trust.

Earnings management practices have become a primary concern in accounting and finance research due to their impact on the quality of financial reporting and investor confidence. Watts & Zimmerman (1986) define earnings management as a company's managers' efforts to influence financial reports through certain accounting policies[1]. The main motivations behind this practice include the desire to maintain stock price stability, meet profit targets expected by investors, and preserve the company's reputation in the eyes of shareholders and creditors.

In the pharmaceutical industry sector, earnings management is of particular concern considering the industry's highly regulated nature and strong dependence on stable financial performance. The pharmaceutical industry is part of the health sector, which significantly contributes to the national economy. Pharmaceutical companies often face external pressures such as government regulations, creditor demands, and high market expectations. In this context, earnings management can become a strategy employed by companies to maintain financial stability and sustain a positive image among stakeholders.

Several financial performance factors contribute to earnings management practices in the pharmaceutical industry, including profitability, leverage, company size, and sales growth. Profitability, often measured by Return on Assets (ROA), reflects a company's ability to generate profits from its assets. Companies with low profitability are more likely to engage in earnings management to create a perception of better performance. Conversely, companies with high profitability may have less incentive to practice earnings management.

Leverage, measured by the debt-to-asset ratio (Debt to Asset Ratio/DAR), is another important factor influencing earnings management. According to agency theory developed by Jensen and Meckling (1976), companies with high leverage usually operate under strict creditor supervision[2]. This oversight can limit managers' discretion to manipulate financial statements. However, in some cases, highly leveraged companies may also be tempted to engage in earnings management to maintain financial stability in the eyes of creditors and investors.

Company size also plays a significant role in earnings management practices. Larger companies typically have more stakeholders and greater resources to ensure strict oversight of operational activities. This can reduce managers' tendencies to manipulate financial reports. On the other hand, large companies also face higher pressure from investors and the capital market, so there remains a possibility that they may engage in earnings management to meet market expectations.

Additionally, sales growth is a factor that can affect earnings management practices. Companies with high sales growth tend to experience more stable performance and have less incentive to manipulate financial reports. However, in situations where sales growth fluctuates sharply, companies may feel pressured to manage earnings to maintain investor and stakeholder confidence.

In recent years, several cases of earnings management in the pharmaceutical sector have emerged, highlighting the importance of deeper research into the factors influencing these

practices. A notable case is PT Kimia Farma Tbk in 2001, where the company was involved in profit inflation amounting to Rp 32.7 billion.

This case significantly impacted public trust and tarnished the reputation of Indonesia's pharmaceutical industry. A similar case occurred at PT Indofarma Tbk in 2024, where the company experienced a 35% decline in net profit due to decreased demand for pharmaceutical products following the COVID-19 pandemic. Alleged manipulation involved delaying the recognition of operating expenses and shifting some costs to subsequent periods, becoming a key issue in this case. This strategy may be effective in maintaining a positive financial image in the short term but risks damaging public trust in the long term if fully exposed.

Besides external pressures such as market expectations and creditor oversight, capital market fluctuations can also influence earnings management practices in the pharmaceutical industry. Fluctuations in the Composite Stock Price Index (Indeks Harga Saham Gabungan/IHSG) and daily trading activities on the Bursa Efek Indonesia (BEI) demonstrate how external pressures can drive companies to engage in these practices. A dynamic and uncertain capital market puts pressure on pharmaceutical companies to show stable financial performance to attract investor interest and maintain their stock value.

In this context, research on the influence of financial performance on earnings management practices is highly relevant. By understanding how factors such as profitability, leverage, company size, and sales growth affect the tendency of companies to engage in earnings management, stakeholders can take more effective steps to improve transparency and accountability in financial reporting within the pharmaceutical industry sector.

This study aims to analyze the influence of profitability, leverage, company size, and sales growth on earnings management practices in pharmaceutical companies listed on the Bursa Efek Indonesia (BEI) during the 2014-2023 period. Using secondary data in the form of annual financial reports from 8 pharmaceutical issuers selected through purposive sampling criteria, this research will apply a non-linear panel data regression model with a quadratic polynomial function to capture the complex relationships between these variables.

The results of this study are expected to contribute to academics, practitioners, and regulators in understanding the dynamics of earnings management in the pharmaceutical industry. From an academic perspective, the study can enrich literature on the impact of financial performance on earnings management practices, especially in the heavily regulated pharmaceutical sector. For practitioners, the research can provide insights into factors that need attention to maintain transparency and credibility in financial reporting. Meanwhile, for regulators, this study can serve as a reference in designing more effective policies to supervise accounting practices in the pharmaceutical industry sector.

Thus, this research is expected to provide new insights into the mechanisms occurring in the pharmaceutical industry and strategic implications for stakeholders. Looking ahead, further studies are needed to develop more effective strategies and policies to prevent earnings management practices that could harm transparency and the integrity of Indonesia's capital market.

2. Literature Riview and Hypotheses

2.1 Signaling and Agency Theory

Signaling theory explains that companies use financial performance as a communication tool to stakeholders to reduce information asymmetry. Spence (1973) stated that the information conveyed by a company can influence the decisions of investors and shareholders[3]. High profitability is often considered a positive signal indicating that the company has good prospects. However, in some cases, companies may exploit earnings management to create the illusion of better performance than the actual condition. In the pharmaceutical industry, signaling theory is very relevant due to the sector's strict oversight and high market expectations. If a company can demonstrate high profitability figures, investor confidence will increase. However, when profitability declines, managers may be driven to engage in earnings management to maintain the company's image.

In addition to signaling theory, agency theory also serves as a foundation for understanding earnings management practices. This theory explains the conflict of interest between the company's owners (principal) and managers (agent). Jensen and Meckling (1976) stated that managers, as agents, have their own interests which may differ from those of the capital owners. In some cases, managers are motivated to engage in earnings management practices to obtain incentives or meet certain financial targets. In the pharmaceutical industry, this conflict of interest can become more complex due to strict regulations governing financial reporting. Therefore, proper regulation and good corporate governance systems are necessary to reduce manipulative practices that could harm shareholders and other stakeholders.

2.2 Research Hypotheses

- a. H1: Profitability affects earnings management.
- b. H2: Leverage affects earnings management.
- c. H3: Sales growth affects earnings management.
- d. H1: Company size affects earnings management.

3. Research Methodology

3.1 Population and Sample

This study uses secondary data in the form of annual financial reports from 8 pharmaceutical issuers listed on Bursa Efek Indonesia (BEI) during the 2014-2023 period, employing purposive sampling method. Samples are selected based on specific criteria, such as the availability of complete data, operational continuity throughout the research period, and absence of delisting during that period. Thus, this research focuses on companies that have operational stability and reflect industry trends in the Indonesian pharmaceutical sector.

3.2 Research Variables

- a. **Dependent Variable:** Earnings management (Discretionary Accruals).
- b. **Independent Variables:** Profitability (ROA), Leverage (DAR), Company Size (Total Assets), Sales Growth (Sales Growth).

These variables are chosen based on their relevance to signaling and agency theories, as well as previous research that indicates a relationship between financial performance and earnings management.

3.3 Analysis Method

This study employs a quantitative approach with a panel data regression analysis method to examine the effect of financial performance on earnings management practices in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during the 2014–2023 period. The data used in this study are secondary data obtained from the annual financial reports of pharmaceutical companies that meet the purposive sampling criteria. The data were collected from the financial statements available on the official IDX website, with the analyzed variables including profitability (ROA), leverage (DAR), firm size (total assets), and sales growth, while earnings management practices serve as the dependent variable measured using the discretionary accruals method. The data were analyzed using descriptive statistics and panel data regression. Descriptive statistics were employed to provide a general overview of the data characteristics, including the mean, standard deviation, minimum, and maximum values of each research variable.

Before conducting further analysis, classical assumption tests were performed, including multicollinearity tests to ensure no high correlation among independent variables, heteroscedasticity tests to examine whether the residual variance remains constant within the regression model, and autocorrelation tests to detect correlations among residuals. The main analysis in this study utilized panel data regression, which considered three primary models: the Common Effect Model (CEM), the Fixed Effect Model (FEM), and the Random Effect Model (REM). The CEM assumes no individual or time differences among firms in the panel data, the FEM accounts for firm-specific effects by incorporating dummy variables to capture unobserved heterogeneity, while the REM assumes that individual differences are treated as random variables.

To select the most appropriate model, a series of model specification tests were conducted, including the Chow test to determine whether the CEM or FEM is more suitable, and the Hausman test to decide between the FEM and REM. Hypothesis testing was performed using the F-test to assess the simultaneous effect of all independent variables on the dependent variable, the t-test to examine the partial effect of each independent variable, and the coefficient of determination (R^2) to measure how well the model explains variations in the dependent variable. Through this approach, the study is expected to provide valid results in measuring the effect of financial performance on earnings management practices in the pharmaceutical industry listed on the IDX.

4. Results And Discussion

4.1 Descriptive Statistics

Descriptive statistical analysis was conducted to provide a general overview of the variables used in this study. Descriptive statistics include the mean, standard deviation, minimum, and maximum values of the analyzed variables.

Tabel 1. Hasil Analisis Deskriptif

Variable	Obs	Mean	Std. Dev.	Min	Max
y	80	-.1217991	.3848184	-1.03297	1.14149
x1	80	.0875	.1753225	-.95	.92
x2	80	.382625	.2774876	.07	2.06
x3	80	.067125	.2229162	-.66	1.27
X4	80	120.5	23.2379	81	160

From the table above, it can be seen that there is considerable variation among the observed variables, particularly in profitability and sales growth.

4.2 Model Specifivation Test

To determine the most appropriate panel data regression model, a series of model specification tests were conducted, namely the Chow test and the Hausman test.

Tabel 2. Hasil Uji Chow

F test that all u_i=0: F(7, 68) = 31.82 Prob > F = 0.0000

Tabel 3. Hasil Uji Hausman

Wald chi2(4) = 30.46
Prob > chi2 = 0.0000

The results of the Chow test indicate that the Fixed Effect Model (FEM) is more suitable than the Common Effect Model (CEM). Furthermore, the Hausman test results show that the FEM is the most appropriate model to be used in this study. Therefore, the FEM was applied in the panel data regression analysis to capture the specific differences among the pharmaceutical companies included in the research sample.

4.3 Classical Assumption Test

Classical assumption tests were carried out to ensure that the regression model used meets the fundamental assumptions required for the analysis results to be interpreted properly.

Tabel 5. Multicollinearity Test Results

Variable	VIF	1/VIF
x1	2.21	0.451614
x2	2.21	0.453073
X4	1.07	0.932633
x3	1.06	0.943695
Mean VIF	1.64	

The multicollinearity test shows that there is no issue of high correlation among the independent variables, as indicated by the Variance Inflation Factor (VIF) values, all of which are below the critical threshold.

Table 6. Generalized Least Square (GLS) Test Results

Cross-sectional time-series FGLS regression						
Coefficients:		generalized least squares				
Panels:		homoskedastic				
Correlation:		no autocorrelation				
Estimated covariances	=	1	Number of obs	=	80	
Estimated autocorrelations	=	0	Number of groups	=	8	
Estimated coefficients	=	12	Time periods	=	10	
Log likelihood	=	36.81371	Wald chi2(11)	=	421.55	
			Prob > chi2	=	0.0000	
y	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
x1	1.081665	.1706552	6.34	0.000	.7471865	1.416143
x2	.4557464	.1198882	3.80	0.000	.2207698	.690723
x3	-.0758239	.0823812	-0.92	0.357	-.2372882	.0856403
X4	.0015536	.0010345	1.50	0.133	-.0004739	.0035811
id						
2	.1423318	.0723365	1.97	0.049	.0005548	.2841088
3	-.1349404	.0837855	-1.61	0.107	-.299157	.0292762
4	-.1629134	.0872892	-1.87	0.062	-.3339972	.0081704
5	.343642	.081624	4.21	0.000	.1836619	.5036221
6	-.0774242	.07857	-0.99	0.324	-.2314187	.0765702
7	-.7070619	.0755385	-9.36	0.000	-.8551147	-.5590092
8	-.5706916	.0722977	-7.89	0.000	-.7123924	-.4289908
_cons	-.3027734	.0724424	-4.18	0.000	-.4447578	-.160789

The heteroscedasticity test using the GLS method indicates that there is no specific pattern in the residual distribution, suggesting that the regression model does not suffer from heteroscedasticity problems. In addition, the autocorrelation test results show that there is no correlation among residuals, meaning that the model used is valid for further analysis.

4.4 Linear and Non-Linear Regression

In this study, regression analysis was conducted using both linear and non-linear approaches. The results of the linear regression indicate that profitability and sales growth have a significant positive effect on earnings management, while leverage has a significant negative effect. Firm size, however, does not have a significant effect.

In the non-linear regression, it was found that the relationship between profitability and earnings management is non-linear, forming an inverted U-shaped pattern. This means that after reaching a certain point, an increase in profitability actually reduces earnings management practices. A similar pattern was also observed for sales growth, where an increase in sales growth beyond a certain level no longer contributes to a rise in earnings management practices

Tabel 7. Likelihood Ratio (LR) Test Results

LR chi2(4)	=	49.62
Prob > chi2	=	0.0000

The results of the Likelihood Ratio (LR) test indicate that the non-linear model fits better than the linear model in capturing the relationship patterns among the studied variables

4.5 Hypothesis Testing

Tabel 8. Regression Test Results

y	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
x1	-.7036456	.4200844	-1.68	0.099	-1.542861	.1355694
roa_sq	2.506352	.4546421	5.51	0.000	1.5981	3.414604
x2	.0998409	.3663599	0.27	0.786	-.6320472	.8317289
dar_sq	-.9027581	.2920611	-3.09	0.003	-1.486217	-.319299
x3	-.0985803	.1022145	-0.96	0.338	-.3027773	.1056167
sales_growth_sq	.4508684	.1225478	3.68	0.000	.206051	.6956858
X4	-.0204613	.0118336	-1.73	0.089	-.0441016	.003179
total_aset_sq	.0000896	.0000493	1.82	0.074	-8.94e-06	.0001881
_cons	1.107009	.7130504	1.55	0.125	-.3174729	2.531491
sigma_u	.29472478					
sigma_e	.12522503					
rho	.84707728	(fraction of variance due to u_i)				

The panel data regression results show that profitability has a positive non-linear effect on earnings management, meaning that companies with higher profitability levels tend to engage in earnings management up to a certain point, after which the tendency decreases. Leverage has a significant negative effect on earnings management, indicating that the higher a company's leverage, the lower its likelihood of engaging in earnings management due to stricter creditor monitoring. Sales growth also has a positive non-linear effect on earnings management, suggesting that companies with higher sales growth are more likely to engage in earnings management within certain limits. However, firm size does not have a significant effect on earnings management practices, implying that the size of the company is not a determining factor in the decision to engage in earnings management.

4.6 Coefficient of Determination Test

Tabel 9. Results of the Coefficient of Determination Test

Adj R-sq:	0.56348448
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The results show that the adjusted R-square (Adj R²) value is 0.5634, indicating that the independent variables collectively explain 56.34% of the variation in the dependent variable. Meanwhile, the remaining 43.66% is explained by other variables not examined in this study.

5. Discussion

The results of this study indicate that financial performance factors have varying effects on earnings management practices in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX). Higher profitability increases earnings management practices up to a certain point; however, beyond that point, market pressure tends to reduce such tendencies. This finding aligns with signaling theory, which suggests that highly profitable firms are less likely to engage in earnings management in order to maintain their reputation

Leverage was found to have a significant negative effect on earnings management, suggesting that companies with higher debt levels are under stricter supervision from creditors and other stakeholders, making it more difficult for them to manipulate earnings. High sales growth encourages firms to engage in earnings management to sustain a positive trend in their financial statements. However, the non-linear regression results indicate that this effect is not linear—after reaching a certain level of sales growth, greater external pressure may limit such practices. Firm size does not have a significant effect on earnings management in this study, implying that although larger firms have more resources to engage in such practices, they are also subject to closer scrutiny from regulators and stakeholders.

The findings of this study are consistent with previous research, which suggests that financial factors such as profitability, leverage, and sales growth play important roles in determining the extent to which firms engage in earnings management. These results provide important implications for investors, regulators, and corporate managers in identifying the factors that influence financial reporting transparency in the pharmaceutical sector. Thus, this study offers new insights into how financial performance factors contribute to earnings management practices and how regulators and stakeholders can utilize this information to enhance oversight and transparency in the Indonesian capital market.

6. Conclusion

The results of this study show that profitability (ROA), leverage (DAR), and sales growth significantly influence earnings management practices in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during the 2014–2023 period. Profitability and sales growth have a significant positive non-linear effect, while leverage shows a

significant negative effect, and firm size has no significant impact. These findings indicate that companies with high profitability and fluctuating sales growth tend to be more prone to earnings management practices in order to maintain financial performance stability. Meanwhile, monitoring by creditors in highly leveraged firms can reduce the likelihood of earnings manipulation. Furthermore, the non-linear positive relationship between sales growth and earnings management suggests that an increase in revenue does not always reflect the company's true financial condition, as firms may use earnings management to align financial reports with market expectations. On the other hand, the insignificant effect of firm size implies that larger firms face more pressure toward operational transparency rather than earnings manipulation

7. Recommendations

1. For Companies

Companies are advised to enhance transparency and accountability in financial reporting by adopting stricter reporting standards to build investor true

2. For Regulators

Relevant authorities should strengthen oversight of corporate accounting practices, particularly for firms with high leverage, to prevent potential manipulation.

3. For Future Research

Future studies are encouraged to explore external factors such as government policies or global market conditions to provide a more holistic understanding of the influence of financial performance on earnings management practices.

4. For Investors

Investors should conduct an in-depth analysis of corporate financial statements to detect potential earnings management practices. Evaluating financial ratios such as ROA, DAR, sales growth, and total assets can help assess the company's financial stability.

5. For Academics

This study can serve as a reference for developing more complex analytical models by incorporating additional variables such as corporate governance or audit quality.

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