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What Are Leverage, Company Size, and Social Disclosure Considered to Reduce Market Response to Earnings Response Coefficient as an Intervening Variable?

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Abstract

Introduction/Main Objectives: *This research examined the influence of leverage, company size and social disclosure on the earnings response coefficient as an intervening variable.* ***Background Problems:*** *Research showed that leverage ability, company size, and social disclosure influence the earning response coefficient. Furthermore, the company size variable positively influenced ERC in various industrial sector companies on the Indonesian Stock Exchange.* ***Research Methods:*** *This type of research used quantitative methods. The research data was manufacturing companies that were registered with an IPO before 2016 and were still listed on the IDX from 2016 to 2020. For this reason, this regression model was suitable for testing and examining the effect of leverage on the earning response coefficient.* ***Finding/Results:*** *The larger the company size increases the market response because the company was considered capable of providing high returns. The social disclosure variable does not influence ERC in various industrial sector companies on the Indonesian Stock Exchange. Social disclosure was a principle or reaction carried out by companies to participate in community activities in general. This practice causes the company's asset value and profits low while the debt value and losses were high.* ***Conclusion:*** *High social disclosure was considered to reduce market response. On the other hand, low social disclosure was deemed to increase market response.*

Keywords: company size; earnings response coefficient; ***l***everage; social disclosure

JEL Classification: M40; M41

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INTRODUCTION

Profit has the benefit of assessing management performance, helping estimate long-term representative profit capabilities, predicting profits and assessing risks in investment or credit (SFAC No. 1). Profit information was a part of financial reports that received much attention. Studies conducted by Beaver et al. (1979) show that earnings have information content reflected in stock prices. Meanwhile, Lev & Zarowin (1999) use the Earnings Response Coefficient (ERC) as an alternative to measuring the value relevance of earnings information. Low ERC indicates that profits

were less informative for investors when making economic decisions. The need to compare profits between companies and understand the differences in quality used as an assessment based on profits was necessary to measure the quality of profits. Earnings quality does not have an absolute measure, but there were qualitative and quantitative approaches that can be used to analyze and explain earnings quality. The quantitative approach uses ratio analysis, while the qualitative approach was based on opinions based on logic, experience and insight. Earnings quality was not related to high or low reported earnings, including understatement and overstatement of earnings, stability of components in the income statement, realization of asset risk, and maintenance of capital. It can predict future profits (Adhariani, 2005).

This research measures earnings information contained in earnings quality. Generally, knowing good earnings quality can be measured by ERC, which measures the information content in earnings. ERC was the effect of each dollar of unexpected earnings on stock returns. The slope coefficient in the regression of abnormal stock returns and unexpected earnings usually measures it. Even though profit information was what investors respond most to because it provides an overview of the company's performance, profit information was sometimes not enough to be used as a basis for investor decision-making because the information may be biased. Among other things, biased earnings information was caused by the delivery of financial reports and earnings management practices and the need for more information to be disclosed in financial reports. If the reported earnings have response strength, they were high quality. Earnings quality does not have an absolute measure. The quantitative approach uses ratio analysis, while the qualitative approach was based on opinions based on logic, experience and insight. Earnings quality was not related to high or low reported profits.

Research on social disclosures that have influenced ERC has been widely conducted but still produces inconsistent results. According to Lehman (1995) and Deegan & Rankin (1996), disclosure of social responsibility reports can be influenced by various factors, including the level of profitability, leverage, company size, and ethnic factors of company leadership. Some corporate organizations can influence decision-making because national traditions can reflect personality. ERC measures the magnitude of abnormal stock returns in response to the expected components of the company's reported profits. Factors influencing ERC were profit persistence, capital structure, risk, growth opportunities, and company size. Murwaningsari (2008) states that leverage and company size were other factors that influence earnings quality.

Financial leverage was a measure that shows the extent to which fixed-income securities were used in a company's capital structure (Brigham & Houston, 2001). Generally, there were two types of leverage: operating and financial. Financial leverage shows the proportion of debt used to finance investments. A company with a high level of leverage means it has more outstanding debt than capital. Thus, if there was an increase in profits, the debtholders would benefit, so the better the company's profit condition, the more negative the shareholder response would be. Shareholders assume that these profits only depend on creditors. Murwaningsari (2008), by testing the effect of leverage on voluntary disclosure with auditor reputation as a control variable, concluded that there was a positive, insignificant influence between leverage and voluntary disclosure. Zubaidi et al. (2011), in their research, explain that there was a significant influence between leverage and company size on ERC.

Another factor that influences earnings quality was company size. Company size was a proxy for price informativeness. Large companies were considered to have more information than small companies. The consequence was that the more informative the stock price, the smaller the

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information content of current earnings. Murwaningsari (2008) states that company size significantly negatively affects ERC, so company size was used as a proxy for stock price informativeness. To examine the relationship between company size and ERC in the long term. The more sources of company information, the more ERC would increase. Researchers were interested in replicating previous research using the Path analysis method to observe the direct and indirect influence on the Earnings Response Coefficient variable with the social disclosure variable as an intervening variable for the leverage and company size variables. The difference between this research and previous research was that the researcher did not include timelines as an intervening variable and did not use audit opinions. The author examines the influence of leverage, company size, and social disclosure on the earnings response coefficient as an intervening variable.

RESEARCH METHOD

This type uses a form of associative study research that suggests the relationship of two or more variables with quantitative methods (Mulyani, 2017). The population in this research was 52 manufacturing companies that were registered with an IPO before 2016 and were still listed on the Indonesia Stock Exchange (BEI) from 2016 to 2020.

RESULTS AND DISCUSSION

Table 1. Statistical Analysis DescriptionDescriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
DAR	175	,0035	5,1677	,681171	,8374382
SIZE	175	25,2156	33,4945	28,606005	1,4867410
CONACC	175	-,7328	1,3596	,010953	,1529891
ERC	175	-4,3079	23,8939	,302170	2,5752175
Valid N (listwise)	175				

Source: Processed data, 2023

Based on Table 1 in this study, the average leverage proxied by the company's DAR was 0.681171.1, the average company size proxied by SIZA was 28.606005, the average social disclosure was 0.010953, and the average earning response coefficient proxied by ERC was 0.302170. Next, the classical assumption test was carried out in this research, consisting of a residual normality test using the One-Sample Kolmogorov-Smirnov method, a multicollinearity test using the Tolerance and Variance Inflation Factor method, a heteroscedasticity test using the Spearman's Rho method, and an autocorrelation test using the runs test method. All test results have been confirmed to meet the requirements of classical assumptions. The following were the results of regression testing, correlation, model feasibility and influence on the research panel, which can be seen in Table 2 below.

Table 2. Multiple Linear Regression Analysis

Model	B	t	Sig.	R	Adj. R Square	F	Sig.
(Constant)	-.685	-3.169	.002				
DAR	.156	7.817	.000	.575[a]	.315	21.559	.000
SIZE	.022	2.890	.005				
CONACC	-.024	-.386	.700				

Source: Processed data, 2023

Based on Table 2, the multiple regression equation was formed as follows:

$$ERC = -0,685 + 0,156\ LEV + 0,022\ SIZE - 0,024\ CSRj + e$$

Information:

ERC: Earning response coefficient
α: Constant
LEV: Leverage
SIZE: Company size
CSRj: Social Disclosure
e: Nuisance or Residual Variable

This test measured the ability of the regression model to explain the dependent variable (Ghozali, 2018). Based on Table 2, it could be seen that the correlation coefficient (R) has a value of 0.575. This correlation value shows a reasonably strong correlation between leverage, company size and social disclosure on ERC. The coefficient of determination (R2) could be seen in the Adjusted R Square, which has a value of 31.5 per cent. It could be concluded that leverage ability, company size and social disclosure influence ERC by 31.5 per cent.

In comparison, the remaining 68.5 per cent was influenced by other factors outside the variables studied. Based on Table 2, it was known that the F test result was 21.559, and the significance value was 0.000. By the previously determined criteria, the significance value of 0.000 was smaller than 0.05 (0.000<0.05), so it could be concluded that this regression model was suitable for testing in testing the first hypothesis, namely testing the effect of leverage on ERC.

Table 2 shows that the leverage variable, which was proxied by social disclosure, has a regression coefficient value of 0.156 with a significance level of 0.000, which was smaller than 0.05. This shows that the leverage variable positively influences the ERC earning response coefficient in various industrial sector companies on the Indonesian Stock Exchange from 2016 to 2020 (H1 was rejected). The greater the leverage ratio, the higher the ERC. A company with a high leverage ratio means that the company uses debt to finance company assets and was at higher risk. However, the high value of the company's debt was expected to increase the profits generated so that the return value was higher than the debt used to finance the company's assets. The results of this research were not in line with the results of research conducted by Dewi & Putra (2017) but were in line with research conducted by Husiano & Suratno (2014).

Testing the second hypothesis was testing the effect of company size on ERC. Table 2 shows that the company size variable, which was proxied by SIZE, has a regression coefficient value of 0.022 with a significance level of 0.005, which was smaller than 0.05. This shows that the company size variable positively influences ERC in various industrial sector companies on the Indonesia Stock Exchange from 2016 to 2020 (H_2 was accepted). Company size, as proxied by SIZE, shows how big the company was through the total assets owned by the company. Company size indicates the company's expertise in growth and investor welfare. The larger the company size increases the market response because the company was considered capable of providing high returns. Conversely, the smaller the company was considered to be, the lower the market response. This research's results align with the research conducted by Kristanti & Almilia (2019).

The third hypothesis was testing the effect of social disclosure on ERC. Table 2 shows that the social disclosure variable proxied by CONACC has a regression coefficient value of -0.024 with a significance level of 0.700, which was greater than 0.05. This shows that the social disclosure variable has no influence on ERC in various industrial sector companies on the Indonesia Stock

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Exchange from 2016 to 2020 (H_3 was rejected). Social disclosure was a principle or reaction carried out by companies to participate in community activities in general. In financial reporting, companies were expected to take time to recognize and measure profits and assets and recognize losses and debts. This practice causes the company's asset value and profits low while the debt value and losses were high. Thus, high social disclosure was considered to reduce market response. On the other hand, low social disclosure was considered to increase market response. However, the social disclosure variable in this study did not affect the ERC earning response coefficient. This was due to the possibility that not all companies apply the principles of social disclosure, and market players know the causes of social disclosure. This research's results align with research conducted by Untari and Budiasih (2014).

CONCLUSION

The research results showed that leverage as proxied by social disclosure and company size as proxied by SIZE positively affect ERC. In contrast, social disclosure, as proxied by CONACC, does not affect ERC. The limitation of this research was that it uses a sample that only focuses on companies in various industrial sectors that had an IPO before 2016 and were still listed on the Indonesia Stock Exchange during 2016-2020. Each independent variable used was only limited to one proxy. Suggestions for future researchers include using other factors, such as profit growth, which was believed to influence ERC, and considering other broader company sectors.

AUTHORSHIP CONTRIBUTION STATEMENT

The article's writers shared responsibilities for research, writing, and analyzing data.

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