

CAPITAL STRUCTURE, LIQUIDITY, AND FINANCIAL PERFORMANCE ON THE QUALITY OF EARNINGS

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Article Information

Article History:

Received June 6, 2022

Revised June 25, 2022

Accepted June 26, 2022

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ABSTRACT

Interested parties consider financial statements necessary because they can analyze the company's profit level. This study aims to provide empirical evidence on the effect of capital structure, liquidity, and financial performance on the quality of earnings in manufacturing companies listed on the IDX in 2019-2021. The sample used in this study was 77 companies with a purposive sampling technique to obtain 231 data. The method used is quantitative, and then the data collected is analyzed using the IBM SPSS version 25 software program. The results show that the capital structure and liquidity variables significantly affect earnings quality. At the same time, the Return on Assets (ROA) variable has no significant effect on earnings quality.

Keywords: Capital Structure, Liquidity, Return on Assets, Earnings Quality

1. INTRODUCTION

The current economic development in Indonesia is still experiencing uncertain conditions, so it impacts the company. Companies in various sectors compete fiercely with each other to attract investors. Investors will invest in companies that are considered profitable and experiencing growth (Safitri & Afriyenti, 2020). The users of financial statements believe the information contained in the income statements important so that companies compete with each other to optimize their profits. Earnings quality defines the company's reported earnings following reality and can predict future earnings (Bemshima et al., 2020). Good earnings quality will influence investors to invest in the company because external parties believe that the company's finances are free from all forms of irregularities.

The phenomenon of low earnings quality impacts one of the manufacturing companies, namely PT. Tiga Pilar Sejahtera Food Tbk which manipulates financial statement data. This kind of action has a substantial negative impact on the company because investors are reluctant to invest in the company. Manufacturing companies with high earnings quality and low earnings quality in 2019 to 2021 are calculated using the ratio to profit, namely operating cash flow divided by operating income. The results obtained are as follows:

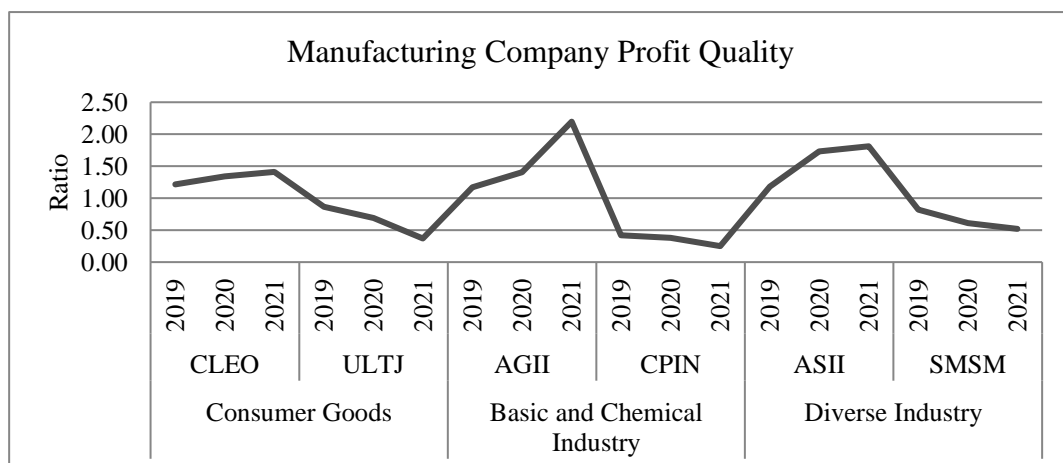


Figure 1. Graph of Manufacturing Company Profit Quality Ratio 2019-2021

The data in Figure 1 above shows that during 2019-2020 there were six Manufacturing Companies with a ratio of high-profit quality and low-profit quality classified by sector. Consumer Goods Sector Manufacturing Companies with high-profit quality in 2019-2021, namely PT. Sariguna Primatirta Tbk. The company experienced an increase in the ratio every year by 1,22, 1,34, and 1,41. Then the company with low earnings quality in 2019-2021 is PT. Ultra Jaya Milk Industry and Trading Company Tbk. This company experienced a low earnings quality ratio of 0,37 in 2021 from 0,69 in the previous year.

The data in Figure 1 above is a manufacturing company in the basic and chemical industry sector that has high-profit quality in 2019-2021, namely PT. Aneka Gas Industri Tbk. The company experienced an increase in the earnings quality ratio of 1,17, 1,40, and 2,20. Then the company with low earnings quality in 2019-2021 is PT. Charoen Pokphand Indonesia Tbk. This company experienced a low earnings quality ratio in 2021 of 0,25 from the previous year of 0,38.

The data in Figure 1 above is a diverse industry sector manufacturing company with high-profit quality in 2019-2021, namely PT. Astra International Tbk. The company experienced an increase in the earnings quality ratio of 1,18, 1,73, and 1,81. Then the company with low earnings quality in 2019-2021 is PT. During Perfect Tbk. This company experienced a low earnings quality ratio in 2021 of 0,52 from the previous year of 0,61.

The earnings quality ratio shows that the higher the ratio, the higher the quality of earnings obtained by the company because the higher the operating income obtained in cash (Herninta & Ginting, 2020). The calculation of the earnings quality ratio can measure the company's ability to achieve or not achieve the operating objectives that have been set so that it is useful for internal and external parties. A high ratio will affect investors in making decisions in the future.

One of the factors that influence the quality of earnings in the company is the capital structure. According to Sokang & Ratanak (2018) capital structure is defined as a source of financing for operating activities which usually consist of equity and long-term debt. If the capital structure in the company is not right, it will increase the company's burden (Wulandari et al., 2021). According to Silfi (2016), companies with high debt levels will have difficulty paying their debts and impact the low quality of company profits. Therefore, companies must consider the use of funds from internal parties and external parties so that their operational activities can be effective. Research conducted by Silfi (2016), Ahmad & Alrabba (2017), and Ashma' & Rahmawati (2019) states that capital structure has a significant effect on earnings quality. In contrast to research conducted by Wulandari et al (2021) which states that capital structure does not significantly affect earnings quality.

One way to determine the quality of the company's earnings is to look at the company's liquidity. Liquidity is a company's obligation to meet its short-term liabilities. Companies with high liquidity indicate that these companies have high earnings quality. If the profit earned by the company is of quality, then the practice of earnings management does not need to be carried out (Silfi, 2016). According to Marpaung (2019), companies that are unable to pay off their current debts will find it difficult to manage the company's current assets and profit engineering actions are likely to occur. Research conducted by Ardianti (2018), Safitri & Afriyenti (2020), Oktavia & Fariana (2021) states that liquidity has a positive effect on earnings quality. This is different from the research conducted by Nugroho & Radyasa (2019) which states that liquidity has no effect on earnings quality.

One way to determine the quality of a company's earnings is to assess its financial performance. Financial performance is used to see how the company maximizes its profits by controlling its operational activities. The financial ratio that can show a company's financial performance is the profitability ratio. According to Ginting (2017) this ratio is used to measure the company's performance in generating profits and is proxied by Return on Assets (ROA). The higher the Return on Assets (ROA) value, the better the company manages its assets to maximize profit (Wulandari et al., 2021). A high Return on Assets (ROA) indicates that the quality of earnings generated by the company also increases. Investors will tend to invest their funds in companies with a high level of profit compared to companies with a low level of profit (Ardianti, 2018). Research conducted by Ginting (2017), Warrad (2017), and Ardianti (2018) has a significant effect on earnings quality. In contrast to research conducted by Wulandari et al (2021) which states that Return on Assets (ROA) does not affect earnings quality.

Based on the inconsistency of previous research and the phenomena that occur in manufacturing companies, this research is interesting to review again with the title "The Effect of Capital Structure, Liquidity, and Financial Performance on Earning Quality in Manufacturing Companies Listed on the Indonesia Stock Exchange".

2. LITERATURE REVIEW

a. Agency Theory

Agency theory, according to Jensen & Meckling (1976) explains the existence of a conflict of interest between principals (investors) and agents (management). This theory assumes that each party acts on its own needs. Principals expect high feedback on their investments, while agents want their performance to the company to be given high compensation such as commissions and flexible working hours. The agent has stronger

information to know the company's activities than the principal. In this case, the principal cannot monitor the work done by the agent optimally. So the agent has the potential to fulfill his personal needs by reporting earnings inaccurately.

b. Pecking Order Theory

The pecking order theory proposed by Myers (1984) explains that financial managers do not consider high levels of debt. According to this theory, companies only need internal funding to meet their investment needs through their profits. Companies with low debt levels tend to generate high returns. This is because companies that have high profits tend to have large internal funds. Meanwhile, less profitable companies will have large debts so that the interest expense becomes high and is threatened with bankruptcy. Management will carry external funding as a last resort if internal funds are insufficient for the company's operational needs.

c. Earnings Quality

Earnings quality defines the company's reported earnings following reality and can predict future earnings (Bemshima et al., 2020). According to Hieu & Quyen (2021) high earnings quality requires predictable problems that impact future cash potential. Reported profit is the main component of the company in managing resources. Therefore, the profit presented must be based on facts so that the information provided is able to assist interested parties in making accurate decisions (Putra & Hermawan, 2021). Good earnings quality will influence investors to invest in the company because external parties believe that the company's finances are free from all forms of irregularities. High-quality earnings are considered very important because they impact the company's future development. According to Penman (2013:608), earnings quality in this study was measured using the earnings quality ratio, which was formulated as follows:

$$\text{Earnings Quality} = \frac{\text{Cash Flow from Operations}}{\text{Operating Income}}$$

The earnings quality ratio shows that the greater the balance, the greater the operating income obtained in cash. Earnings quality is high if the ratio results are more than 1.0, and earnings quality is said to be low if the ratio results are less than 1,0 (Hadi, 2021).

d. Capital Structure

According to Sokang & Ratanak (2018), capital structure is defined as financing for operating activities that usually consist of equity and long-term debt. The use of company debt depends on the need for the necessary sources of funds and the ability of external parties to provide financing for the company. The company considers the capital structure vital because it can examine the long-term impact of the earned income as long as it carries out its operational activities (Fahmi, 2020:111). If the company cannot manage its capital structure properly, the higher debt will lead to a high-interest expense as well. The management seeks to improve its performance to pay off its debts so that the company can continue to grow (Hakim & Abbas, 2019). The ratio to assess the optimal capital structure is the Debt to Equity Ratio. This ratio is used to evaluate how the company pays off long-term debt with its capital. According to Fahmi (2020:108), the formula for calculating the capital structure is as follows:

$$\text{Debt Equity Ratio} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

This study supports the results of research conducted by Silfi (2016), Ahmad & Alrabba (2017), and Ashma' & Rahmawati (2019), stating that capital structure has a significant effect on earnings quality. In contrast, Luas et al (2021) and Wulandari et al (2021) stated that capital structure has no significant effect on earnings quality.

H1 : Capital Structure Significantly Affects Earnings Quality.

e. Liquidity

Liquidity is a company's obligation to meet its short-term debt. A low level of liquidity will disrupt the activities carried out by the company so that it cannot normally run (Fahmi, 2020:96). Liquidity provides an essential signal for investors and creditors before making decisions based on disclosed earnings. The availability of current assets in the company can positively impact the company because the company can finance its current debt but still has existing assets for the continuity of its operations (Hasanuddin et al., 2021). Companies that can manage their liquidity well will credibly report their earnings. The higher the liquidity ratio, the better the management in managing their finances. According to Fahmi Fahmi (2020:59) to measure the company's liquidity using the current ratio, which is formulated as follows:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

This study supports the results of research conducted by Ginting (2017), Ardianti (2018), and Safitri & Afriyenti (2020), which state that liquidity affects earnings quality. In contrast to the research conducted by Hakim & Abbas (2019) and Luas et al. (2021) stated that liquidity does not affect the quality of company earnings.

H2: Liquidity Significantly Affects Earnings Quality.

f. Return on Assets (ROA)

Return on Assets (ROA) is the company's ability to generate net income through the management of company assets. According to Putri & Rahyuda (2020), a high level of profitability will indicate the prospect of a good quality company giving a positive response from the market. The higher the profitability ratio proxied by ROA, the better the management of assets generates enormous profits. Investors believe that the company will further increase its earnings in the future. According to (Hakim & Abbas, 2019), a company is said to have high earnings quality if the Return on Assets (ROA) value is more significant. Assets that are appropriately managed will get a considerable return from investors. Investors will invest their shares in companies with high profits because investors believe that the profits generated can be maximized regardless of whether or not there is fraud in the company. Return on Assets can be formulated as follows:

$$\text{Return On Assets} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

This study supports the results of research conducted by Ardianti (2018), Herninta & Ginting (2020), and Luas et al. (2021), stating that Return on Assets has a positive effect on earnings quality. In contrast to, research conducted by Hakim & Abbas (2019) and Wulandari et al (2021) stated that Return on Assets does not affect the quality of company earnings.

H3: Return on Assets (ROA) significantly affects earnings quality.

3. RESEARCH METHOD

This study uses a quantitative approach method. The quantitative approach is a method in the form of numbers used to examine the population, random sampling, and research media used to collect data to conclude established hypotheses (Sugiyono, 2019:17). The independent variables in this study are Capital Structure, Liquidity, and Financial Performance with the dependent variable being earnings quality.

The population used in this study are manufacturing companies listed on the Indonesian Stock Exchange in 2019-2021 with a total of 183 companies. This study uses a sample of 77 companies with purposive sampling technique with the following conditions:

Table 1. Sampling Technique

No	Descriptions	Total
1.	Manufacturing companies listed on the Indonesia Stock Exchange until 2021.	183
2.	Manufacturing companies delisting on the Indonesia Stock Exchange consecutively from 2019 to 2021.	(11)
3.	Manufacturing companies that do not publish consecutive annual financial statements from 2019 to 2021.	(9)
4.	Manufacturing companies that do not use Rupiah currency.	(31)
5.	Manufacturing companies that suffer consecutive losses from 2019 to with 2021.	(55)
Observation Sample		77
Observation Period		3 Tahun
Total Sample (77 x 3)		231 data

The data collection technique used in this study is secondary data through documentation study techniques by obtaining data on the annual financial statements of manufacturing companies listed on the

Indonesia Stock Exchange through the official website www.idx.co.id. This research was conducted for two years, from 2019 to 2021, and obtained 77 companies so that 231 data were obtained.

The analytical method used in this study uses quantitative analysis. Data analysis was carried out after all research data had been collected. Then the data were processed using the SPSS version 25 application program.

4. RESULTS AND DISCUSSION

a. Normality test

Table 2 Normality Test Results
One-Sample Kolmogorov-Smirnov Test

		<i>Unstandardized Residual</i>
N		187
<i>Normal Parameters^{a,b}</i>	<i>Mean</i>	-.3222077
	<i>Std. Deviation</i>	.62567888
<i>Most Extreme Differences</i>	<i>Absolute</i>	0.031
	<i>Positive</i>	0.030
	<i>Negative</i>	-0.031
<i>Test Statistic</i>		0.031
<i>Asymp. Sig. (2-tailed)</i>		0.200 ^{c,d}

Source: Secondary Data (processed, 2022)

Based on the results of table 2, the Asymp significance is $0,200 \geq 0,05$. The conclusion is that all data are normally distributed.

b. Multiple Linear Regression Analysis

Table 3 Multiple Linear Regression Test Results

Model		<i>Unstandardized Coefficients</i>		<i>Standardized Coefficients</i>	<i>t</i>	<i>Sig.</i>
		<i>B</i>	<i>Std. Error</i>	<i>Beta</i>		
1	<i>(Constant)</i>	.998	.068		14.750	.000
	Capital Structure	.111	.055	.147	2.025	.044
	Liquidity	.006	.003	.154	2.128	.035
	ROA	-.006	.007	-.056	-.777	.438

Source: Secondary Data (processed, 2022)

Based on the results of table 3, the results of the multiple linear regression equation are obtained as follows:

$$Y = 0.998 + 0.111X_1 + 0.006X_2 - 0.006X_3 + e$$

Based on the results of multiple linear regression testing above, it can be described as follows:

1. The constant (α) of 0,998 means that all independent variables are equal to zero, so the earnings quality is 0,998.
2. Capital Structure (X_1) has a positive regression coefficient of 0,111, which means that if the capital structure increases by 1 point, the quality of earnings will also increase by 1 point.
3. Liquidity (X_2) has a positive regression coefficient of 0,006, which means that if liquidity increases by 1 point, earnings quality will also increase by 1 point.
4. ROA (X_3) has a negative regression coefficient of -0,006, which means that if ROA decreases by 1 point, earnings quality will also decrease by 1 point.

c. Hypothesis test

Table 4 Partial Test Results

Model		<i>Unstandardized Coefficients</i>		<i>Standardized Coefficients</i>	<i>t</i>	<i>Sig.</i>
		<i>B</i>	<i>Std. Error</i>	<i>Beta</i>		
1	<i>(Constant)</i>	.998	.068		14.750	.000
	Capital Structure	-.111	.055	.147	2.025	.044
	Liquidity	.006	.003	.154	2.128	.035
	ROA	-.006	.007	-.056	-.777	.438

Source: Secondary Data (processed, 2022)

Based on the results of the partial test above, it can be stated that the significance value of the capital structure is $0,044 < 0,05$, it can be stated that H1 is accepted. The t_{count} value of the capital structure variable is $2,025 > t_{table}$ is 1,97301. It can be concluded that the capital structure has a significant effect on the quality of earnings in Manufacturing Companies listed on the Indonesia Stock Exchange.

Based on the partial test results above, it can be stated that the liquidity significance value of $0,035 < 0,05$ can be stated that H2 is accepted. The t_{count} value of the liquidity variable is $2,128 > t_{table}$ is 1,97301. It can be concluded that liquidity significantly affects earnings quality in Manufacturing Companies listed on the Indonesia Stock Exchange.

Based on the partial test results above, it shows that the ROA significance value of $0,438 > 0,05$ can be stated that H3 is rejected. The t_{count} value of the ROA variable is $-0,777 < t_{table}$ is 1,97301. It can be concluded that ROA has no significant effect on earnings quality in Manufacturing Companies listed on the Indonesia Stock Exchange.

DISCUSSION

a. Effect of Capital Structure on Earnings Quality

The first hypothesis in this study is the effect of capital structure on earnings quality in manufacturing companies listed on the BEI. The partial test results above show that the t_{count} value of the capital structure variable is $2,025 > t_{table}$ is 1,97301 with a significance value of $0,044 < 0,05$. Based on the results above, it can be said that the capital structure has a significant effect on earnings quality, so H1 is accepted.

Capital structure has a significant effect on earnings quality. Parties will assess the impact that will occur in the future if the company cannot balance internal and external funding. Capital structure is a comparison between own capital and debt. Companies with a high capital structure indicate that their company produces high-quality earnings. However, if external parties more capitalize on the company's assets, the company's operating cash flow will decrease and impact low earnings quality. Operational activities that use more debt are considered to have a high-interest expense, and as a result, the company cannot pay off its debts.

On the other hand, external parties will be adrift to invest in companies with a stable financial situation and generate positive returns. The average manufacturing company used in the study has a DER (Debt to Equity Ratio) value of less than 1, which means that the company has a smaller debt level than its capital. So it can be concluded that the better the capital structure proxied by DER (Debt to Equity Ratio), the better the quality of the company's earnings through operating cash flow which is assessed based on the earnings quality ratio of more than 1.

The company's capital structure is considered necessary because the company's capital finances all company activities. A good capital structure can improve the quality of company earnings and can affect shareholders. This study supports the results of research conducted by Silfi (2016), Ahmad & Alrabba (2017), Ashma' & Rahmawati (2019), Pardosi et al. (2019), and Lusiani & Khafid (2022), stating that capital structure has a significant effect on earnings quality. This is because companies with a reasonable capital structure can show that their company is getting better. The company will ultimately be motivated to optimize the performance of its company further and be able to make external parties give a positive response to the company to invest their capital in the company.

The study results are not in line with the research proposed by Luas et al. (2021) and Wulandari et al. (2021), which state that capital structure does not affect the quality of company earnings. The company will be more focused on funding so that operational activities can run smoothly to obtain maximum profit. Balanced company funding does not necessarily result in high-quality earnings because investors will be attached to the profits informed by the company, so changes in capital structure do not affect earnings quality.

b. Effect of Liquidity on Earnings Quality

The second hypothesis in this study is the effect of liquidity on earnings quality in manufacturing companies listed on the BEI. The partial test results above show that the t_{count} value of the liquidity variable is $2,128 > t_{table}$ is 1,97301 with a significance value of $0,035 < 0,05$. Based on the results above, it can be said that liquidity has a significant effect on earnings quality, so H2 is accepted.

Liquidity has a significant effect on earnings quality. This is because the higher the level of short-term debt payments made by the company, the higher the quality of profits generated by the company. In addition, a company with a high level of liquidity can be said to have a satisfactory performance because liquidity is the company's ability to meet its short-term debt. Liquidity relates to investors' and creditors' trust in the company to be used as a significant consideration in making investment decisions related to earnings quality. Good liquidity is easier to get capital from external parties. That companies with a high rate of repayment of short-term debt tend to have high earnings quality through operating cash flow which is assessed based on the ratio of higher earnings quality of 1.

A company with a high liquidity level means that the company has a high quality of earnings so that earnings management practices do not need to be carried out. This study supports the results of research conducted by Ginting (2017), Ardianti (2018), Saraswati et al. (2020), Safitri & Afriyenti (2020), and Hasanuddin et al. (2021), which state that liquidity affects earnings quality. This is because the quality of a good company's earnings can be seen from the ability of a company to meet its short-term debt. High liquidity will cause the company to provide profit information more broadly to external parties, which can provide good value for investors.

The results of the study are not in line with the research conducted by Hakim & Abbas (2019), Herninta & Ginting (2020), Luas et al. (2021), and Putra & Hermawan (2021), which states that liquidity does not significantly affect the quality of company earnings. The level of high or low liquidity does not impact the quality of profits generated by the company because if the company's liquidity is high, the company will have difficulty managing its current assets. This will have an impact on the decline in the company's financial performance and can lead to fraud in the financial statements.

c. Effect of Return on Assets (ROA) on Earning Quality

The third hypothesis in this study is the effect of Return on Assets on earnings quality in manufacturing companies listed on the BEI. The partial test results above show that the t_{count} value of the Return on Assets variable is $-0,777 < t_{table}$ of 1,97301 with a significance value of $0,438 > 0,05$. Based on the results above, it can be said that the Return on Assets has no significant effect on earnings quality, so H3 is rejected.

Return on Assets (ROA) has no significant effect on earnings quality. This is because ROA is the company's ability to earn profits through its assets. However, the size of the company's ROA value does not reflect the quality of the profits generated. High yields can be reported unhealthy because they want to attract investors like PT. Three Pillars of Prosperous Food Tbk. Most investors will invest their funds in companies that generate high profits without observing the presence or absence of financial engineering in the company. Poor company performance does not necessarily result in low ROA, it can be caused by large liabilities, losses that occurred in the past period, and uncertain income. The average manufacturing company used in the study has a low level of ROA with a value of less than 0.0598. It does not have an impact on the good or bad quality of the company's earnings because quality earnings are profits that realize conditions, actually, without any manipulation.

This study supports the results of research conducted by Marsela & Maryono (2017), Hakim & Abbas (2019), Bemshima et al. (2020), and Wulandari et al. (2021) stating that Return on Assets (ROA) does not significantly affect the quality of company earnings. This is because the high and low value of a company's ROA does not cause the low quality of the profits generated. Good quality earnings do not mean that the company's asset value is large, and poor quality earnings have small asset values. It depends on how the management in reporting the actual profit.

The results of the study are not in line with research conducted by Ardianti (2018), Jannah et al. (2019), and Herninta & Ginting (2020), which states that Return on Assets (ROA) has a positive effect on earnings quality. This is because the higher the ROA value of a company, the quality of its earnings will also be increased. If a company has low profitability, the rate of its earnings will also decrease compared to companies that have high profitability.

5. CONCLUSION

Based on the hypothesis test results above, the following conclusions are that capital structure has a significant effect on earnings quality; liquidity has a significant impact on earnings quality, and Return on Assets (ROA) has no significant effect on earnings quality. For the next researcher who will conduct similar research, it is expected that adding other variables to have more influence on profit quality, such as Growth Opportunity, audit quality, and conservatism accountancy.

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