The Effect of Leverage, Firm Size, Profitability and Political Connections on Income Smoothing

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Keywords: Leverage, Profitability, Political Connection, Firm Value, Income Smoothing.

Abstract:
This study aims to determine the effect of leverage, firm size, profitability and political connections on income smoothing with firm value as a moderating variable. The approach used in this research is a quantitative approach. The data in this study are secondary data and data obtained from the site www.idx.go.id and company performance reports. The sampling technique used was purposive sampling technique with a total sample of 90 observation data from manufacturing companies in the consumer goods industry sector in 2016-2020. The data analysis technique uses multiple linear regression analysis using SPSS version 23 program. The results of this study indicate that the Leverage variable has no effect on income smoothing, while Company Size, Profitability and Political Connections affect income smoothing. For the moderating variable, firm value is proven to be able to moderate Leverage and Profitability, and not able to moderate the variables of Firm Size and Political Connections.
Introduction

Every company has many ways to generate profits, not only from increasing sales but also preparing company strategies. Today's increasingly stringent business conditions require every company to have an adequate strategy in order to compete with other similar companies. Not only a strategy in selling products, but also a strategy to increase the value of the company. To increase the value of the company, it can be done by improving the company's performance, especially financial performance by looking at the company's annual report and financial statements.

One of the company's strategies to increase the value of the company is to do income smoothing. Income smoothing is a tool to minimize fluctuations in reported earnings (Syahriana, 2006). The company's financial statements that show stable profits are certainly more attractive to potential investors because they consider the company successful in managing profits so that the return from investors' investment can be high. In addition, companies with stable profits can better convince investors that the company is going concern, meaning that the company is predicted to be able to run for the long term, thus providing a sense of security to potential investors.

Income smoothing is a form of earnings management and is an action problem that can cause losses for investors, is an accounting manipulation that can cause asymmetry of financial information. There are three types of earnings management strategies, namely:

1. Manager increases profit (Increasing income)
2. The manager made a big bath by reducing profit for this period
3. Manager reduces / Fluctuations in earnings by income smoothing

Based on the description above, it can be concluded that to achieve good company performance, good financial performance is needed, one of which is the practice of income smoothing. There are many factors that support the practice of income smoothing, including Leverage, Company Size, Profitability, and Net Profit Margin. Several phenomena related to Income Smoothing Practices are described in the description and table below:
The first factor is *Leverage*. Companies that are financed by high debt will harm the company, because with high debt, the debt interest that must be paid is also high. The company's burden will be higher if it does not pay on time, because the fines for the delay will be high and the company's finances will be more burdensome. To see the effect of DER on income smoothing, the phenomenon of Manufacturing Companies in the Consumer Goods Industry Sector for the 2016–2020 period is presented.

Based on table 1 above in the numbers in bold, it was found that there was a phenomenon at PT. Delta Djakarta, Tbk (DLTA), PT. Darya Varia Labotaria Tbk, and PT. Gudang Garam Merah Tbk. In theory, an increasing DER results in the possibility of increasing profit because if the DER increases, it means that the company's debt to equity increases, the interest expense that must be paid by the company increases, then the cash owned by the company decreases, so the company is likely to practice income smoothing so that the company looks good. At PT. Delta Djakarta From 2016 to 2017 the DER ratio decreased, while income smoothing in that period did not find income smoothing practices. From this phenomenon, it proves that DER does not always have a positive effect on income smoothing practices in accordance with existing theory.

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Based on table 1 above in the figures in bold, it was found that there was a phenomenon at PT. Delta Djakarta, Tbk (DLTA), PT. Darya Varia Labotaria Tbk, and PT. Gudang Garam Merah Tbk. In theory, an increased ROA results in companies not having to practice income smoothing because...
if the ROA increases, it means that the company's profits increase, and the dividends distributed will also increase, if the dividends distributed to investors increase, it will increase the interest of investors, and share prices will increase because the demand is high while the stock provided is limited in accordance with the law of demand, the company does not need to perform income smoothing.

The reason for choosing a company in the manufacturing sector of the consumer goods industry is because companies in this sector are quite attractive to investors because it has been proven by the growing power of the manufacturing sector which is supported by the consumer goods industry sector which grew 28% and is one of the stable sectors and is not affected by the situation economy. (https://www.kemenperin.go.id, November 2021.)

Previous research has discussed the determinants or factors that can affect the practice of income smoothing. Research conducted by Oktoriza (2018) in his research shows that profitability has a significant positive effect on income smoothing practices, meaning that companies that have low profitability are highly likely to practice income smoothing, however profitability is stated to have no effect on income smoothing practices in the research conducted by Sudarsi (2012). This is due to differences in earnings management by each company.

Leverage proven to have a significant effect on the practice of income smoothing in a study conducted by Prasetya (2018). However, Leverage is stated to have no significant effect on income smoothing practices in the research conducted by Oktoriza (2018) and Ginartra (2015) and Putra (2015). This is due to the different strategies taken by the company in dealing with high leverage. Firm size has been shown to have a significant effect on income smoothing practices in the research conducted by Prasetya (2013) and Sudarsi (2012). Research conducted by Apriyani, et al (2019) states that Political Connections have a positive effect on Earnings Management and research conducted by Tee (2020) states that political connections have a positive effect on Income Smoothing Practices. However, Chandra (2021) states that political connections have a negative effect on earnings management. For income smoothing itself, not many studies have been carried out related to political connections, so it needs to be investigated further. This is due to differences in company conditions and different ways of managing profit margins for each company.

The Hypothesis are:

H1 : Leverage, Positive and Significant Effect on Income Smoothing Practices
H2 : Profitability, Negative and Significant Effect on Income Smoothing Practices
H3 : Firm Size, Negative and Significant Effect on Income Smoothing Practices
H4 : Political Connections Have a Positive and Significant Effect on Income Smoothing Practices
H5: Leverage Affects Income Smoothing Practices Moderated by Firm Value
H6: Profitability Affects Profit Smoothing Practices Moderated by Firm Value
H7: Firm Size Affects Income Smoothing Practices Moderated by Firm Value
H8: Political Connections Affecting Profit Smoothing Practices Moderated by Firm Value.

Research Method

Dependent Variable

**Profit Smoothing Practice**

To find out whether a company is included in the group that performs income smoothing or not, the Eckel index (1981) is used. \[ \text{Indeks Perataan Laba} = \frac{CV_{\Delta I}}{CV_{\Delta S}} \]

CVΔI and CVΔS can be calculated as follows:

\[
\sqrt{\frac{n \cdot (\Delta X)^2}{\sum (X - \bar{X})^2}}
\]

\[
\Delta X
\]

Independent Variable

**Leverage**

\[ \text{Debt to Equity Ratio (DER)} = \frac{\text{Total Utang}}{\text{Total Ekuitas}} \]

**Firm Size**

\[ \text{Firm Size} = \ln(\text{Total Asset}) \]

**Profitability**

\[ \text{Return on Assets} = \frac{\text{Earning after Taxes}}{\text{Total Asset}} \]

**Political Connection**

The measurement of this variable uses a dummy as used (Wati, 2017) number 1 to indicate companies that have political connections and number 0 to indicate companies that do not have political connections.

Moderating Variables

**The value of the company**

\[ \text{Price Book Value} = \frac{\text{Price per share}}{\text{Book value per share}} \]
In this study, using a quantitative method with the population being manufacturing companies in the consumer goods industry sector listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period. The total population is 40 companies and not all of them will be used as objects of research so it is necessary to take samples. The sampling technique used is purposive sampling technique. Purposive sampling is a sampling technique with certain considerations. Researchers select samples based on.

This study aims to examine the effect of the independent variables, namely Leverage, Firm Size, Profitability and Political Connections on the dependent variable of Income Smoothing Practice with the moderating variable of Firm Value. The data used are secondary data, namely data that has been collected by data collection institutions and published to the public as users, obtained through the Indonesia Stock Exchange (IDX) and the websites of each company.

The selection of research samples was based on the Purposive Sampling method, namely the technique of determining the sample with certain considerations or criteria. The sampling criteria set by the researcher include:

2. Provide periodic financial reports to the Indonesia Stock Exchange and published on the IDX official website for 5 consecutive years.
3. Companies in the consumer goods industry sector that have published financial reports that provide complete data on the required financial ratios and stock price information for 2016-2020

The data analysis methods carried out include: (1) Descriptive statistics, this analysis is used to provide an overview of the research variables (the dependent variable (Return on Assets), the independent variable (Debt to Equity Ratio) and the current ratio) seen from the average value (mean), standard deviation, maximum, minimum. (2) Classical assumption testing, classical assumption testing is carried out to determine the existing data conditions in order to determine the appropriate analytical model (normality, multicollinearity, heteroscedasticity, and autocorrelation) (3) MRA regression analysis. (4) The coefficient of determination. (5) Hypothesis Testing (T-Test and F-Test).

Result and Discussion

Based on DER data, Ln Total Assets, ROA, Political Connections, PBV and Income Smoothing, the data is recapitulated and processed using SPSS 3 software and then analyzed using the Classical Assumption Test, Multiple Linear Regression Analysis, Correlation Test, Determination Test, t Test and Simultaneous Test. Descriptive statistics are used to provide an overview or descriptive of a data seen from the average value (mean), minimum value, maximum value, and standard deviation of the research data, the results of descriptive analysis of the data can be seen in table 2.

<table>
<thead>
<tr>
<th>Table 2 Results of Descriptive Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Descriptive Statistics</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>N</td>
</tr>
<tr>
<td>----------------------</td>
</tr>
<tr>
<td>DER</td>
</tr>
<tr>
<td>Ln Total Assets</td>
</tr>
<tr>
<td>ROA</td>
</tr>
<tr>
<td>Political Connection</td>
</tr>
<tr>
<td>PBV</td>
</tr>
<tr>
<td>Income Smoothing</td>
</tr>
</tbody>
</table>

| Valid N (listwise) | 90       |

Source: Data processed from SPSS 23, (2022)

Based on the results of the descriptive statistics in Table 1, the following are presented:

1. Debt to Equity Ratio (DER) has a minimum value of 0.02 occurs at PT. Mandom Indonesia Tbk.
2. Debt to Equity Ratio (DER) has a maximum value occurs at PT. Kimia Farma Tbk, which is 4.02,
3. Debt to Equity Ratio (DER) has an average value (mean) of DER of 0.8383
4. Debt to Equity Ratio (DER) has a standard deviation of 0.83144
5. Ln Total Assets has a minimum value of 23.52 occurred at PT Tunas Baru Lampung Tbk.
6. Ln Total Assets has a maximum value of 32.72 occurs at PT. Indofood Sukses Makmur Tbk
7. Ln Total Assets has an average (mean) of 29.2723
8. Ln Total Assets has a standard deviation of 1.93742
9. ROA has a minimum value of 0.01 occurs at PT. Kimia Farma Tbk.
10. ROA has a maximum value of 0.78 occurs at PT. Unilever Indonesia Tbk
11. ROA has an average (mean) ROA of manufacturing companies in the consumer goods industrial sector in 2016-2020 of 0.16.
12. ROA has a Standard deviation of Variable Return On Assets (ROA) is 0.131.
13. Political Connections uses a dummy variable. Of the 18 companies, it was found that 10 companies were proven to have connections with the government, and as many as 8 companies were proven to have no connection to the government. Companies that have political connections to manufacturing companies in the consumer goods industry in 2016 – 2020 are more than companies that are not politically connected,
14. Political Connections has a standard deviation of 0.499 for this variable.
15. Price Book Value (PBV) has a minimum value of 0.17 occurs at PT Mandom Indonesia Tbk.
16. PBV has a maximum value of PBV value that occurs in the company PT. Unilever Indonesia Tbk with a value of 74.89
17. PBV has an average of 8.056
18. PBV has a standard deviation of Variable Price Book Value (PBV) is 14.6.
19. Income smoothing has a minimum value of -17.44 occurs at PT Kimia Farma Tbk.
20. Income smoothing has a maximum value. Income smoothing occurs in the company PT. Darya Varia Laboratoria Tbk with a value of 31.26,
21. Income smoothing has an average of 2.1710
22. Income smoothing has a standard deviation of Variable Price Book Value (PBV) of 9.48.

Table 3 Classical Assumption Test Results

<table>
<thead>
<tr>
<th>Test</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normality test</td>
<td>0.153</td>
</tr>
<tr>
<td>Multicollinearity Test (Tolerance Sign and VIF)</td>
<td>0.888 and 3.544</td>
</tr>
<tr>
<td>Heteroscedasticity Test (Glejser Test)</td>
<td>0.009, 0.758, 0.258, 0.097, 0.243</td>
</tr>
<tr>
<td>Autocorrelation Test (Run Test)</td>
<td>0.480</td>
</tr>
</tbody>
</table>

Source: Secondary Data processed through SPSS 23, (2022)

The results of the Kolmogorov - Smirnov test in table 2 show that the data is normally distributed. This is evidenced by the results of the KS Test which shows the Asymp value. Sig. (2-
tailed) for all variables > 0.05 which is 0.153 so that the regression model meets the assumption of normality.

Based on table 3 above, it can be seen that the data in this study does not contain multicollinearity or there is no relationship between the independent variables in this study. This can be seen from the VIF (Variance Inflation Factor) value of all variables in the range of 1 to 10 and the Tolerance value of each variable is less than 1. Based on this value, it can be seen that all variables have a significance value of more than 0.05 which means that there is no independent variable which is statistically significant affecting the dependent variable absolute value of the residual. So it can be concluded that the regression model does not contain any heteroscedasticity. seen that the Asymp Value. Sig (2-tailed) is greater than 0.05, which is 0.480, so it can be concluded that there is no autocorrelation in the data in this study.

**Regression Analysis with Moderating Variables**

Moderated Regression Analysis (MRA) or interaction test is a special application of linear multiple regression where the regression equation contains an interaction element (multiplication of two or more independent variables) with the following equation formula: (Liana, 2009) [24]

\[
\begin{align*}
\text{a) } Y &= + 1X_1 + 2X_2 + 3X_3 + 4X_4 + \ldots \\
\text{b) } Y &= + 1X_1 + 2X_2 + 3X_3 + 4X_4 + 4Z + 5X_1Z + 6X_2Z + 7X_3Z + \beta 8X_4Z + \ldots
\end{align*}
\]

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>.512</td>
<td>1.160</td>
<td>0.627</td>
<td>.007</td>
</tr>
<tr>
<td>DER</td>
<td>.266</td>
<td>1.198</td>
<td>-.065</td>
<td>-.616</td>
</tr>
<tr>
<td>Ln Total Assets</td>
<td>-1.441</td>
<td>.508</td>
<td>-.294</td>
<td>-2.836</td>
</tr>
<tr>
<td>ROA</td>
<td>-.614</td>
<td>7.397</td>
<td>.064</td>
<td>.624</td>
</tr>
<tr>
<td>Political Connection</td>
<td>4.589</td>
<td>1.921</td>
<td>.242</td>
<td>2.389</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Income Smoothing

*Source: Secondary Data processed through SPSS 23, (2022)*

\[ IC = + 1X_1 + 2X_2 + 3X_3 + 4X_4 + \ldots \]

\[ IC = 0.512 + 0.266\text{DER} + (-)1.441\text{LN Total Assets} + (-)1.614\text{ROA} + 4.589 \text{Political Connections} + \ldots\]

1. Constant \((\alpha) = 0.512\)

The regression equation has a positive value at the constant 0.512 which means if Leverage, Company Size, Profitability and Political Connections are 0%, then Income Smoothing will be 0.512 or 51.2%
2. Regression coefficient 1 DER = 0.266
   The regression equation has a positive value at the coefficient of 0.266. It means that every Leverage proxied by DER increases by 1%, it will increase Income Smoothing by 0.266 or 26.6%

3. Regression coefficient 2 Firm Size = -1.441
   The regression equation has a negative value at a coefficient of 1.441. Means that each company size proxied by Ln Total Assets has decreased by 1%, it will increase income smoothing by 1.441

4. Regression coefficient 2 ROA = 0.614
   The regression equation has a negative value at a coefficient of 0.614. It means that every profitability proxied by ROA has decreased by 1%, it will increase income smoothing by 0.614 or 61.4%

5. Regression coefficient 2 Political Connection = 4.589
   The regression equation has a positive value at a coefficient of 4.589. It means that every Political Connection increases by 1%, it will increase income smoothing by 4.589.

### Table 5 Regression Test Results 2

<table>
<thead>
<tr>
<th>Coefficients</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>B, Std. Error, Beta</td>
<td>t, Sig.</td>
</tr>
<tr>
<td>(Constant)</td>
<td>61,210, 17,996, -.255</td>
<td>3,401, .001</td>
</tr>
<tr>
<td>DER</td>
<td>-2,907, 1.568, -1.855</td>
<td>-1.855, .067</td>
</tr>
<tr>
<td>Ln Total Assets</td>
<td>-2,006, .610, -.410</td>
<td>-3,290, .001</td>
</tr>
<tr>
<td>ROA</td>
<td>-8,959, 15.186, -.590</td>
<td>-.590, .557</td>
</tr>
<tr>
<td>Political Connection</td>
<td>4.639, 2.963, .244</td>
<td>1.566, -121</td>
</tr>
<tr>
<td>PBV</td>
<td>-1.191, .978, -1.836</td>
<td>-1.218, .227</td>
</tr>
<tr>
<td>DER*PBV</td>
<td>.146, .120, .594</td>
<td>1.220, .000</td>
</tr>
<tr>
<td>Ln Total Assets*PBV</td>
<td>.041, .029, 1.874</td>
<td>1.442, .153</td>
</tr>
<tr>
<td>ROA*PBV</td>
<td>.224, .344, .179</td>
<td>.650, .000</td>
</tr>
<tr>
<td>Political</td>
<td>-.274, .494, -.435</td>
<td>-.556, .580</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Income Smoothing

1. In Table 5 it is known that the significance value of the interaction variable between DER and PBV is 0.000 (<0.50), so it can be concluded that the PBV variable is able to moderate the influence of the Leverage variable on the Income Smoothing variable.

2. The significance value of the interaction variable between Ln Total Assets and PBV is 0.153 (> 0.50), so it can be concluded that the firm value variable is not able to moderate the influence of the Firm Size variable on the Income Smoothing variable.
3. The significance value of the interaction variable between ROA and PBV is 0.000 (<0.50), so it can be concluded that the firm value variable is able to moderate the effect of the Profitability variable on the Income Smoothing variable.

4. The significance value of the interaction variable between Political Connections and PBV is 0.580 (> 0.50), so it can be concluded that the firm value variable is not able to moderate the influence of the Political Connection variable on the Income Smoothing variable.

Conclusion

Based on the results of data analysis and discussion that has been described, the conclusion of this study is that leverage has no effect on income smoothing hypothesis (H1) is rejected, firm size affects income smoothing hypothesis (H2) is accepted, ROA has an effect on income smoothing hypothesis (H3) is accepted. Political connection has an effect on income smoothing hypothesis (H4) is accepted.

Based on the conclusions that have been described previously, the authors can provide suggestions, namely:

For investors, in making a decision to invest in consumer goods manufacturing companies, they can pay attention to the company’s financial performance through investment information that is the benefit of this research. Investors are expected to be wiser in choosing companies to invest in by analyzing financial statements and financial conditions as well as possible, so that investors can get returns that are in accordance with investment objectives. For further researchers, it is hoped that: Taking into account events that have economic consequences, such as when experiencing a decline or economic growth, such as an economic downturn during the Covid-19 pandemic; Choose a sample with a wider scope; Extending the research period so that the research results can be tested for consistency and generalization.

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