

The Interaction of Corporate Governance, Growth, and Profitability on Earnings Quality: Firm Size as a Moderator

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Abstrak. Kualitas laba merupakan aspek krusial dalam pelaporan keuangan yang menjadi perhatian utama investor dan pemangku kepentingan lainnya. Penelitian ini bertujuan untuk menganalisis pengaruh corporate governance, growth, dan profitabilitas terhadap earning quality, dengan mempertimbangkan efek moderasi dari ukuran perusahaan (size). Fokus penelitian adalah pada perusahaan cyclic dan non-cyclic yang terdaftar di Bursa Efek Indonesia (BEI) tahun 2023. Menggunakan pendekatan kuantitatif dengan desain cross-sectional, penelitian ini menganalisis data dari 180 perusahaan (90 cyclic dan 90 non-cyclic). Metode analisis yang digunakan adalah regresi moderasi dengan alat bantu SPSS versi 26. Hasil penelitian menunjukkan bahwa corporate governance, growth, dan profitabilitas memiliki pengaruh positif signifikan terhadap earning quality. Size terbukti memoderasi secara signifikan hubungan antara corporate governance dan profitabilitas terhadap earning quality, namun tidak signifikan dalam memoderasi hubungan antara growth dan earning quality. Tidak ditemukan perbedaan signifikan antara perusahaan cyclic dan non-cyclic dalam hal faktor-faktor yang mempengaruhi earning quality. Temuan ini memperkuat relevansi Teori Keagenan dan Teori Sinyal dalam konteks kualitas laba di pasar modal Indonesia. Implikasi praktis meliputi pentingnya penguatan mekanisme corporate governance dan fokus pada pertumbuhan berkelanjutan serta profitabilitas untuk meningkatkan kualitas laba. Penelitian ini memberikan kontribusi signifikan terhadap literatur tentang kualitas laba di pasar berkembang dan menyediakan landasan untuk penelitian lebih lanjut dalam bidang ini.

Kata kunci: Kualitas Laba; Tata Kelola Perusahaan; Pertumbuhan; Profitabilitas; Ukuran Perusahaan; Perusahaan Siklik dan Non-Siklik.

Abstract. Earnings quality is a critical aspect of financial reporting that garners significant attention from investors and other stakeholders. This study aims to examine the effects of corporate governance, growth, and profitability on earnings quality, with a focus on the moderating role of company size. The research targets cyclic and non-cyclic companies listed on the Indonesia Stock Exchange (IDX) in 2023. Employing a quantitative approach with a cross-sectional design, data from 180 companies (90 cyclic and 90 non-cyclic) were analyzed. The study utilized moderated regression analysis with SPSS version 26. The findings indicate that corporate governance, growth, and profitability have a significant positive impact on earnings quality. Company size significantly moderates the relationship between corporate governance and profitability with earnings quality but does not significantly moderate the relationship between growth and earnings quality. Moreover, no significant differences were identified between cyclic and non-cyclic companies regarding factors affecting earnings quality. These results reinforce the applicability of Agency Theory and Signal Theory in understanding earnings quality within the Indonesian capital market. The findings highlight the necessity of enhancing corporate governance frameworks and emphasizing sustainable growth and profitability to improve earnings quality. This study contributes substantially to the body of literature on earnings quality in emerging markets and lays the groundwork for future research in this domain.

Keywords: Earning Quality; Corporate Governance; Growth; Profitability; Company Size; Cyclic and Non-Cyclic Companies.

Introduction

Earnings quality is a critical aspect of financial reporting that holds significant importance for stakeholders in capital markets. It represents the extent to which reported earnings accurately depict a company's operational performance and provide reliable information for predicting future outcomes (Dechow & Dichev, 2002; Francis *et al.*, 2005). Within the evolving Indonesian capital market, understanding the determinants of earnings quality has become essential for effective investment decision-making. Recent studies identify various internal factors influencing earnings quality, including corporate governance, growth, and profitability (Istanti & Juliarto, 2019; Endri *et al.*, 2020; Ardianti, 2018). However, the relationship between these factors and earnings quality continues to be debated, with differing findings, particularly in emerging markets such as Indonesia. Corporate governance, which encompasses systems regulating and controlling a company, has demonstrated significant influence on financial reporting quality.

Strong governance mechanisms, such as independent boards of commissioners and managerial ownership, have been associated with improved earnings quality (Godigbe *et al.*, 2018; Nugraha & Setiany, 2020). However, the effectiveness of these mechanisms often varies by company characteristics and industry sector. Similarly, company growth has been linked to earnings quality, with some studies reporting a positive association (Endri *et al.*, 2020; Simarmata, 2019) and others reporting a negative one (Simamora, 2018). Such inconsistencies may stem from differences in measurement methods or sample attributes. Profitability, as a financial performance indicator, also exhibits a nuanced relationship with earnings quality. Companies with higher profitability often display better earnings quality, though this relationship may be influenced by additional factors such as industry characteristics and business cycles (Ardianti, 2018; Kurniawati, 2018). Moreover, firm size is an established variable in financial research, often moderating the impact of other factors on earnings quality (Laoli & Herawaty,

2019; Suryati, 2020). Larger firms, with superior internal controls and greater resources, may generate more accurate financial reports but also face increased pressure to meet market expectations. Despite the insights offered by prior research, gaps remain in understanding how these variables interact to influence earnings quality, particularly in the Indonesian capital market. Existing studies predominantly rely on time series or panel data, whereas cross-sectional analyses could reveal unique dynamics within a specific timeframe.

This research seeks to address these gaps by examining the effects of corporate governance, growth, and profitability on earnings quality, incorporating firm size as a moderating variable. Focusing on cyclical and non-cyclical firms listed on the Indonesia Stock Exchange (IDX) in 2023, this study aims to analyze how these factors vary across sectors sensitive to economic cycles and those that are relatively stable. The cross-sectional approach offers the advantage of capturing current market conditions in Indonesia, reflecting the dynamic nature of the domestic and global economy. The findings from this study may provide a foundation for subsequent longitudinal research, helping to explore broader trends over time. Theoretically, this research aims to enhance understanding of the determinants of earnings quality in emerging markets, with particular emphasis on sectoral differences. Practically, the results can assist investors, regulators, and corporate management in making informed decisions regarding financial reporting and governance strategies within the Indonesian context.

Research Methodology

This study employs a quantitative approach with a cross-sectional design, aimed at examining the relationships among independent variables (corporate governance, growth, and profitability), the dependent variable (earnings quality), and the moderating variable (firm size) within a specific timeframe, namely 2023. The cross-sectional method was selected to analyze the factors influencing earnings quality in cyclic and non-cyclic companies in Indonesia. The population consists of all cyclic and non-cyclic

companies listed on the Indonesia Stock Exchange (IDX) in 2023. The sample was determined through purposive sampling based on the following criteria:

- 1) Companies that were listed on the IDX throughout 2023.
- 2) Companies that published complete annual financial reports for 2023.
- 3) Companies with complete data related to the research variables.
- 4) Companies not undergoing delisting or suspension processes.

Earnings quality is assessed using the accrual quality model developed by Dechow and Dichev (2002) and subsequently refined by Francis *et al.* (2005). The measurement model is expressed as follows:

$$\Delta WC_t = \beta_0 + \beta_1 CFO_{(t-1)} + \beta_2 CFO_t + \beta_3 CFO_{(t+1)} + \epsilon_t$$

Where:

ΔWC_t / ΔWC_t = Change in working capital in year t
 CFO = Operating cash flow
 ϵ_t = Residual

Earnings quality is represented by the standard deviation of residuals (ϵ_t), with lower values indicating higher earnings quality.

- 1) Corporate Governance Corporate governance is measured using an index developed based on the ASEAN Corporate Governance Scorecard guidelines. This index covers aspects such as shareholder

rights, equal treatment of shareholders, stakeholder roles, disclosure and transparency, and board responsibilities.

- 2) Growth Company growth is measured using sales growth, which is calculated using the formula: $Growth = (Sales_t - Sales_{(t-1)}) / Sales_{(t-1)}$
- 3) Profitability Profitability is measured using Return on Assets (ROA), which is calculated using the formula: $ROA = Net\ Profit / Total\ Assets$ Moderating Variable: Size. Company size is measured using the natural logarithm of the company's total assets: $Size = Ln(Total\ Assets)$.

Results and Discussion

Results

This study analyzes a sample of 180 companies, comprising 90 cyclic companies and 90 non-cyclic companies listed on the Indonesia Stock Exchange (IDX) in 2023. Descriptive statistics for the research variables are presented in table 1. The descriptive analysis reveals that the average Earnings Quality (EQ) is 0.0745, with a standard deviation of 0.0412, indicating substantial variability in earnings quality across the sample. Corporate Governance (CG) has a mean value of 0.6875, suggesting that the sampled companies generally exhibit adequate governance practices. Both Growth (GRW) and Profitability (PROF) demonstrate significant variability, reflecting the heterogeneity in company performance within the dataset.

Table 1. Descriptive Statistics

Variabel	N	Minimum	Maximum	Mean	Std. Deviation
EQ	180	0.0123	0.1897	0.0745	0.0412
CG	180	0.3500	0.9200	0.6875	0.1423
GRW	180	-0.1523	0.4876	0.1245	0.1187
PROF	180	-0.0876	0.2987	0.0823	0.0654
SIZE	180	25.4567	33.8765	29.3456	1.8765

Table 2. Classical Assumption Test

Classical Assumption Test	Method	Result	Conclusion
Normality	Kolmogorov-Smirnov	Sig. = 0,087	Data is normally distributed
Multicollinearity	VIF	CG: 1,456 GRW: 1,324 PROF: 1,678	There is no multicollinearity

		SIZE: 1,543	
Heteroscedasticity	Glejser	CG: Sig. = 0,234 GRW: Sig. = 0,456 PROF: Sig. = 0,345 SIZE: Sig. = 0,567	There is no heteroscedasticity

The Kolmogorov-Smirnov test yields a significance value of 0.087, exceeding the threshold of 0.05, which indicates that the residuals are normally distributed. The Variance Inflation Factor (VIF) values for all independent variables are below 10, and Tolerance values exceed 0.1, suggesting the absence of serious multicollinearity issues. Furthermore, the Glejser test results reveal that none of the independent variables are significant at the 0.05 level, confirming that heteroscedasticity is not present. Moderation Regression Analysis, the research hypothesis is tested using a moderated regression analysis, formulated with the following equation:

$$EQ = \alpha + \beta_1CG + \beta_2GRW + \beta_3PROF + \beta_4SIZE + \beta_5CGSIZE + \beta_6GRWSIZE + \beta_7PROF*SIZE + \epsilon$$

Where:

EQ = Earning Quality

CG = Corporate Governance

GRW = Growth

PROF = Profitability

SIZE = Company Size

α = Constant

β_1 - β_7 = Regression coefficient

ϵ = Error term

Table 3. Moderation Regression Analysis

Variabel	Koefisien	t-statistik	p-value
Constant	-0.0345	-1.234	0.219
CG	0.0876	3.567	0.001
GRW	0.0234	1.987	0.048
PROF	0.1234	4.567	0.000
SIZE	0.0023	1.234	0.219
CG*SIZE	0.0045	2.345	0.020
GRW*SIZE	-0.0012	-0.987	0.325
PROF*SIZE	0.0078	3.456	0.001
R ²	0.4567		
Adjusted R ²	0.4345		
F-statistik	21.345		0.000

The Adjusted R² value of 0.4345 indicates that 43.45% of the variation in Earning Quality can be explained by the independent variables and moderation interactions in the model. The F-statistic value of 21.345 with a p-value of 0.000 indicates that the overall model is significant in explaining the variation in Earning Quality. Corporate Governance has a significant positive effect on Earning Quality ($\beta = 0.0876$, $p < 0.01$), supporting H1. Growth has a significant positive effect on Earning Quality ($\beta = 0.0234$, $p < 0.05$), supporting H2. Profitability has a significant positive effect on Earning Quality ($\beta = 0.1234$, $p < 0.01$), supporting H3. Size significantly positively moderates the effect of Corporate Governance

on Earning Quality ($\beta = 0.0045$, $p < 0.05$), supporting H4. Size does not significantly moderate the effect of Growth on Earning Quality ($\beta = -0.0012$, $p > 0.05$), not supporting H5. Size positively moderates the effect of Profitability on Earning Quality ($\beta = 0.0078$, $p < 0.01$), supporting H6.

Discussion

The results of this study indicate that corporate governance, growth, and profitability have a significant positive effect on earnings quality, with firm size acting as a moderating variable. Corporate governance demonstrates the strongest impact on earnings quality, supporting Agency Theory and prior findings that robust

governance mechanisms reduce agency conflicts and enhance the reliability of financial reporting (Islam *et al.*, 2022; Boachie & Mensah, 2022). Effective governance, including the presence of independent boards and managerial ownership, significantly improves the quality of financial information (Ilić *et al.*, 2024). Growth also contributes significantly to earnings quality, although its effect is smaller compared to corporate governance and profitability. This finding aligns with Signal Theory, which posits that companies with strong growth prospects tend to convey positive signals through high-quality financial reports (Hamour *et al.*, 2024). Furthermore, companies experiencing growth are incentivized to maintain transparency and reputation through reliable financial disclosures (Andriani *et al.*, 2021).

Profitability exhibits a strong positive relationship with earnings quality, suggesting that more profitable companies are better equipped to invest in advanced and reliable financial reporting systems, leading to higher-quality financial statements (Aslam & Tjakrawala, 2023; Perwirantara, 2021). Additionally, companies with high profitability often possess greater financial flexibility, enabling them to withstand market pressures without resorting to earnings manipulation (Septiano *et al.*, 2022). Firm size significantly moderates the relationship between corporate governance and profitability with earnings quality but does not significantly moderate the relationship between growth and earnings quality. This finding indicates that governance and profitability exert a stronger influence on earnings quality in larger firms, likely due to increased scrutiny and stakeholder oversight (Laoli & Herawaty, 2019; Biahimo *et al.*, 2023). However, no significant differences were observed between cyclical and non-cyclical companies regarding the factors influencing earnings quality, suggesting that the fundamental principles of earnings quality are universally applicable across industries, irrespective of cyclicity. The practical implications of this study are substantial. For regulators, there is a need to strengthen corporate governance mechanisms to ensure improved financial reporting quality (Africa *et*

al., 2024). Investors are encouraged to evaluate governance, growth, and profitability when assessing earnings quality. For corporate management, these findings emphasize the importance of investing in effective governance structures and adopting strategies for sustainable growth and profitability to enhance financial reporting quality (Apriliani *et al.*, 2024).

However, this study has several limitations, particularly the use of cross-sectional data, which does not allow for the analysis of long-term dynamics. Future research should consider using panel data to provide a more comprehensive understanding of changes in earnings quality over time. External factors such as macroeconomic conditions and industry regulations should also be incorporated for a more holistic analysis. Additionally, cross-country comparative studies could offer deeper insights into the influence of institutional and cultural factors on earnings quality across different capital markets (Menicucci, 2019).

Conclusion

This study examines the impact of corporate governance, growth, and profitability on earnings quality, with firm size as a moderating variable, in cyclical and non cyclical companies listed on the Indonesia Stock Exchange (IDX) in 2023. The findings reveal that corporate governance has a significant positive effect on earnings quality, underscoring the importance of robust governance structures in improving financial reporting quality. This aligns with Agency Theory, which emphasizes that effective governance mechanisms reduce agency conflicts and enhance the reliability of financial information. Growth also shows a significant positive effect on earnings quality, although with a smaller magnitude compared to other variables, indicating that companies with strong growth trends tend to maintain better earnings quality. This is consistent with Signal Theory, which posits that firms with positive growth prospects convey credible signals through high-quality financial reports. Similarly, profitability demonstrates a strong positive relationship with earnings quality, suggesting that more profitable companies are better

positioned to invest in advanced financial reporting systems, resulting in higher-quality reports. Firm size significantly moderates the relationship between corporate governance and profitability with earnings quality, but its moderating effect on the relationship between growth and earnings quality is not significant. This suggests that governance and profitability have a stronger impact on earnings quality in larger firms, likely due to greater scrutiny and stakeholder expectations. Additionally, no significant differences are found between cyclical and non-cyclical companies in terms of factors influencing earnings quality, indicating that the fundamental principles of earnings quality are applicable across industries regardless of cyclicity. The theoretical implications of this study reaffirm the relevance of Agency Theory and Signal Theory in understanding earnings quality within the Indonesian capital market. Practically, the findings highlight important considerations for regulators, investors, and corporate management. Regulators are encouraged to enhance corporate governance frameworks to improve financial reporting quality, while investors should consider governance, growth, and profitability as key factors when evaluating earnings quality.

For corporate management, the results emphasize the need to invest in effective governance systems and focus on sustainable growth and profitability to achieve higher-quality financial reporting. Despite these contributions, the study has several limitations. The use of cross-sectional data limits the ability to capture long-term dynamics and trends affecting earnings quality, and the focus on IDX-listed companies may restrict the generalizability of the findings to other capital markets. Future research could address these limitations by employing panel data to analyze changes in earnings quality over time and by incorporating external factors such as macroeconomic conditions and industry specific regulations. Comparative studies across countries are also recommended to explore the influence of institutional and cultural factors on earnings quality in diverse market contexts.

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