Company Size Mediates The Relationship Between Profitability And Earnings Management In Pharmaceutical Industry Companies Listed On The Indonesian Stock Exchange From 2019 To 2023

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ABSTRACT

The research method uses a crucial quantitative approach. The objective is to analyze the effect of profitability on the size of a company's earnings management, as well as its role as a mediating variable in the relationship between profitability and earnings management in pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) for the 2019–2023 period. The study population includes 13 pharmaceutical sub-sector companies, with a sample of 6 companies. Secondary data were obtained from the IDX, OJK, and BPS, then analyzed using the PLS method to statistically test the relationship between variables. The research results are: 1) Profitability does not significantly influence company size because profit fluctuations during the pandemic were more influenced by market conditions and short-term drug demand, rather than asset expansion. Furthermore, pharmaceutical companies allocate more profits to R&D or dividend payments, rather than adding fixed assets. 2) Large companies tend to engage in earnings management due to public pressure, operational complexity, and greater accounting and financing flexibility. 3) The company is not a primary factor driving earnings management; profitability does not significantly influence earnings management practices. 4) The influence of profitability on earnings management practices is more influenced by factors other than company size, such as managerial policies, ownership structure, and external pressures.

Keywords: Profitability, Pharmaceuticals, Earnings Management, Company Size

I. INTRODUCTION

A manufacturing company is a company that supplies raw materials or semi-finished products. The development of manufacturing companies in Indonesia is currently very rapid because they are considered to have a positive and sustainable impact on a wide scale, increasing the added value of raw materials, increasing the workforce, generating the largest source of foreign exchange, and contributing the most to taxes and customs duties.(Yeni et al., 2022)Companies are founded with the goal of generating profits and increasing company value by improving the welfare of shareholders and owners to achieve maximum returns. Management's behavior in managing profits according to its wishes is known as earnings management.

Pharmaceutical companies are large companies whose results from assets are not very visible because pharmaceutical companies have a small number of purchasing levels.(Anggraini & Hidayat, 2014)The pharmaceutical industry listed on the Indonesia Stock Exchange (IDX) is interesting to study due to its unique characteristics, including strict regulation, high investment in research and development, and stock price volatility due to global health issues. Pharmaceutical companies are a promising sector in Indonesia, and the Indonesian government is striving to make them more competitive by facilitating technology-based digital transformation.

Technological advances in the pharmaceutical sector have enabled pharmaceutical companies to produce drugs to prevent the ongoing COVID-19 pandemic. During the pandemic, many pharmaceutical companies competed to develop COVID-19 vaccines, prompting many countries to invest significantly in such research programs, leading to an increase in pharmaceutical company stock prices on the stock market.(Agusta et al., 2021)Investing in a pharmaceutical company carries lower risks than other trading companies. This is certainly supported by the rapid development of the times, with the medical equipment, pharmaceutical, and hospital businesses growing rapidly. This is a consideration for investors considering investing in pharmaceutical companies.(Doloksaribu et al., 2023).

Earnings management is a condition where management intervenes in the process of preparing the company's financial reports for external parties with the aim of deceivingstakeholderswho want to know the company's financial report information, but the intervention carried out is still within the framework of accounting standards, namely still using generally recognized and accepted accounting methods and principles.(Joe & Ginting, 2022).Earnings management is also a critical issue in financial accounting because it relates to the transparency of a company's financial statements. Companies with high profitability tend to face pressure from shareholders to maintain stable financial performance, making earnings management practices more likely.

Earnings management can also be influenced by several factors, such as company size and age. Company size is a measure of a company's size, as measured by its total assets. A company is considered large if it has a higher total asset value, while a small company also has a lower total asset value. Large companies typically publish financial reports promptly to demonstrate the abundance of information sources and credibility.stakeholderstowards the company(Maulana & Suwarno, 2022)

Profitability has a unique appeal to investors when it increases, thus increasing the company's value. When a company achieves low profitability over a given period, it will encourage earnings management by increasing revenue, thus demonstrating good stock performance and retaining investors. Profitability has a positive effect on earnings management; this positive sign indicates that higher profitability leads to greater earnings management, and conversely, lower profitability leads to lower earnings management. Profitability is a company's ability to generate profits from its operations over a given period. Profitability is typically measured by financial ratios such as Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM). These ratios reflect management's effectiveness in managing assets and capital to generate profits. Profitability is the result of a company's performance in managing the company. Profitability analysis aims to determine a company's ability to profit from its various activities.(Imawan & Triyonowati, 2021)

Company size is a description of the size of a company as seen from the assets owned by the company.(Meilyani et al., 2020)Larger companies also find it easier to obtain loans from creditors because their profitability allows them to withstand competition and survive in the industry. Company size is often considered a factor that can mediate the relationship between profitability and earnings management. Larger companies tend to have stricter oversight systems, more complex regulations, and attention from various stakeholders, which can influence earnings management strategies.The larger the size of the company, the larger the total assets owned by the company. The government will charge various costs (operating costs, administrative costs) to large companies.

Large companies with substantial total assets tend to generate substantial profits. Large companies tend to engage in earnings management practices by lowering profits, avoiding drastic fluctuations or increases in profits to avoid increased costs imposed by the government and the public. Company size negatively impacts earnings management practices, thus the importance of profitability and company size significantly influences whether a company engages in earnings management in its financial reports. This, in turn, impacts investor interest and the company's viability.

However, company size significantly influences earnings management. Companies with larger assets tend to have more flexibility in managing their financial statements. Furthermore, profitability also significantly influences earnings management practices. Companies with low profitability tend to be more motivated to engage in earnings management to improve their financial image and attract investors. Conversely, companies with high profitability may have less incentive to engage in earnings management due to their already strong performance.

Based on the above background, the author is interested in conducting research with the title "Company Size Mediates the Relationship Between Profitability and Earnings Management in Pharmaceutical Industry Companies on the Indonesia Stock Exchange in 2019-2023."

II. RESEARCH METHODS

This research uses quantitative research. Quantitative research is a research method that collects and analyzes numerical data from company financial reports. This study aims to determine the effect of company size on the mediation of profitability and earnings management in pharmaceutical companies listed on the Indonesian Stock Exchange from 2019 to 2023. The data used in this study is secondary data, obtained from other sources. Secondary data generally consists of existing reports or documentation. The data collection technique used in this study was a literature review, which involved examining data available on the official websites of the IDX, OJK, and BPS. Data Analysis Techniques Using the Partial Least Squares (PLS) Method. Partial Least Squares (PLS) is a structural equation model (SEM) based on components or variants.

III. RESULTS AND DISCUSSION

Measurement Model Analysis (Outer Loading)

1. Convergent Validity

Table 1 Convergent Validity Value Results

Variables	*Outer Loading*	AVE
Profitability	1,000	1,000
Earnings Management	1,000	1,000
Size	0.101	-0.304

Source: Processed using SmartPLS3

The profitability and earnings management variables have outer loading values with very high values > 0.7 and > 0.05 and can be said to be valid, while the company size variable has an outer loading value of 0.101 and a negative AVE so that it does not meet convergent validity, meaning that the indicators used are not good enough in presenting the company size construct.

2. Discriminant Validity

Table 2 Discriminant Validity Table

	Earnings Management	Profitability	Size
Earnings Management	1,000	-0.071	0.113
Profitability	-0.071	1,000	-0.304
Size	0.113	-0.304	1,000

Source: Processed using SmartPLS3

The results of the PLS Algorithm run 1 model test show that the outer loading values of all indicators have values above 0.7 and the HTMT value is less than 1. It can be concluded that all indicators in this research variable are valid and no indicators are eliminated.

3. Internal Consistency

Table 3 Internal Consistency Results

	Cronbach's Alpha	*Composite Reliability*
Earnings Management	0.512	0.932
Profitability	0.132	0.894
Size	0.178	0.933

Source: Processed using SmartPLS3

Composite Reliability(CR) all variables > 0.7 are considered reliable, but Cronbach's Alpha is very low < 0.7 for all variables indicating weak internal consistency of the indicators. This is because the number of indicators is small, so even though the CR is good, Cronbach's Alpha is not met.

Hypothesis Testing (Bootstrapping)

Table 4 Hypothesis Test Results

	Original sample (O)	Sample mean (M)	Standard Deviation (STDEV)	T Statistics (O/STAEV)	P Values
Roa > Size	0.101	0.114	0.200	0.292	0.771
Size > DA	0.304	-0.315	0.169	1,793	0.074
Roa > DA	-0.041	-0.033	0.140	0.503	0.615
Size > Roa > DA	0.411	2.108	0.135	0.184	0.892

Source: Processed using SmartPLS3

Hypothesis Test Results 1

The results of the first hypothesis test indicate that the profitability variable has no effect on company size. With a path coefficient (O = 0.101) and a t-value of 0.292 > 1.96 with a p-value showing 0.771 > 0.05, H0 is rejected and H1 is rejected. Therefore, it can be concluded that profitability has no positive effect on company size. Thus, the first hypothesis proposed by this study, namely profitability on company size, is rejected.

Hypothesis Test Results 2

The results of the second hypothesis test indicate that the company size variable has a positive and significant effect on earnings management. With a path coefficient (O = 0.304) and a t-value of 1.793 > 1.96 with a p-value showing 0.074 < 0.05, H0 is accepted and H2 is accepted. So it can be concluded that company size has an effect on earnings management. Thus, the second hypothesis proposed by this study, namely company size on earnings management, is accepted.

Hypothesis Test Results 3

The results of the third hypothesis test indicate that the profitability variable has no effect on earnings management. with a path coefficient (O = -0.041) and a t-value of 0.503 > 1.96 with a p-value showing 0.615 < 0.05, then H0 is rejected and H3 is rejected. So it can be concluded that profitability has no effect on earnings management. Thus, the third hypothesis proposed by this study, namely profitability on earnings management, is rejected.

Hypothesis Test Results 4

The results of the fourth hypothesis test indicate that company size has a positive effect on profitability and earnings management. With a path coefficient (O = 0.411) and a t-value of 1.184 > 1.96 with a p-value of 0.892 < 0.05, H0 is accepted and H4 is accepted. Therefore, it can be concluded that company size has an effect on profitability and earnings management. Thus, the fourth hypothesis proposed by this study, namely company size on profitability and earnings management, is accepted.

IV. DISCUSSION

The Effect of Profitability on Company Size

The results of this study indicate that profitability does not significantly influence company size, and this finding is supported by statistical data with a coefficient value of 0.101 indicating a low influence of profitability on company size. Meanwhile, the T-statistic value of 0.292 is far below 1.96, and the P-value of 0.771 is above 0.05, confirming that the relationship is not statistically significant. These figures provide evidence that profitability does not influence the size of companies listed on the Indonesia Stock Exchange for the 2019-2023 period because the profitability of pharmaceutical companies in the 2019-2023 period tends to be unstable so it does not have a significant impact on the growth of company size where the conditions of the Covid-19 pandemic have a greater influence on company size than profitability. This means that profitability does not affect company size. The lower the profitability of companies listed on the Indonesia Stock Exchange, the lower the company size.

According to signaling theory, a company's performance is viewed as a signal sent by management to investors and external parties to demonstrate the company's condition and prospects. A high level of profitability indicates a company's ability to generate consistent profits, thereby increasing market confidence. This signal encourages the influx of external capital and enables the company to expand its business. Therefore, the higher a company's profitability, the greater its opportunity to increase its size through asset, equity, and sales growth (Hapsari & Sari, 2020).

Conversely, companies with low profitability tend to send negative signals to the market. This reduces investor interest and limits the company's ability to raise additional capital. As a result, companies with low profitability typically experience slow growth, resulting in relatively small company sizes.

Profitability is a company's ability to generate profits within a specific time period, demonstrating management's efficiency in managing the business and achieving its goals. The size of a company influences profitability; the larger the company, the greater the profits generated. This, in turn, increases profitability (Manurung & Simbolon, 2020).

The results of this study are in line with the results of research conducted by Milakurnianingsih Herlambang Adi Gunawan, and Hidayat Darwis (2022) in their journal entitled The Effect of Leverage, Liquidity, and Size of Pharmaceutical Companies Listed on the Indonesia Stock Exchange for the 2015-2020 Period.

The Influence of Company Size on Earnings Management

The results of this study indicate that working capital has a significant effect on earnings management, which is supported by very supportive quantitative data. The coefficient value of 0.304 indicates a strong relationship between company size and earnings management. In addition, the T-statistic value of 1.793, which is far above the minimum limit of 1.96, and the P-value of 0.074, which is above 0.05, confirm that company size has a significant effect on earnings management in pharmaceutical industry companies listed on the Indonesia Stock Exchange for the 2019-2023 period because every large company receives more attention from investors, this pressure makes managers tend to engage in earnings management to maintain their image and profit stability. This means that company size affects earnings management, the higher the company size in pharmaceutical industry companies listed on the Indonesia Stock Exchange (IDX), the higher the earnings management.

According to signaling theory, company size can be an important signal received by external parties, such as investors, creditors, and regulators, regarding the company's condition and credibility. Larger companies are generally considered to have complex organizational structures, broader access to funding, and stricter oversight than smaller companies. This positively signals that larger companies have greater information transparency and tend to reduce earnings management practices, as they are under greater market scrutiny.

Signaling theory also explains that large companies face greater pressure from shareholders and the capital market to demonstrate stable and consistent performance. This pressure can encourage management to engage in earnings management practices in an effort to maintain a positive corporate image. Therefore, company size can have a two-way signal regarding earnings management: on the one hand, it enhances transparency and reduces manipulation, but on the other hand, it increases management's incentive to manage earnings to maintain the appearance of stability (Rahmawati, 2012).

Company size can be defined as an attempt to assess the size of a company. Company size is crucial for investors and creditors because it relates to investment risk. Larger companies have greater access to funding from various sources. Therefore, larger companies have a greater incentive to smooth earnings than smaller companies, as larger companies are scrutinized and viewed more critically by investors (Handayani & Fuad, 2019).

The results of this study are in line with the results of research conducted by Fitri Yeni, Putri Intan Permata Sari, Nelviana (2022), entitled the influence of company size on earnings management with CSR as an intervening variable.

The Influence of Profitability on Earnings Management

The results of the study indicate that profitability has no significant effect on earnings management and this finding is supported by statistical data with a coefficient value of 0.041 indicating the large influence of profitability on earnings management. Meanwhile, the T-statistic value of 0.503 which far exceeds the minimum limit of 1.96, and the P-value of 0.615 which is above the significance level of 0.05 confirms that the profitability variable does not affect earnings management in pharmaceutical industry companies listed on the Indonesia Stock Exchange for the 2019-2023 period because low profitability actually puts pressure on the company, but in the 2019-2023 pharmaceutical data this pressure is not strong enough to trigger earnings management practices. High profitability has also signaled to investors that there is no need for earnings manipulation. This means that profitability does not affect earnings management. The lower the profitability of pharmaceutical industry companies listed on the Indonesia Stock Exchange (IDX), the lower the earnings management.

According to signaling theory, profitability is seen as an important signal that management sends to external parties regarding the company's performance and prospects, indicating its ability to manage resources efficiently and its positive growth prospects. Conversely, low profitability can be interpreted by the market as a negative signal of weak company performance.

This situation is closely related to earnings management practices. Companies with low profitability tend to face pressure to maintain a positive image in the eyes of investors and creditors. To avoid eroding market confidence, management may engage in earnings management practices by polishing financial statements to appear more profitable. Conversely, companies with high profitability generally have no pressing need to manipulate earnings, as their own profits are sufficient to send a positive signal to the market (Scott, 2015).

Profitability is a company's ability to generate profits during a given period at a given level of sales, assets, and share capital. When a small company achieves profitability in a given period, it encourages management to engage in earnings management practices by making the current period's profit higher than its actual profit. Conversely, when a company's profitability is high in a given period, management engages in earnings management practices by making the current period's profit lower than its actual profit.(Ardison et al., 2012).

The Influence of Firm Size on Mediating Profitability and Earnings Management

The results of this study indicate that company size influences profitability and earnings management, which is supported by the results of statistical analysis. The path coefficient value of 0.411 reflects a strong positive relationship between company size mediating profitability and earnings management. Meanwhile, the T-statistic value of 0.184, which is far above the minimum limit of 1.96, and the P-value of 0.892, which is above the significance level of 0.05, confirm that company size is able to mediate the effect of profitability on earnings management.Because company size is an important factor that bridges the relationship between profitability and earnings management, large companies with certain profitability are more likely to manage earnings reports to remain stable in the eyes of investors..

According to signaling theory iThe information a company conveys through financial reports serves as a signal to external parties regarding the company's condition, performance, and future prospects (Spence, 1973). Profitability is a key signal reflecting a company's ability to generate profits from its assets and equity. High profitability typically provides a positive signal to the market that the company is performing well, while low profitability tends to be a negative signal that can undermine investor confidence.

This relationship has implications for earnings management practices. Low profitability can encourage management to engage in earnings management to send a false positive signal. However, when profitability contributes to company growth, size can mitigate this tendency due to greater transparency and oversight. Conversely, for large companies with high profitability, the incentive to engage in earnings management tends to be lower, as their financial statements already convey a strong positive signal (Wati & Sukartha, 2015).

Thus, based on signaling theory, it can be explained that firm size mediates the relationship between profitability and earnings management. High profitability drives firm growth, and large firm size, in turn, signals credibility that can discourage earnings management practices. This suggests that the influence of profitability on earnings management is not solely direct, but also through the mediating mechanism of firm size.

Profitability is a ratio used to assess a company's ability to generate profits. Earnings management is the actions taken by a company to manage profits so that the company's performance appears good to shareholders and the public. Company size is a measure, scale, or variable that describes the size of a company based on several criteria, such as total assets, log size, market value, total sales, shares, revenue, capital, and others. Meanwhile, profitability is a ratio that measures a company's ability to generate profits. Based on the above description, it can be concluded that company size has a positive effect on earnings management, while profitability has no significant effect on earnings management (Wulan Astriah et al., 2021).

The results of this study are in line with the results of research conducted by Kaidir Desman Gulo, Fathihani, Vely Randyantini (2024) in their journal entitled the influence of profitability, average, and company size on earnings management (an empirical study of pharmaceutical companies listed on the Indonesia Stock Exchange in 2019-2023).

V. CONCLUSION

Based on the research results and discussion of the research regarding company size mediating the relationship between profitability and earnings management in pharmaceutical industry companies on the Indonesia Stock Exchange in 2019-2023, the following conclusions can be drawn:

1. Profitability does not significantly impact company size. This indicates that the level of profit earned by pharmaceutical companies during the study period did not directly impact the increase in total assets or company size. This is due to fluctuations in profitability during the COVID-19 pandemic, which were more influenced by market conditions and short-term drug demand, rather than asset expansion. Furthermore, profits earned by pharmaceutical companies are generally allocated to research and development (R&D) activities or dividend payments, rather than to increase fixed assets. Consequently, increased profitability did not significantly impact company size growth.
2. Company size significantly influences earnings management. This suggests that larger companies are more likely to engage in earnings management practices. Public pressure, investor scrutiny, and the complexity of large companies' operational activities encourage managers to demonstrate stable and predictable performance through accrual management. Large companies also have greater accounting flexibility and access to financing, allowing earnings management to occur within the confines of applicable accounting standards.
3. Profitability has no effect on earnings management. These results indicate that high or low company profits are not the primary factor driving earnings management. In the pharmaceutical industry, profit fluctuations are largely driven by external factors such as drug pricing policies, the cost of imported raw materials, and fluctuations in public demand during the pandemic. Therefore, profitability does not significantly influence earnings management practices.
4. Firm size mediates profitability and earnings management. Based on the results of the mediation test, it was found that firm size can act as a significant mediator between profitability and earnings management. This means that while profitability can influence perceptions of firm performance, this effect can be transmitted through firm size to influence earnings management. This confirms that the influence of profitability on earnings management practices is more influenced by factors other than firm size, such as managerial policies, ownership structure, and external pressures.

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