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Profit Leveling Actions in Banking in terms of Profitability, Company Size and Capital Structure

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Abstract

This study aims to examine the effect of profitability, company size and capital structure on profit leveling practices in the banking sector listed on the Indonesia Stock Exchange for the 2020-2022 period. The type of research used is associative quantitative research. The population in this study is banking companies listed on the Indonesia Stock Exchange during 2020-2022, which is 47 companies. The sampling technique in this study is using *purposive sampling* techniques, so that the number of samples in this study is 84 sample data on financial statements of banking companies for the 2020-2022 research period. The data analysis method uses Logistic Regression analysis (logistic regression). The results of the study found that profitability has a positive and significant effect on profit smoothing in banking companies listed on the Indonesia Stock Exchange, Company size has no influence on profit smoothing in banking companies listed on the Indonesia Stock Exchange, *Capital structure* does not have a significant effect on profit smoothing in banking companies listed on the Indonesia Stock Exchange

Keyword : Profitability, Company Size, Capital Structure, Profit Leveling

A. INTRODUCTION

The rapid development of media technology in the era of globalization requires the business world to be able to provide useful information to information users, such as investors and interested parties. Information in the form of financial statements is the main media used to evaluate company performance (Ibrahim et al., 2022). Financial reporting is also a form of management control over the use of resources that help it in managing the company. To achieve these objectives, comprehensive financial statements include: statement of financial position, income statement, statement of equity development, financial statements and notes and financial statements. Financial statements are considered a concept that shows the performance of the company, so any information that can be seen in the financial statements is one of the most important information, namely profit

(Amin et al., 2022).

Investor attention is often focused on raising money, prompting managers to take actions that can improve financial reporting, including financial management. The opportunity cost management process often involves the process of capital acquisition. Income growth reduces annual fluctuations by shifting income from high-income years to low-income periods (Fatimah &; Danial, 2019). Profit Leveling Practices is common practice in many countries. Many people wonder whether profit leveling is good or bad, as well as why this profit leveling is numerous and doable. Profit leveling is not a problem to achieve as long as the implementation is not fraudulent (House & Assyria, 2020). On the other hand, financial improvements can harm parties interested in the business, such as investors and users of financial statements. The presentation of benefits information is misleading and will lead to errors in decision making. Companies listed on the BEI (Indonesia Stock Exchange) are divided into several sectors such as banking, finance, manufacturing, etc. However, auditors will conduct audits in the banking sector. The reason is, banking is one of the sectors that is expected to have a good future and make a large contribution to state finances, so many businesses still need banking services. Even though currently the daily life of the Indonesian people cannot be separated from banking services. Due to the importance of the role of banking in the country, the financial sector attracts the attention of investors. The government is responsible for controlling the banking system and is regulated so that the banking world is always professional and transparent in managing public money in order to provide trust and good value in the eyes of the public.

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Researchers also found the phenomenon of *income smoothing* in banking companies listed on the IDX which was measured using the *ECKEL index*.

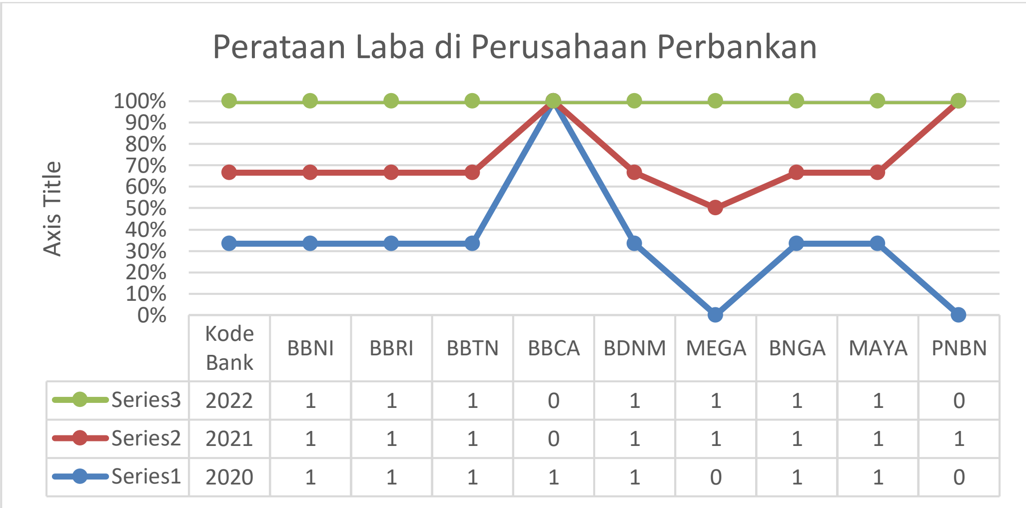

Figure 1. Profit Leveling in Banking Companies

Sumber data *: www.idx.co.id, (data diolah 2023)*

Information:

Number 1 = Profit smoothing occurs

Number 0 = No profit smoothing occurs

The picture above of companies with codes BBNI, BBRI, BBTN, BNGA and MAYA, as well as BDNM from the calculation results using the *eckel index* in 2020 to 2022 is proven to have carried out profit leveling practices for three consecutive years. Meanwhile, banks with BBCA, MEGA and PNBN codes from the results of the *eckel index* calculation carried out in three consecutive years have been inconsistent in carrying out profit leveling practices. So based on the results of *the calculation of the eckel index*, it proves that there are still many companies that carry out profit leveling practices that can cause a decrease in public credibility with banking companies in conducting transactions at the company. Therefore, this research is important to research. Management's actions to level profits are generally based on various reasons, including to meet internal targets, meet external party expectations, make profits stable, and so that financial statements appear good for the benefit of the Company (Don et al., 2021). The act of profit leveling hurts potential investors because the information provided becomes irrelevant as a decision-making tool. The practice of profit leveling is also inseparable from several factors that influence it. In this study, factors that affect profit leveling practices are profitability, company size and capital structure.

Profitability is the ability of an entity to make a profit within a certain period of time. The profitability of the company is closely related to the smoothing of profits because with high profits, it will attract investors in investing (Maotama and Astika, 2020). Therefore, profitability as an important factor that needs to be studied in relation to profit leveling practices. Profitability was proxied by using *Return On Asset* Where to measure the ability of management to obtain overall profits

(profits) with its own assets Framita (2018) deep Julia *et al*. (2022:3). Reasons to use *Return On Asset* (ROA) that ROA is an important measure and is often used as a reference by investors in assessing the performance of a company, which will ultimately influence investors to make decisions in investing in the company. Companies with a high ROA level will have a greater tendency to average profits compared to companies with a lower ROA level, because the company has the ability to earn profits in the future so that are able to managers delay or accelerate profits that make investors interested in investing in the company (Ramadani and Nuryatno, 2020).

The second factor that affects the smoothing of profits is the size of the company. Company size is a scale where the size of the company can be classified according to several ways, including total assets and value per share (Julia *et al*, 2022). Because large companies are highly watched and viewed critically by investors, it is important to conduct research related to the size of the Company, especially large companies that tend to practice profit leveling. Investors are interested in investing in companies that have relatively stable profits, so large companies always want to show stable profits and perform well (Guide and Vaya, 2018). The third factor is in terms of capital structure. The company's capital structure describes the comparison between the amount of debt and equity capital employed by the Company (Ramadani day Nuryatno, 2020). Capital structure is important to examine because if a company is unable to fulfill its payment obligations within a predetermined payment period, profit leveling is carried out to check whether there are deficiencies in the debt agreement (Ayunika and Yadnyana, 2018).

Some previous studies that have been conducted have obtained inconsistent results. Research conducted by Setyaningsih *et al.*(2021) says that profitability (ROA) has a positive effect on *income smoothing*. Instead research conducted by Rianto and Yudinur (2022) found that profitability (ROA) had no effect on profit smoothing. Research conducted by Aemanah and Isynuwardhana (2019)Where profitability has a positive and significant effect on profit smoothing. While the research conducted by Shopian and Atalia (2022) found that profitability had a negative and significant effect on profit smoothing.

Further research conducted by Setyaningsih *et al*. (2021) Where the size of the company has a positive and significant effect on *income smoothing.* Instead research conducted by Sophian and Atalia (2022) The size of the company has no effect on the smoothing of profits. Research was also conducted by Earth *et al*. (2021) Where the size of the company negatively affects the smoothing of profits while the research conducted Ni Komang *et al.* (2022) shows the size of the company has a positive effect on profit smoothing. Research conducted by (Nurani & Dillak, 2019) and (Febrianti

& Lasiyono, 2019) says that *Capital structure* Positive and significant effect on profit smoothing. While the research conducted by (Yunengsih et al., 2018) and (Tiwow et al., 2021) found that the capital structure proxied by DER had no effect on profit leveling. The reason this study was conducted is because the results of several previous studies still do not show consistent results and also based on the phenomenon that has been explained that there are still many banking companies that practice profit leveling. Therefore, this study aims to examine the effect of profitability, company size and capital structure on profit leveling practices in the banking sector listed on the Indonesia Stock Exchange for the 2020-2022 period.

B. LITERATURE REVIEW

Agency Theory

The relationship between agency theory and profit leveling practice is that there is a conflict of interest that occurs between principals and *agents*. The contract between the principal and the agent allows them to put each other's interests first.

The Effect of Profitability on Profit Smoothing

Profitability is a ratio that shows the level of the company's ability to generate profits. The higher the profitability ratio, the better the level of effectiveness of a company's management in generating profits. Companies with a high level of profitability tend to do profit leveling, because management knows the company's ability to earn profits in the future. Stable profitability will benefit management, such as maintaining positions and getting bonuses (Ni Komang *et al*. 2022). By theory *agency*, profitability describes the difference in goals that are between *principal* (investor) and *Agent* (manager), where each individual wants to take action in accordance with his own wishes, this is done in order to prosper himself. The occurrence of information asymmetry causes the practice of profit leveling, where a manager manipulates data in presenting accounting information in accordance with expectations *principal*, although the information does not describe the actual condition of the company. This is in line with research conducted by Maotama and Astika (2020) which states that profitability (ROA) has a positive effect on profit smoothing. Research was again conducted by Setyaningsih *et al*. (2021) which states that profitability has a positive effect on profit smoothing. While research conducted by Shopian and Atalia (2022) states that profitability has a significant negative effect on profit smoothing. Based on the statement above, the proposed research hypothesis is:

H_1:P rofitability has a positive effect on profit smoothing in banking companies listed on the IDX.

The Effect of Company Size on Profit Smoothing

The size of the company describes the number of assets that the company owns. This means that the greater the total assets owned by the company, the larger the size of the company. The number of company assets can increase and maximize production more efficiently so that it will have an impact on increasing revenue so that the profits obtained by the company will also increase (Setyaningsih *et al.* 2021). Based on the theory agency that companies that have a large size have a stronger motivation to flatten profits compared to small companies, because large companies get more supervision from investors, so managers prefer to use accounting methods that suspend reported profits from the current period to the future, so as to minimize reported profits. This is done by the company to avoid changes in profits that are too drastic, because large fluctuations in profits indicate a large risk in investment, thus affecting investor confidence in the company.

Thus, the larger the company, the greater the possibility of management to carry out profit leveling practices. This is in line with previous research conducted by Setyaningsih *et al*. (2021) which states that the size of the company has a significant positive effect on *income smoothing.* Research was also conducted by Ni Komang *et al*. (2022) states that the size of the company has a positive effect on profit smoothing. While the research conducted by Rianto and Yudinur (2022) states that the size of the company has a significant negative effect on profit smoothing. Based on the statement above, the proposed research hypothesis is:

H2: Company size has a positive effect on profit smoothing in banking companies listed on the IDX.

The Effect of Capital Structure on Profit Smoothing

Capital Structure with the Debt to Equity Ratio (DER) indicator is a ratio that measures the extent to which the amount of debt can be covered by own capital. The higher the DER, the greater the assets that will be financed with debt and the more risky it is for the company. By using more debt than own capital, the fixed burden borne by the company is high and will ultimately reduce the company's revenue. The use of debt will increase the value of the company, but at a certain point, namely in the optimal capital structure, the value of the company will decrease with more and more the proportion of debt in its capital structure. The greater the company's debt, the greater the risk faced by investors, so investors will ask for a higher level of profit. The use of debt will determine the level of debt to equity of the company. As a result of these conditions, companies will tend to carry out profit leveling practices.

Based on *agency* theory that managers have information asymmetry towards external parties such as creditors and investors which occurs when managers have more internal company information than external parties. With these conditions, managers can use the information they know to manipulate the company's financial statements in maximizing their welfare by leveling profits. In other words, the large level of capital structure can affect management's actions in carrying out *income smoothing actions.* This is in line with research conducted by (Nurani & Dillak, 2019) and (Febrianti & Lasiyono, 2019) says that *Capital structure* Positive and significant effect on profit smoothing. While the research conducted by (Yunengsih et al., 2018) and (Tiwow et al., 2021) found that the capital structure proxied by DER had no effect on profit leveling. Based on the statement above, the proposed research hypothesis is:

H_3: *Capital structure* has a positive effect on profit smoothing in banking companies listed on the IDX.

C. RESEARCH METHODS

The type of research used is associative quantitative research. The population in this study is banking companies listed on the Indonesia Stock Exchange during 2020-2022, which is 47 companies. The sampling technique in this study is using *purposive sampling techniques.* Based on the criteria above, of the 47 banking companies made into the population, there are only 28 companies that meet the criteria, so that the number of samples in this study is 28 x 3 = 84 sample data of financial statements of banking companies for the 2020-2022 research period. The data analysis method uses Logistic Regression analysis (logistic regression).

D. RESEARCH RESULTS AND DISCUSSION

Coefficient of Determination Test (R2 McFadden)

In logistic regression, it is not possible to use the conventional value of the R2 coefficient to measure the goodness of the regression line. Instead, the coefficient of determination developed by McFadden was used.

Table 1. Coefficient of Determination Test

McFadden R-Squared	0,68349	Mean dependent was	0,71652
S.D depended was	0,40912	S.E. of regression	0,33614

In this study it is known that, the value of R 2 McFadden from the estimated results is 0.68349. This means that the independent variables (profitability, company size and capital structure) in the model are able to explain the change in the probability of income smoothing of 68.34% and the remaining 31.66% is explained by other variables outside the model.

Likelihood Ratio Test (LR Test)

Statistical likelihood ratio (LR) test to test whether all explanatory variables together affect the dependent variable. Statistical likelihood ratio (LR) test as F test in OLS regression method.

Table 2. Likelihood Ratio Test

LR Statistic	22.429	Avg.Log Likelihood	0,36174
Prob. (LR Statistics)	0,004		

Based on the estimated results, the statistical LR value or chi-square count is 22,429, while the chi-square value of table df 3, α = 0.05 is obtained at 7.815. The value of the LR statistic or chi-square count (22.429) > the chi-square value of the table (7.815). In addition, you can see the LR Test by comparing Prob (LR statistics) at α, the value of Prob (LR statistics) 0.004 < 0.05, then the decision is to reject Ho and accept Ha which means that all independent variables together affect the dependent variable.

Uji Statistik Z

The Z test is performed to find out whether the independent variable individually affects the dependent variable. The Z test can be done by comparing the probability value against the α, if the probability value is < α, then Ho is rejected which means that the independent variable affects the dependent variable, while if the probability value is > α, then Ho is accepted which means that the independent variable does not affect the dependent variable.

Table 3. Z Statistical Test

Variable	Coefficient	Std.Error	Z Statistic	Prob.
C	18.170	8.523	4.046	0.000
Profitability	0.181	0.006	3.140	0.001
Company Size	0.709	0.340	1.082	0.160
Capital structure	0.201	0.758	1.823	0.122

Based on the Z test, it is known that the profitability variable proxied by return on assets (ROA) is significantly positive for income smoothing practices and can prove the hypothesis of previous research built, where there is an influence between profitability (ROA) and income smoothing practices. A positive coefficient of 0.181 indicates that the profitability value (ROA) has a unidirectional relationship with income smoothing practices. Based on the Z test, it is known that the variable size of the company does not have a significant effect on the practice of income smoothing and cannot prove the hypothesis of previous research built, where there is an influence between the size of the company and the practice of income smoothing. A positive coefficient of 0.709 indicates that the size of the company does not have a strong relationship with income smoothing practices.

Based on the Z test, it is known that the capital structure variable proxied with the debt to equity ratio (DER) does not have a significant effect on the practice of income smoothing. A positive coefficient of 0.201 indicates that the capital structure is unable to prove the research hypothesis built where there is an influence between the debt to equity ratio resulting from total debt divided by total equity in the company and income smoothing.

The Effect of Profitability on Profit Smoothing

The results of this study found that profitability has a positive and significant effect on profit smoothing. That is, the profitability of the enterprise is one of the factors affecting the smoothing of profits. A stable and high level of profitability can attract investors in investing because the company is considered good at generating profits, from here the management tries to make the level of profitability look stable so as to encourage management to take profit leveling actions. Stable profitability will benefit management, such as maintaining positions and getting bonuses (Ni Komang *DKK*. 2022). This is in line with research conducted by Aemanah and Isynuwardhana (2019) which states that profitability has a positive and significant effect on profit smoothing. Research was also conducted by Setyaningsih *DKK*. (2021) which states that profitability has a positive effect on profit smoothing. However research conducted by Rianto and Yudinur (2022) states that profitability has no effect on profit smoothing.

The Effect of Company Size on Profit Smoothing

The results of this study found that the size of the Company did not have a significant effect on profit smoothing. This means that the greater the total assets owned by the company, the larger the size of the company. The number of company assets can increase and maximize production more efficiently so that it will have an impact on increasing revenue so that the profits obtained by the company will also increase (Setyaningsih *et al.* 2021). According to Pratnatika (2018), the reason for the company's size not affecting profit smoothing is that managers are not afraid to level profits in large companies because large companies are in the public and government spotlight. If fraud is found, it will affect investor confidence in the company. An increase in the size of the company will give the company great responsibility in presenting relevant information. Because it is seen as more critical and conscientious by investors and the government, companies tend to reduce the practice of profit leveling in presenting profits. Because this will reduce the value of the stock price if external parties know the untruth of the information presented in the financial statements, this allows management to reduce the practice of profit leveling when the size of the company increases. This is in line with research conducted by Shopian and Atalia (2022) which states that the size of the company has no effect on profit smoothing. Research was also conducted by Putu,*et al*(2021) which states that the size of the company has no effect on profit smoothing. However research conducted by Ni Komang dkk. (2022) states that the size of the company has a positive effect on profit smoothing. Research was also conducted by Rianto and Rizka (2022) states that the size of the company has a negative and significant effect on profit leveling.

The Effect of Capital Structure on Profit Smoothing

The results of this study found that capital structure did not have a significant effect on profit flattening. This means that a high level of capital structure can reduce the level of creditor confidence in providing credit in the Company, thus making the company not flatten profits. The results of this study are not in line with the results of research (Yunengsih et al., 2018) which states that the capital structure proxied with the debt to equity ratio (DER) affects the practice of income smoothing. *Capital structure* is a ratio used to measure how far a company uses funding through debt Setyaningsih *et al*. (2021). In this study, *Capital structure* measured by ratio *Debt to Equity ratio*(DER) which reflects the company's ability to pay or meet its obligations with capital. This is in line with research (Tiwow et al., 2021) found that the capital structure proxied by DER had no effect on profit leveling. But it is different from the results of research conducted by (Nurani & Dillak, 2019) and (Febrianti & Lasiyono, 2019) says that *Capital structure* Positive and significant effect on profit smoothing.

E. CONCLUSION

Based on the results of data analysis that has been carried out, the following conclusions can be drawn: Profitability as measured by *Return On Assets* (ROA) has a positive and significant effect on profit smoothing in banking companies listed on the Indonesia Stock Exchange, Company size has no influence on profit smoothing in banking companies listed on the Indonesia Stock Exchange, *Capital structure* measured by *Debt To Equity Ratio* (DER) does not significantly affect the flattening of profits in banking companies listed on the Indonesia Stock Exchange.

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