THE EFFECT OF FIRM CHARACTERISTICS AND EARNING MANAGEMENT TOWARD SHARE RETURN: BEFORE AND DURING PANDEMIC

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Abstract:	The main purpose of investors investing in the firm stocks is to achieve wealth growth through stock return. Stock return is one of the most important factors in choosing the best investments. This study investigates the relationship between firm characteristics and earning management on stock return before and during the pandemic and also when the periods are combined. It involves firms in the IDX Basic industry with the use of audited financial reports. The observation period is from 2016–2020 and using balanced panel data to produce generalizable results. For data analysis, we use the multiple regression method to prove the hypothesis and tested using the application of Stata. The results obtained from this study show that before pandemic, earning per share has negative effect on stock return. During pandemic, capital structure shows negative effect on stock return. While combining the period before and during the pandemic, firm size shows significant positive and earning per share shows significant negative on stock return.
Keywords:	*Earning management, Firm characteristics, Stock return*

1. Introduction

The capital market plays a strategic role in developing and strengthening a country's economy (Amogha & Suresh, 2019; Undang-Undang Republik Indonesia No. 8, 1995). In Indonesia, it is known as the Indonesia Stock Exchange (IDX) and has become a forum for investors to carry out investment activities as well as a source of funding for businesses (Handayani et al., 2019). Investment is a business activity that seeks to obtain multiple returns in the future by investing in companies or on high-value assets (Pasha, 2019).

The world economy, including Indonesia, is currently experiencing a drastic decline, as shown in Figure 1 (Sari & Suharti, 2021). The spread of pneumonia virus like influenza around the world which came from the city of Wuhan, Hubei-China province has caused the government to issue various policies such as lockdown or quarantine to suppress its spread. This policy resulted in restrictions on carrying out economic activities do have a major impact on various industrial sectors (Centers for Disease Control and Prevention, 2021; Oktaria & Alexandro, 2020; Sari & Suharti, 2021; Rahmayani & Oktavilia, 2020). WHO (World Health Organization) designated the virus as a pandemic in March 2020 and has identified it as Corona Virus Disease 19 (COVID-19) (Junusi, 2020; Nurcahyono et al., 2021; Oktaria & Alexandro, 2020; Sodikin, 2020).

Besides that, these policies also have led to massive unemployment and business failure (Zhang et al., 2020). Before the pandemic, the Indonesian economy was still shrouded in optimism that 2020 will be better than 2019, as shown in the positive percentage in Figure 1. The Composite Stock Price Index (IHSG) also reached 6,385 in early January 2020 and when this pandemic emerged, it then fell to the level of 5,361 as the closing price of trading during the announcement of the first Corona case and continued to fall below the level of 4,000 at the end of March (Berita Satu, 2021; CNBC Indonesia, 2021).

Figure 1. Indonesia's economic growth quarter IV-2020

Source: Badan Pusat Statistik (2021)

The challenge facing many businessmen in a pandemic is that they must spin their brain to find ways to carry on the breath of the firm (Populix, 2020). Each firm is divided into various industrial sectors. Of course, each industry has its own characteristics, whether it is financial or non-financial (M'muriungi et al., 2019). The unique characteristics of each firm have the ability to predict stock returns (Tahir et al., 2013). The uniqueness is also believed to be able to cultivate perceptions of the firm's performance and prospects in the minds of financial information users (M'muriungi et al., 2019).

Looking at the pandemic sweeping the world in 2020, it has hit every country's economy from various sectors. The same applies to the capital market. However, even in bad circumstances, there will always be opportunities. Some industries still recorded positive performance even exceeded the IHSG performance. One of them is the basic materials industry sector (IDX Basic) (Siregar, 2021).

Good firm performance and prospects will be more attractive to investors (Paryanto & Sumarsoso, 2018). When investing, investors usually intend to obtain expected returns in the future (Acheampong et al., 2014). In order to obtain the expected return, investors need to consider the investment decisions they take before investing, such as checking whether the invested capital can provide the expected return or by looking at the nature of what has happened, such as the realized return, which is important to measure and know the performance of a firm before invest (Endri et al., 2019).

When making investment decisions, information related to firm size is part that investor's must consider (Rahmawati et al., 2015). It can be reflected in the total assets owned which can be found on the firm's financial reports (Shuaibu et al., 2019). If the total assets are large, the firm's risk will be small, because large firms often have many sources of funds in funding their operational activities, both internal or external (Hendra et al., 2018). Firms can also use the sources of funds to make a profit in its operations. With high profits, the firm is expected to provide investors with high returns. Therefore, investors will prefer larger firms in order to obtain high returns (Handayani et al., 2019). These results are in line with the study of Ayuba et al. (2019), Duy and Phuoc (2016), Hidayat (2016), Acheampong

et al. (2014), Sudarsono and Sudiyatno (2016). However, studies by Nadiya and Suryono (2017) and Setiyono and Amanah (2016) shows no significant effect.

H_{1o}: *Firm size does not influence stock return before, during pandemic, and mixed period.*
H_{1a}: *Firm size positively influences stock return before, during pandemic, and mixed period.*

Followed by the capital structure, which plays an important role in the firm's performance, growth, and survival (Ahmad et al., 2013). It is a combination of funding sources in the form of debt to equity that is used by a firm's financial managers to raise funds (Ansca et al., 2019; Le & Phan, 2017; Li et al., 2019). Firms that rely heavily on the use of debt financing will also face interest expenses that must be paid.

Although it can be used by firms in tax saving, it also requires a greater expense that must be paid. This can trigger a high risk due to the firm's inability to pay and result in bankruptcy. The higher the risk tends to lower the stock price, but require higher rate of return to shareholders in order to compensate them against the higher level of risk. In creating an optimal capital structure, financial managers ultimately require a trade-off between risk and expected return to be balanced so that it can maximize the share price and attract investors (Sharif, 2019). These results are in line with the study of Ahmad et al. (2013) and Hermuningsih (2013), but in contrast to the study by Oktaviana et al. (2020) that shows no significant effect.

H_{2o}: *Capital structure does not influence stock return before, during pandemic, and mixed period.*
H_{2a}: *Capital structure negatively influences stock return before, during pandemic, and mixed period.*

A study by Jusriani and Rahardjo (2013) and Pratama and Wiksuana (2016) shows that the attractiveness of investors usually lies in whether a firm can generate returns from invested funds by managing funds in its operating activities. Cash flows generated by operating activities determines whether a firm can generate sufficient cash flow to fund activities without relying on external funding sources (Wahid, 2020).

Firms with good operating activities often have surplus cash that can be used to support further operations. This will send a positive signal to investors, who will believe that the firm has good value. Good firm value is evidenced by an increase in stock prices. As the stock price rises, the rate of return on shares is believed to be high (Utomo & Pamungkas, 2018). These results are in line with the study of Fawzi et al. (2015) dan Collins et al. (2014). However, studies by Santoso (2018) and Yulius and Tan (2016) shows no significant effect.

H_{3o}: *Operating cash flow does not influence stock return before, during pandemic, and mixed period.*
H_{3a}: *Operating cash flow positively influences stock return before, during pandemic, and mixed period.*

When analyzing firm finances, Emamgholipour et al. (2013) stated that earning per share is a part that investors must pay attention. It is used to show the results obtained by the firm for each outstanding share in a certain accounting period in the form of profit/loss. Higher earning per share means that the firm's profits will be high, as will stock return (Tahir et al., 2013). These results are in line with the study of Emamgholipour et al. (2013) and Khan et al.

(2013), but in contrast to the study by Sari and Hermuningsih (2020) and Matiin (2020) that shows no significant effect.

H_{4o}: *Earning per share does not influence stock return before, during pandemic, and mixed period.*

H_{4a}: *Earning per share positively influences stock return before, during pandemic, and mixed period.*

According to Pujiati and Arfan (2013), statement of profit/loss in financial reports is one of the parameter in estimating management performance. Financial reports are prepared as a form of management accountability for the performance and success of the firm to interested parties at a certain period for decision making (Hutagaol, 2012). In practice, many firm managers seek to maximize their interests by sacrificing the shareholders' interests, which is known as earning management (Saedi, 2018).

They manipulate financial reports by improving or reducing firm performance to maximize their satisfaction (Hastuti et al., 2018). This is also related to the concept of agency theory that there is a conflict of interest between the agent and the principal in maximizing the welfare of both parties (Saedi, 2018). Firms that perform earning management especially on the profit/loss information may cause investors to make wrong investment decisions. A high level of earning management implies high risk which will indirectly make investors receive a low return on the invested shares (Nuryaman, 2013). These results are in line with the study of Istiqomah and Adhariani (2017), Sugiarto and Deviesa (2017), but in contrast to the study of Roslita and Kurniawan (2017) that shows no significant effect.

H_{5o}: *Earning management does not influence stock return before, during pandemic, and mixed period.*

H_{5a}: *Earning management negatively influences stock return before, during pandemic, and mixed period.*

Figure 2. Theoritical framework
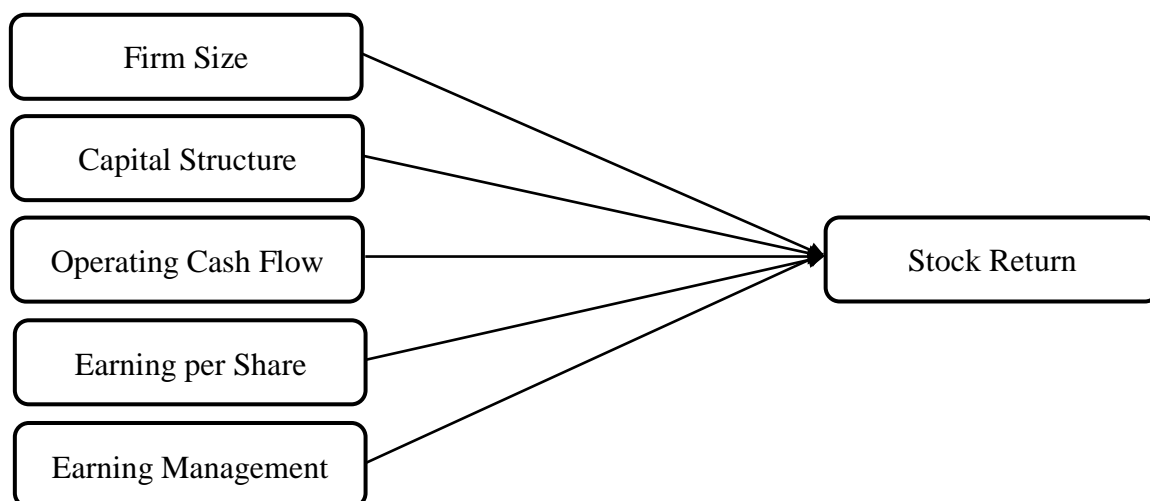
Source: Author (2021)

Earning management makes the shareholders doubt and wonder about the relationship on the return of invested shares (Omush et al., 2019). Some evidence shows a varied relationship and there is still a lack of literature evidence (Sayari et al., 2013). At the same time, previous

researcher revealed that firm characteristics have attracted great interest both among the corporate finance experts and researcher because it can show a significant effect on stock return (Akbar & Baig, 2010; Tripathy & Ahluwalia, 2015). In addition, there are only a few studies have examined the relationship of these variables to stock return by comparing them before and during the pandemic, and there are no studies investigated this relationship if the periods before and during the pandemic are combined.

2. Research Method

This study uses secondary data from IDX focusing on the basic industry through audited financial reports as of December 31 that have been published and with available stock prices. The pandemic period is determined based on the year the WHO declared a pandemic in Indonesia, which is 2020. The observation period is from 2016 to 2020 and used balanced panel data to produce generalizable results (Robin, 2021). Therefore, this study adopted a purposive sampling method in the selection and determination of the sample.

The data analysis is using the multiple regression method to prove the hypothesis. The IDX Basic firms consist of 85 firms with 26 firms that do not meet the research criteria. Thus, the total sample of firms is 59. The data processing that has been collected will be tested using the application of Stata. The independent variables are lagged 1 period except for the test during the pandemic period. Besides that, all variables are winsorized at 1% and 99% only for normal data (not for Ln data) to address the outliers.

For the operational variables measurement, stock return is the current stock price minus the previous stock price plus the dividend per share and divided to the previous stock price (M'muriungi et al., 2019). Firm size is the natural logarithm of the total assets (Shuaibu et al., 2019). Followed with capital structure is the total debt divided to the total equity (Sharif, 2019). Operating cash flow is the current OCF minus the previous OCF and divided to the previous OCF (Kasmiati & Santosa, 2019). Earning per share is the net income divided to the number outstanding shares (Salamat & Mustafa, 2016). Lastly, for earning management – modified Jones Model (discretionary accruals) is the current total accrual divided the total aset of the previous period and minus the current non-discretionary accruals (Mouselli et al., 2014).

3. Results and Discussion

3.1. Results

The results of the descriptive statistics display information related to the amount of data, mean, standard deviation, and the minimum or maximum value of each variable. As can be seen on Table 1, the mean of stock return before the pandemic was higher than during the pandemic. This may be due to a decline in stock prices or the firm's dividend per share distribution in the basic industries. In the mixed period, the mean of stock return does have a positive value indicates that the average stock return on basic industries can offer capital gain. Based on the standard deviation value, it shows that sample are classified as having varied data because the results are higher than the mean value generated (M'muriungi et al., 2019).

Furthermore, based on the mean value of firm size, the average IDX Basic industry is classified as a large-scale firm with assets of more than 250 billion. Firm size reflects how many assets a firm owns, both large and small (Shuaibu et al., 2019). However, there are also small-scale firms in this industry with assets no more than 50 billion, namely the Inter Delta

Tbk.. The firm is engaged in trading of photographic products including photo paper, photo chemicals and processing tools. As for medium-scale firms, the total assets will be between IDR 50-250 billion rupiah (Otoritas Jasa Keuangan No. 53/POJK.04/2017).

As for the capital structure used by the firm's financial manager to raise funds, it can be seen that the average IDX Basic sector firm both before, during or combined before and during the pandemic period resulted in a value above 1. A high DER indicates that the composition of total debt/liabilities is greater than the total net equity it owns, which also causes the firm to impose a large burden on outsiders. At the same time, if the result is negative, it means that the firm's accumulated losses exceed the amount of its equity. It is recommended that firms in this sector industry can manage their debt in appropriate and optimal way to maintain the firm's financial health (Andirerei, 2019).

Kasmiati and Santosa (2019) stated that operating cash flow is the amount of cash generated or used by a firm from operating activities in a certain period of time. The average firm IDX Basic sector shows positive cash flow, which means that the firm's cash inflow is greater than the cash outflow. Meanwhile, the negative cash flow result indicates that the firm failed to generate revenue to cover the firm's operational costs (Tambunan, 2015).

Followed by earning per share, which is the result obtained by the firm in the form of profit/losses for each share outstanding in a certain fiscal period (Emamgholipour et al., 2013). Before the pandemic, the average firm's EPS were high compared to during the pandemic. A positive EPS value indicates that the firm effectively manages its operations and therefore can generate net profit after tax, and vice versa if the result is negative (Sharif, 2019).

Lastly, Saedi (2018) for earning management pointed out that this is an opportunistic behavior of managers in preparing financial report and setting certain transactions to modify financial reports to manipulate the amount of profit to several stakeholders. It can be seen on Table 1 that the average earning management before the pandemic was positive, indicating that the firm was conducting earning management by increasing the reported profit figures, and vice versa for result during the pandemic. Overall, earning management practices show an average of positive value (Rohmaniyah & Khanifah, 2018).

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Stock return [SR]					
- Before Pandemic	236	0.35004	1.32558	-0.82190	8.61856
- During Pandemic	59	0.21115	0.53980	-0.91588	2.04202
- Mixed Period	295	0.32215	1.21052	-0.86420	8.61856
Firm size (in billion IDR) [SIZE]					
- Before Pandemic	232	10,900	20,700	47	127,000
- During Pandemic	59	12,500	24,600	42	120,000
- Mixed Period	290	11,200	21,500	42	127,000
Capital structure [DER]					
- Before Pandemic	232	1.86752	3.4147	-1.61840	22.01414
- During Pandemic	59	1.73582	6.6063	-6.30052	49.5011

- Mixed Period	290	1.73599	3.5816	-6.30052	1 23.91730
Operating cash flow [OCF]					
- Before Pandemic	232	0.56693	5.9691	-12.60568	36.04008
- During Pandemic	59	0.37843	2.6969	-8.73058	13.55040
- Mixed Period	290	0.53424	5.4714	-12.60568	36.04008
Earning per share [EPS]					
- Before Pandemic	232	86.68810	223.3046	-315.13630	1,142.90300
- During Pandemic	59	65.50052	217.832	-409.57580	1,004.33600
- Mixed Period	290	82.86820	221.8537	-323.92100	1,142.90300
Earning management [EM]					
- Before Pandemic	232	0.00360	0.01420	-0.02655	0.07544
- During Pandemic	59	-0.00350	0.00822	-0.02737	0.01533
- Mixed Period	290	0.00217	0.01354	-0.02737	0.07544

Source: Data processed (2021)

Table 2. Pearson correlation coefficient

Variable	Stock return		
	Before	**During**	**Mixed**
SR	1	1	1
SIZE	0.04620	0.17490	0.05240
DER	0.05970	-0.15100	0.03000
OCF	0.04890	0.15660	0.04820
EPS	-0.05110	0.04770	-0.04340
EM	-0.01110	0.13910	0.00570

Source: Data processed (2021)

Table 2 shows the Pearson correlation coefficient between two variables independent. The variables are not affected by multicollinearity problem since it all less than 0.7 (Wooldridge, 2013). Multicollinearity problem is a situation where two or more independent variables have a strong correlation or relationship in a multiple regression model.

Table 3. Multiple linear regression

	Stock return		
	Before	**During**	**Mixed**
Constant	-1.3286	-1.3376	-1.1512
	(-1.06)	(-1.15)	(-1.16)
SIZE	0.0787	0.0556	0.0731*

	(1.63)	(1.36)	(1.88)
DER	0.0308	-0.0139***	0.0146
	(1.05)	(-4.23)	(0.64)
OCF	0.0111	0.0318	0.0110
	(0.61)	(1.31)	(0.62)
EPS	-0.0006*	-0.0002	-0.0005**
	(-1.90)	(-0.92)	(-2.15)
EM	-0.2465	5.8992	0.0427
	(-0.06)	(0.85)	(0.01)
Control fo			
Year FE	Yes	Yes	Yes
Obs.	232	59	290
Adj. R^2	0.0495	0.0048	0.0475
* $p<0.10$, ** $p<0.05$, *** $p<0.01$			

Source: Data processed (2021)

The constant value in Table 3 shows that in the condition that the independent values are zero (ceteris paribus), the stock return shows a number of -1.3286 before the pandemic, -1.3376 during the pandemic, and -1.1512 for overall. The regression equation of the research model is based on the value of regression coefficient of the test results, which are:

(1) $SR_{BeforePandemic}$ = -1.3286 + 0.0787SIZE + 0.0308DER + 0.0111OCF − 0.0006EPS − 0.2465EM

(2) $SR_{DuringPandemic}$ = -1.3376 + 0.0556SIZE − 0.0139DER + 0.0318OCF − 0.0002EPS + 5.8992EM

(3) SR_{Mixed} = -1.1512 + 0.0731SIZE + 0.0146DER + 0.0110OCF − 0.0005EPS + 0.0427EM

3.2. Discussion

For hypothesis testing, it is found that firm size both before and during the pandemic has no significant effect on stock returns. When buying stocks, investors usually do not consider the size of the firm. This is because the growth of a firm is not only in terms of size. Even if the firm has large assets, if the business activities are not properly managed, the firm will not make a lot of profit. Therefore, firm size will not be able to predict the amount of profit that will be obtained by a firm and the return that will be obtained by investors (Nadiya & Suryono, 2017; Setiyono & Amanah, 2016). However, when author combined the period before and during the pandemic, it turns out that firm size affects the stock return positively in general. These results indicate that H_{1o} hypothesis applies only before and during the pandemic, while the H_{1a} hypothesis applies only to mixed period.

As for capital structure, it is found that before the pandemic and mixed periods yield insignificant results on stock return. These results indicate that the size of capital structure will not increase the stock return in a company. The debt-to-equity ratio does not provide investors with relevant information because investors believe that a high proportion of debt can reduce tax expenditures, thereby increasing profit. In addition, it will also improve the firm's performance on the obligations that must be paid by maximizing profits and allowing investors to have confidence in the firm's liquidity (Oktaviana et al., 2020). However, during

the pandemic, it shows strong significant result negatively. These results indicate that H_{2o} hypothesis applies only before pandemic and the mixed period. While the H_{2a} hypothesis applies only during the pandemic.

Meanwhile, in operating cash flow, the test results show that only H_{3o} is acceptable. Operating cash flow is not significant to stock return, either before or during the pandemic or even in the mixed period. Investors in considering investment decision do not only consider operating cash flow (Yulius & Tan, 2016). In assessing good cash flow, it is not enough just to measure the value of operating cash flow, but there are many other cash flows that have a relationship between one to another on financial reports such as investment and funding cash flow (Santoso, 2018).

Earning per share turns out to result significant negative before the pandemic and in the mixed period. However, during the pandemic, this earning per share shows insignificant result. Therefore, it can be concluded that the fourth hypothesis for H_{4o} applies only during the pandemic, and H_{4a} is unacceptable. EPS can have a significant negative effect because investors sold their stocks in the previous year and repurchased the sold stocks in the following year, then the effect on the numerator of EPS will be affected by profit after tax or fund savings that is used to fund the share buy-back program. This buy-back program causes EPS to decrease but stock return remain high (Aisah & Mandala, 2016. Lusiana, 2020). As for the insignificant effect result during the pandemic shows that the market is not sentimental by the size of EPS because considering the current situation, even in the digital era, firms are currently making stronger savings due to the market or economic conditions that have not improved (Sari & Hermuningsih, 2020; Matiin, 2020).

For earning management results turn out that each period shows no significant effect on stock return (H_{5o} is acceptable). In accordance with agency theory that managers are the only parties who control all the information needed to prepare financial reports while other parties outside the firm, which are owners, potential investors, stakeholders, etc. have limited sources and access to obtain information about the firm. The limited access was allegedly the reason investors did not pay attention to the earning management carried out by the management (Roslita & Kurniawan, 2017).

4. Conclusion

This study aims to investigate the relationship between firm characteristics and earning management on stock return focusing in IDX Basic industry both before and during the pandemic and in general by combining the period. The main purpose of investors investing in the firm stocks is to achieve wealh growth through stock return. Stock return is one of the most important factors in choosing the best investments. The results of this study found that before the pandemic, earning per share has a significant negative effect on stock return in the IDX Basic industry. This is because investors sold their stocks in the previous year and repurchased it in the following year (buy-back), which in turn will affect the firm's after-tax profit. This buy-back program led to a decline in earning per share but the return on stocks remain high. The variable firm size, capital structure, operating cash flow, and earning management do not affect the stock return.

Meanwhile, during the pandemic, it is found that capital structure has a significant negative effect on stock returns in the IDX Basic industry. This indicates that during the pandemic, the use of debt financing in fundraising plays an important role for IDX Basic industry. However, the firm will also face interest expenses that must be paid. Although it can

be used by firms in tax savings, it also requires greater costs to be incurred, which are the principal and interest debt. This may also trigger a high risk of the firm's inability to pay and lead to bankruptcy. High risk can trigger a decline in stock prices and stock returns. Therefore, in order to create an optimal capital structure, financial managers ultimately need a trade-off between risk and expected return to be balanced to maximize stock prices and attract investors. The variable firm size, operating cash flow, earning per share, and earning management do not affect the stock return.

In general, when the periods before and during the pandemic are combines, the result shows that firm size and earning per share have significant effect on stock return. Firm size is found to have a significant positive effect, indicating that the size of a firm is an important factor in stock return. With a large size, the risk of the firm becomes small because large firms usually tend to have many sources of funding to fund their operational activities. Where with these sources of funds, the firm can use it to gain profits in its operations, and thus the returns to investor are believe will also experience the same thing. While earning per share is found to a significant negative effect on stock return and in line with findings made during the pandemic period. The variable capital structure, operating cash flow, and earning management do not affect the stock return.

The limitation of this study is first on the variables, especially cash flow variable. This study only examines the operating cash flow and doesn't include other cash flow such as investing and financing. Next followed by the sample that is only limited to the IDX Basic industry. In addition, this study suggests to include the variables investing and financing cash flow or just the total cash flow, and include all the firms listed in the IDX to make the results more general. Besides that, this study also suggests firm's management in the IDX Basic industry to maintain and improve these significant factors. Hence, it can increase investors' confidence for investing in the firm.

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