

INSTITUTIONAL OWNERSHIP, FAMILY FIRMS, LEVERAGE, AND EARNINGS MANAGEMENT

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ABSTRACT

*This study aims to record the empirical finding on the influence of family firms and institutional ownership on earnings management. It also examines the effect of leverage on the correlation between family firms and institutional ownership to earnings management. The object of the study comprises manufacturing firms registered on the Indonesia Stock Exchange from 2017 through 2020. The observations are 44 firm years in total. The data were collected from their annual financial reports, using panel regression as the analysis method. The findings suggest that family firms negatively influence earnings management, whereas institutional ownership has no impact on earnings management. These findings imply that the family firm's ownership generates an alignment effect. Furthermore, leverage negatively influences earnings management, but it has a positive impact on the relationship between family firms with earnings management, likewise has no consequence on the institutional relationship effect with earnings management. Finally, it indicates that family firms with high leverage intend to minimize the chance of violation against debt covenants and, at the same time, intensify the firm's negotiation power over debt negotiation.*

**Keywords:** institutional ownership, family firms, leverage, earnings management

Studi ini bertujuan untuk menguji secara empiris pengaruh perusahaan keluarga dan kepemilikan institusional terhadap manajemen laba. Kami juga menguji apakah leverage memiliki pengaruh pada hubungan antara perusahaan keluarga dan kepemilikan institusional terhadap manajemen laba. Kami secara khusus memeriksa perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia selama 2017-2020. Total observasi adalah 44 perusahaan-tahun. Data penelitian dikumpulkan dari laporan keuangan tahunan. Analisis data menggunakan regresi data panel. Bukti menunjukkan bahwa perusahaan keluarga berpengaruh negatif terhadap manajemen laba, sedangkan kepemilikan institusional tidak berpengaruh terhadap manajemen laba. Hal ini menunjukkan bahwa kepemilikan perusahaan keluarga cenderung menghasilkan efek keselarasan. Selanjutnya, leverage berpengaruh negatif terhadap manajemen laba, tetapi berpengaruh positif terhadap hubungan antara perusahaan keluarga dan manajemen laba, tetapi tidak berpengaruh terhadap hubungan institusional dan manajemen laba. Hal ini menunjukkan bahwa perusahaan keluarga dengan leverage yang tinggi ingin mengurangi kemungkinan pelanggaran perjanjian utang dan meningkatkan kekuatan negosiasi perusahaan selama negosiasi utang.

**Kata kunci:** kepemilikan institusional, perusahaan keluarga, leverage, manajemen laba

INTRODUCTION

Earnings figures are among many indicators commonly used by investors, suppliers, employees, customers, communities, and regulators to measure performance (Prior, Surroca & Tribó, 2008). However, the management might take advantage of its discretion over accounting to influence such figures to pursue its specific purpose.

Agency theory underlies earnings management derived from the agency relationship, namely the relationship between the principal and the agent based on a written agreement. In such a relationship, agents act on behalf and for the principals' interest. However, the segregation of the ownership and control of a company's property typically causes issues. Jensen & Meckling (1976)

declared that agency issues might occur, as management, acting as the agent, holds the authority in decision making. It then tends to work for its interest, regardless of the possibility of harming the principals' wealth. One example is earnings management.

Whether family firms and institutional ownership influence earnings management has been an intense discussion and a spotlight of the many previous studies. Examining the association between founding family ownership and earnings quality using the data from the Standard & Poor's 500, Wang (2006) found that family ownership would possibly result in the provision of earnings quality through either the entrenchment effect or the alignment effect. The proponent of entrenchment theory believes that concentrated family ownership ends up with the expropriation of business wealth by family members at the cost of minority shareholders (Wang, 2006). It is possible since the family members hold managerial functions, both directly and indirectly, within the scope of family firms (Yang, 2010). Nonetheless, the financial statement users might demand superb earnings quality for shielding their assets and interests if they believe that the firm is low in corporate governance.

Recently, despite the reality that some studies have argued that family ownership is strongly related to higher earnings quality (Hashmi, Brahmana & Lau, 2018); and overall company performance (Zraiq & Fadzil, 2018; Anderson & Reeb, 2003; Wang, 2006), earnings management has become an essential hassle for family-controlled companies. Family firms have much less severe company problems because of their reduced separation of ownership and control. Through the alignment motive, earnings management can be reduced utilizing concentrated family ownership (Setiawan, Taib, Phua & Chee, 2020); thus, the family reputation and overall performance of the firm, in the long run, are protected (Cascino, Pugliese, Mussolino & Sansone, 2010; Jiraporn & DaDalt, 2009; Wang, 2006). Therefore, family firms are motivated to provide more presentable earnings to guard the familys' recognition

and improve the firms' overall performance over a more extended period. It represents the stewardship theory where the managers and owners from the family members are influenced to act in the companys' best interests. (Davis, Schoorman & Donaldson, 1997).

Families typically have managed the holding company and feature shareholdings in many different businesses. Regarding managerial discretion, the monitoring and control are mightily affected by the ownership structure, which dominates the family in Indonesia. There may be insufficient protection of minority rights in Indonesia due to the lack of knowledge of a manner to put into effect enterprise governance through a method of approach of the overall public listed corporations to the opportunistic behavior of public listed corporations the usage of loopholes with inside the regulations and weaknesses withinside the enforcement of capital markets law (Sya'bani, 2014).

Like in remarkably Asian countries, corporate ownership is highly concentrated in Indonesia. In most countries with a high concentration of ownership, there is a tendency for weak protection of minority shareholders so that controlling shareholders can manipulate information to maintain control over the company (Al-Jaifi, 2017). Asian Development Bank (2000) proved that the five largest shareholders of Indonesian public companies retain an average of 68% of shareholding (Zhuang, Edwards & Capulong, 2001). Furthermore, family groups dominate the corporate ownership of companies in Indonesia (Carney & Gedajlovic, 2002). Claessens, Djankov & Lang (2000) found that in 72% of public listed firms in Indonesia, the control is assumed by families with their proxies on the board of directors. Related to ownership structure, in the top 100 listed companies, the majority of the shares are held by institutional investors (62.39% on average) (Wulandari & Rahman, 2004).

There are opposing views, namely managerial myopia (Bushee, 1998) and active monitoring (Shleifer & Vishny, 1986), concerning the way wherein institutional investors might also additionally impact

the earnings management activities of companies (Potharla, Bhattacharjee & Iyer, 2021). The second view contends that institutional investors tend to be short-term period oriented, myopic, or temporary, with immoderate attention on current instead of long-term earnings to figure out stock prices (Koh, 2003). Guthrie & Sokolowsky (2010) suggest that, in general, firms have a propensity to control their earnings around seasoned equity offerings with the substantial ownership of outboard block holdings. Overall, the preceding arguments propose that institutional investors, centered on attaining short-term earnings goals at the cost of long-term value maximization, might also strain managers to interact in earnings management activities (Porter, 1992).

This study aims to present insight into these conflicting perspectives by examining the relationship between family firms, institutional ownership, and earnings management. Furthermore, this study proposes leverage to moderate the effect of family firms and institutional ownership on earnings management. Exploring this problem withinside the Indonesian context, together with inspecting institutional ownership and the moderating role of leverage, offers an exciting institutional setting to conduct empirical analysis for the following reasons.

Foremost, Indonesia is an emerging market. However, the problem of earnings management is not always advanced and investigated well in emerging countries, with diverse motives for this (Durana, Valaskova, Chlebikova, Krastev & Atanasova, 2020). Furthermore, even as highly studies associated with earnings management had been centered on advanced countries, this examination appears at Indonesia as an emerging country. For example, Masulis, Pham & Zein (2011) discover that Indonesian family business corporations own about 53% of overall stocks in the Indonesian market. Moreover, with concentrated ownership, Indonesian companies lack protection from investors (Utama, Utama & Amarullah, 2017). Those traits, therefore, might also create a typical market reaction (earnings quality in this mat-

ter) compared to the ones in advanced countries.

Second, Indonesian companies are closely managed through family firms, as we referred to before. As Claessens *et al.* (2000) mention, over two-thirds of listed companies in Indonesia are worked through the family, which hold the most effective 60%. Fan & Wong (2002) also discovered that Indonesia is an East Asia country with the most significant percentage of family ownership in the companies listed. Further, these controlling families usually hold extra management through pyramidal possession systems or cross-holdings (Claessens, Djankov, Fan & Lang, 2002). That place provides additional opportunity and capability for minority shareholders to expropriate and conduct opportunistic earnings management.

Compared to previous research, e.g., Asim & Ismail (2019); Alhebri & Al-Duais (2020); Shahzad, Rauf, Saeed & Al Barghouthi (2017); Chi, Hung, Cheng & Lieu (2015); Potharla *et al.* (2021); Alzoubi (2016); Hunjra, Perveen, Li, Chani & Mehmood (2020), this study differs in two respects. First, it examines whether there is an impact of leverage on the relationship between family firms and earnings management. Second, it examines whether leverage influences the relationship between institutional ownership and earnings management.

This study has three specific contributions to the extant body of knowledge. First, it expands the current literature on institutional ownership, family firms, leverage, and earnings management in the Indonesian context. Second, the findings signify that family firms ownership tends to cause an alignment effect. Third, leverage is found to increase earnings management in the family firm.

The rest of this paper is outlined as follows. Section 2 comprises the literature review and discussion about the expectation on the relationship between institutional ownership, family firms, leverage, and earnings management. Section 3 elaborates the research methodology, including the data, measurement of variables, and model specifications. Section 4 includes the

empirical findings and discussions. Lastly, Section 5 contains the conclusion.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### Family Ownership and Earnings Management

Fan & Wong (2002) found that families dominate East-Asian-based companies' control. Despite being rare in Western countries, family businesses are prevalent in Asia (Goel, Mazzola, Phan, Pieper & Zachary, 2012; La Porta, Lopez-de-silanes & Shleifer, 1999). In the vast majority of Asian emerging markets, they have a high occurrence of pyramidal firms, a flawed legal system, and high reliance of the enterprises on bank lending (Chandera, Utama, Husodo & Setia-Atmaja, 2018). Most Asian companies, big or small, are family businesses with a family-led structure. Family firms exhibit quite apparent differences compared to non-family firms. Therefore, the company actively participates in this business (Paiva et al., 2016). With the increase in ownership concentration, when family owners gain control of the company, the agency conflict changes from the conflict between managers and shareholders (type 1) to the conflict between controlling and minority shareholders (type 2) (Shleifer & Vishny, 1997). A high level of ownership concentration leads to the establishment of agency problem type II in emerging economies (Hunjra et al., 2020). Previous research based on listed USA and listed Italian companies proposes that less serious Type I agency problems result in better financial reporting practices, including lower earnings management in family firms (Wang, 2006; Cascino et al., 2010; Jiraporn & DaDalt, 2009; Prencipe & Bar-Yosef, 2011).

Using the Standard and Poor 500's companies, Wang (2006) examines the correlation between founding family and earnings quality. The result suggests that family ownership may influence the earnings quality report through either the entrenchment effect or the alignment effect. The former predicts that founding family ownership is associated with lower earnings quality. Furthermore, there is evidence that

supports the entrenchment hypothesis that family firms have poor earnings quality because of earnings manipulation; thus, there is a positive correlation between family firms and earnings management (Chi et al., 2015; Alhebri & Al-Duais, 2020; Kumala & Siregar, 2020; Tahir, Akram, Perveen, Ahmad & Ullah, 2020). However, to protect their assets and interests, users of financial statements can demand a higher quality of earnings if they distrust due to the chance of entrenchment effect posed by the family ownership, which encourages these firms to convey a high earnings quality. However, to protect their assets and interests, users of financial statements can demand a higher earnings rate if they distrust the potential entrenchment effect of family ownership, which encourages these firms to convey a higher earnings quality.

On the other hand, the alignment effect implies that the majority owners' interests are brought into line with the other shareholders' interests since the founding families hold a significant portion of the shares and have been present in the company for a long time from various shareholders through the families who own massive stakes in the claims and an extensive presence in the company. Accordingly, founding families are motivated to provide higher earnings quality to shield the families' recognition and enhance the long-time period achievement of the corporation. As such, family groups controlled via the first generation keep away from earnings control to preserve family control. In contrast, the succeeding generations follow earnings management to safeguard the companies' business (Suprianto, Rahmawati, Setiawan & Aryani, 2019). Furthermore, families are more likely to forgo the short-time period advantages from earnings management due to the incentive to hand down their own business to their subsequent family members folk and shield the popularity in their family name. Therefore, family ownership is much less prone to appoint their strength in opportunistic conduct in earnings (Borralho, Vázquez & Hernández-Linares, 2020). It could presumably damage the popularity in their family, wealth, and long-time period overall performance of

the corporation (De Massis, Kotlar, Campopiano & Cassia, 2015). So, the higher the family ownership, the lower the opportunity to do earnings management practices (Chen, Chen, Cheng & Shevlin, 2010; Setiawan *et al.*, 2020). Therefore, the following hypothesis is proposed:

H1: Family ownership is associated with positive earnings management

### **Institutional Ownership and Earnings Management**

Agency theory suggests that institutional investor monitoring may be an essential governance mechanism (Efficient Monitoring Hypothesis). Institutional ownership plays an influential role in monitoring management discretion and enhances information competition in capital markets as institutional ownership is sophisticated. Some studies suggest that the part of the institutional investor in firms can be estimated based on the level of ownership. For example, institutional ownership can act as a governance mechanism influencing earnings management based on the level of ownership (Hadani, Goranova & Khan, 2011; Siregar & Utama, 2008; Alzoubi, 2016). Lemma, Negash, Mlilo & Lulseged (2018) found strong evidence (no evidence) that the management of accrual (real) earnings increases (associated) with the percentage of institutional ownership.

The extant accounting literature gives contrasting perspectives concerning the affiliation between institutional ownership and earnings management. On a side, some of the articles about empirical studies and the literature of the study propose that institutional investors constrain managers to gain short-term earnings with the exchange of long-term value (e.g., Coffee Jr, 1991), leading to more outstanding earnings management companies with higher institutional ownership.

Moreover, it is common for institutional investors to be regarded as more educated than individual investors. As a result, they will look on the far side of current earnings, creating less motivation for companies to manage earnings. In addition, because of their special access to databases and analytical appliances, firms would

spend less to conduct an exhaustive firm analysis (Hope, 2013). Furthermore, institutional investors seem to watch managers with significant shares in the firm. Bricker & Markarian (2015) show that institutional investors restrict the profit from trading.

On the other hand, Chung, Liu, Wang & Zykaj (2015) argue that long and enormous ownership of institutions increases a firms' financial capacity, whereas short ownership otherwise decreases it. The monitoring role competed by institutional investors is proven to result in higher earnings quality (Zhong, Chourou & Ni, 2017). The more considerable involvement by institutional investors is indicated to positively influence company behaviour because the managers would feel discouraged to interact in earnings management attributable due to pressure from the investor ownership to consider the long term, that planned a negative correlation between institutional ownership and earnings management (Lazzem & Jilani, 2018). Kałdoński, Jewartowski & Mizerka (2020) figure out that institutional investors with steady equity take a chance to take a significant monitoring role in minimizing real earnings management by managers strained by capital market constraints to "meet or beat" earnings targets.

Institutional investors are responsible for decision-making at the managerial level. Therefore, they become more concerned about the company following institutional ownership (Jiang & Anandarajan, 2009). These types of investors offer more thought to firm performance to extend the value for the stockholder. In addition, agency theory declares that fraud conducted by managers is often hindered by effective monitoring implementation, similar to enhancing institutional ownership (Jensen & Meckling, 1976). Cornet, Marcus, Saunders & Tehranian (2007) argue that management by institutional investors could encourage the managers to emphasize their interest in corporations' performance further and cut back their opportunist action.

Institutional investors strongly negatively impact earnings management, endorsing the active monitoring hypothesis (Potharla *et al.*, 2021; Alzoubi (2016). Simi-

larly, other studies have shown that Institutional ownership negatively impacts earnings management for more prominent and matured firms (Ajay & Madhumathi, 2015); for more noticeable and riskier banks (Elyasiani, Wen & Zhang, 2017). Accordingly, institutional investors are expected to have a more reasonable force to monitor upstairs managers. Moreover, institutional and managerial ownership is supposed to enhance earnings quality because institutional investors must enforce their monitoring action effectively. Thus the following hypothesis is formulated as follows:

H2: Institutional ownership has a negative impact on positive earnings management

### The Role of Leverage to the Relationship of Family Firms and Institutional Ownership to Earnings Management

Prior research spotlight that leverage affects earning management activities. Most researchers have argued that leverage will increase the capacity for earnings management, which is a response to keeping away from debt covenant violations (Dichev & Skinner, 2002; Moghaddam & Abbaspour, 2017; Asim & Ismail, 2019); bargaining at some point of debt negotiation (Iatridis & Kadorinis, 2009; Chamberlain, Butt & Sarkar, 2014; Obeidat, 2016; Tonye & Sokiri, 2020); lower detection risk of real earnings management (Shahzad *et al.*, 2017).

While the initial research has supplied references to the positive correlation between earnings management and leverage, empirical results on the opposing view are also present. For example, prior research (Jelinek, 2007; Wasimullah & Abbas, 2010) proposes that leverage limits earnings management. In addition, Afza & Rashid (2014) suggest that managers in leveraged corporations might also face manipulation from lenders, causing it tough for them to be involved in earnings management.

This study suggests leverage to examine the impact of family firms and institutional ownership on earnings management. On the whole, the evidence of preceding studies concerning the issue reviewed continues to be inconsistent. After

this, even as extensively studies associated with earnings management were centered on developed countries, this research appears on Indonesia as a developing country.

H3: There is an impact of leverage on the relationship between family firms and positive earnings management

H4: There is an impact of leverage on the relationship between institutional ownership and positive earnings management

## RESEARCH METHODS

### Earnings Management

Earnings management is measured by considering the magnitude value of discretionary accruals adjusted with performance. For their estimation, a cross-sectional Jones model was employed, with Kothari, Leone, & Wasley (2005) modification.

$$\text{Accruals}_t = a + b (1/\text{Assets}_{t-1}) + c \Delta\text{Sales}_t + d \text{PPE}_t + e \text{ROA}_t + \mu_t$$

In regression (1), the total assets at the beginning of the year (Assets) deflate the total accruals (Accruals); change in sales ( $\Delta\text{Sales}$ ); gross property, plant, and equipment (PPE). Return on assets (ROA) is added as a control variable since the Jones model is unspecified for well-performing or poor-performing companies (Kothari *et al.*, 2005). ACCR is the total accruals of the company *i* in year *t* determined as the operating cash flows subtracting the earnings excluding extraordinary items.  $\text{TAit-1}$  is the total assets of the company *i* in year *t-1* of the observation. An estimate of total accruals is obtained by applying the parameter estimates to the actual values for each firm-year yield. The difference between actual and estimated total accruals generates the proxy for the discretionary accruals, which reflects its extent.

Following the definition of Villalonga & Amit (2006), a family firm is recognized as a firm whose founder or a member of the family by either blood or marriage is an officer, a director, or the owner of at least 5% of the firms' equity, individually or as a group (Villalonga & Amit, 2006) where all the proprietor, excluding public companies, state-owned corporations, and financial

enterprise (Arifin, 2003). With the assumption that the controlling family will have control over management, family ownership is measured as a percentage of family-owned shares. Regarding Kim et al. (2016) and Potharla *et al.* (2021), institutional ownership was calculated as the percentage of institutional investors' shareholdings to the company's total shareholdings.

Two statistical tests were carried out to identify the most suitable empirical methodology—pooling, random effect, or fixed effect regression. The first is the Lagrangian Multiplier (LM) test (Breusch & Pagan, 1980) of the random-effect model. Second, we conduct the Hausman specification test (Hausman, 1978) to compare the fixed-effect and the random-effect models.

### Hypothesis Test

Panel-regression model was employed to identify the impact of family firms and institutional ownership on the earnings management. Different from previous studies, leverage is included to analyze the relationship between family firms and institutional investors with earnings management as follows:

$$AEM_{it} = a_0 + a_1 FF_{it} + a_2 IO_{it} + a_3 LEV_{it} + a_4 LEV_{it} \times FF_{it} + a_4 LEV_{it} \times IO_{it} + FA_{it} + \varepsilon_{it}$$

Where: AEM : earnings management firm *i* during year *t*, that is measured from discretionary accruals; FF : family firms. that is estimated from shares proportions owned by family firms of total shares; IO : Institutional ownership firm *i* for year *t* that is measured from shares proportions owned by the institutional investor of total shares; LEV : Leverage firm *i* for year *t* that is measured from the debt to equity ratio;  $\varepsilon_{it}$  : other value-relevant information of firm *i* for year *t*

From hypothesis 1,  $a_1$  is expected to be not zero, indicating an impact of family firms on positive earnings management. From hypothesis 2,  $a_2$  is expected to be not zero, meaning there is an impact of institutional ownership on positive earnings management. Furthermore, from hypothesis 3 and 4,  $a_3$ ,  $a_4$ ,  $a_5$ , are expected to be not zero respectively, indicating there are the impact of leverage to positive earnings management, the impact leverage to

the relationship between family firms to positive earnings management and the impact leverage to the relationship between institutional ownership to positive earnings management.

### Leverage

Leverage was measured by the proportion of long-term debt to the total book value of equity. This measure was once used by Jelinek (2007), Wasimullah & Abbas (2010), Lazzem & Jilani (2018). The book value of debt can better clarify the indebtedness of the firms as market value of debt may be soared because of the stock (Lazzem & Jilani, 2018).

### Institutional Ownership

We define institutional ownership, as we have in previous studies, as the percentage of a company's shares held by institutional investors. Despite the free-rider problem, institutional investors have a considerably stronger motivation to monitor the firms they own than individual investors due to their larger shares in those companies, especially if an exit is costly (i.e., huge trading costs) (Chung *et al.*, 2015).

### Control Variable

In the research model, a control variable was incorporated. Firms need fixed assets as collateral to secure external finance sources, according to the trade-off theory (debts). According to Panda & Nanda (2020), enterprises with high fixed asset levels find it easier to produce more debts. Firms are also more likely to use debt when their fixed assets are higher. It was predicted that fixed assets would be negatively correlated with earnings management. On the basis that managers of high debt are less involved in earning manipulation because managers may encounter control from creditors. As a result, they will be hindered from employing in earnings management.

### ANALYSIS AND DISCUSSION

The samples utilized were manufacturing firms registered on the Indonesia Stock Exchange throughout 2017-2020. This type of company industry was selected because it

tends to have significant assets, often the object of earnings management. The total observations are 44 firm years. The number of samples conforms with the general terms established by statisticians, i.e. that for most population distributions, with a sample size of at least 30, the sampling distribution of the mean will be approximately normal (Berenson, Levine & Watson, 2012).

Table 1 outlines the descriptive statistics for the research. Family firms of the research samples have the ownership of 56.8% until 94.3% of total shares. At the same time, institutional ownership research samples have 40.2% until 50% of total shares. The proxy for earnings management is the value of performance-accruals earnings management (AEM). Based on table 1, the mean of AEM is 0.006. In other words, the samples on average employ earnings management for about 0.6% of their assets. The positive sign of AEM implies that firms engage in earnings management via income increasing. On average, manufacturing companies have fixed assets of IDR 564.936.975. This figure represents that the sample consists of typically large companies. According to the average

leverage (LEV) of 38.4%, the companies depend heavily on equity as a funding source.

There is a correlation between independent variables when the coefficient of the independent variables is above 0.90 (Gujarati & Porter, 2009; Midi et al., 2010; Pallant, 2011). As outlined in Table 2, the result clarifies that there is no evidence of multicollinearity between the independent variables. In other words, the independent variables are valid to include in the study model.

Table 3 delivers the regression results for H1, H2, H3, and H4 with the chosen common effects, concluding that family firms have a significant negative coefficient. Thus, H1 is accepted. It indicates there is an alignment effect in family firms in Indonesia. It is following the agency theory that portends that family ownership attention might cause advanced financial reporting quality. It is also consistent with the research of Cascino *et al.* (2010), Jiraporn & DaDalt (2009), Wang (2006), and Prencipe & Bar-Yosef (2011). As the family fellow controls family firms, their interest translates to their interests. Thus, it rejects the family management from manipulating earnings numbers since the family reputation and the firm's overall performance would be at stake in the long run.

Shleifer & Vishny (1986) claim that owing to their majority shareholdings, institutional investors are better informed compared to individual investors. They are also provided with high incentives to observe corporate performance since they potentially reap the most from this monitoring capability and hold greater voting power that enables corrective action. Insti-

**Tabel 1.**  
Descriptive Statistics

Research Variable	Mean	Minimum	Maximum	Std Deviation
AEM	0.006	-0.088	0.130	0.052
FF	0.568	0.102	0.943	0.243
IO	0.402	0.333	0.500	0.078
LEV	0.384	0.141	0.634	0.172
FA	8.752	7.903	9.720	0.606

**Tabel 2.**  
Correlation Matrix of the Independent Variables

	FF	IO	LEV	LEV X FF	LEV X IO	FA
FF	1.000	0.045	0.113	0.632	0.0689	-0.838
IO	0.045	1.000	-0.112	-0.140	0.307	0.101
LEV	0.113	-0.112	1.000	-0.781	0.8941	-0.076
LEV X FF	0.632	-0.140	0.781	1.000	0.658	-0.536
LEV X IO	0.069	0.307	0.894	0.658	1.000	0.071
FA	-0.838	0.102	-0.0767	-0.536	0.071	1.000



tutional investors can be categorized about their horizons of investment (Bushee, 2001), i.e., as either transient or long-term investors, to assess the correlation between institutional investor type and firms' accruals management. Long-term institutions restrict aggressive accruals management among firms with the incentives and the capacity in earnings management to satisfy/surpass earnings benchmarks. Conversely, transient institution-related aggressive accruals management only appears when managers conduct earnings management upward to meet/exceed earnings benchmarks. Compared to short-term-oriented transient investors, long-term stable institutional investors are far more concerned with long-term value creation. On the other hand, with highly diverse portfolios, transient investors frequently trade with a short-term focus in hand, often based on companies' current earnings (Kałdoński *et al.*, 2020).

Furthermore, the hypothesis that institutional ownership has a negative effect on positive earnings management has not been proven. Instead, it indicates the dominance of transient institutional ownership who do not have incentives and the capacity to manage earnings to meet/beat earnings benchmarks in the Indonesian capital market. It corresponds with (Koh, 2007), who implies that, in addition to not being systematically connected with aggressive earnings management, transient institu-

tional ownership is evident only among firms carrying out earnings management to satisfy/surpass their earnings benchmarks.

Agency theory views leverage as an instrument that disciplines the management and therefore restricts the opportunistic behavior of the management, which sometimes takes the forms of enjoying extravagant benefits, building an empire, and aiding their relatives by placing them in a significant position (Jensen, 1986). This mechanism puts a boundary on opportunistic behavior; thus, management is not required to manage earnings to hide or manipulate their actions. For example, Jelinek (2007) proves that increased leverage holds back opportunistic behavior, resulting in far fewer earnings management. Lee, Peng & Barney (2007) present that a firm with creditor-controlled leverage leaves little opportunity to engage in earning management.

The results show that leverage negatively impacts positive earnings management. It is consistent with Jelinek (2007), Wasimullah & Abbas (2010), Zamri, Rahman & Isa (2013), Lazzem & Jilani (2018), Afza & Rashid (2014), but contrary to Iatridis & Kadorinis (2009) and Chamberlain *et al.* (2014). As the possible cause, management tends to use an accounting policy representing the actual situation of the company's future to bring down the cost of funding (Ghosh & Moon, 2010). Qamar, Shahzad & Masood (2015) also state that

**Tabel 3.**  
Hypothesis Results

Research Variable	Predict Sign	Coefficient	T Statistic	Prob	Conclusion
C		0.679	2.056	0.047	
FF	-	-0.319	-4.298	0.000	accepted
IO	-	-0.068	-0.243	0.809	refused
LEV	-	-0.505	-1.885	0.067	accepted
LEV X FF	-/+	0.617	0.617	0.002	accepted
LEV X IO	-/+	0.430	0.620	0.539	refused
FA	-/+	-0.054	-1.993	0.054	accepted
Adj R <sup>2</sup>			0.366		
F- statistic			3.552		
Prob			0.007		

creditors hold the motive to observe the managements' course of activity. Hence, companies maintain to present quality information to reduce funding costs.

In addition to the available incentives to manage earnings through accruals, family firms pose additional potential features that may motivate their earnings management decisions. Further, According to Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes (2007), family businesses do not prefer to dilute their ownership. Obtaining more equity funding may reduce ownership and loosen family control; the family control shareholders closely guard the firm's capital structure. As a result, family-controlled businesses rely on debt funding more than non-family-controlled businesses. Likewise, Anderson & Reeb (2003) found that Family firms strongly rely on debt to finance their activities and build a long-term relationship with their creditors.

Family firms have greater leverage ratios than non-family firms. However, the differences are only statistically and economically significant for medium-large companies. Furthermore, having a family member in active management leads to much higher levels of leverage since the family endowment in the firm is higher in terms of family identity, influence, and personal investment (Gottardo & Moisello, 2014). As a result, they may enhance their earnings to avoid breaching debt covenants, especially if they are severely indebted (Ferramosca & Ghio, 2018). Therefore family firms exhibit higher accrual-based earnings management when highly leveraged (Kvaal, Langli & Abdolmohammadi, 2012).

Furthermore, we find a positive effect of leverage on the relationship between family firms and positive earnings management. It means the leverage increases the correlation between family firms and positive earnings management. It serves as a new finding that previous studies are unable to expose. This result shows that leverage has a positive correlation with positive earnings management in family firms, possibly due to the need of the family firms to lessen the possibility of vio-

lation against debt covenants and, at the same time, increase the firm's negotiation power during negotiation of debt.

Jalil & Rahman (2010) classify institutional ownership into insensitive and sensitive investors. The former is negatively associated with leverage, thus suggesting that the latter is more likely to invest in firms with less leverage. Additionally, sensitive institutional investors are not strongly related to discretionary accruals. Brickley, Lease & Smith (1988) defined sensitive institutional investors as institutional investors with an actual or potential business relationship with investee enterprises. On the other hand, insensitive institutional investors have a lower natural potential to engage in business ties with investee companies.

This study concludes that leverage does not influence the correlation between institutional investors and positive earnings management. As a possible reason, institutional investors involved in this research are investors with an actual or potential business relationship with an investee firm.

This study uses fix assets as a control variable. Fix asset has a negative impact on positive earnings management; as predicted earlier, it may be due to control from creditors, making managers less engaged in positive earnings management. Fixed assets as a control variable proved to have a negative effect on positive earnings management as predicted; this shows that managers of high debt are less involved in positive earning manipulation because firms managers may deal with control from lenders, hindering them from engaging in positive earnings management.

## CONCLUSION

This study aims to record the empirical finding on the impact of family firms and institutional ownership on positive earnings management. It also investigates whether leverage influences the correlation between family firms and institutional ownership to positive earnings management. The results indicate that family firms have a negative effect on positive earnings management. It proposes that family firms

ownership commonly found in Indonesia leans to generate an alignment effect while controlling stockholders do not expropriate non-controlling stockholders. Furthermore, the results show that institutional ownership has no impact on positive earnings management. There is also another finding that leverage has a negative effect on positive earnings management, but it positively impacts the relationship between family firms with positive earnings management; however, it does not affect the relationship between institutional ownership with positive earnings management. Finally, it indicates that family firms with high levels of leverage want to lessen the possibility of violation against debt covenants and, at the same time, increase the firm's negotiation power during the negotiation of debt.

#### LIMITATIONS AND SUGGESTIONS

This study bears some limitations, e.g., using only IDX-listed manufacturing companies from 2017 to 2020 as a sample. Thus, it is essential to care if the conclusions are generalized to other industries. Hence, it is suggested that future research extend the sample to the different industry types to generalize the study results. Lastly, this study did not detail institutional ownership types, e.g., commercial banks, pension funds, etc. Subsequent research may observe this theme to obtain the characteristics of each institutional ownership and the basis for the investment to recognize the kind of institutional investor that has a propensity to invest.

The results have several theoretical and practical implications. First, the rationale for family ownership and earnings management is based on agency theory. The results validate the lower Type 1 agency problems between shareholders and managers in family ownership. This finding also delivers valuable data for capital-market regulators seeking to lessen earnings management behavior in IDX-listed companies by focusing on the effect of leverage on earnings management, specifically concerning family-owned firms. The results are also beneficial for other financial statement users. Such users may need to be warier when investigating firms with both

family ownership and institutional ownership.

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