CHAPTER I
INTRODUCTION

1.1 Background

Large number of populations provides opportunities to make business in Indonesia, hence it makes Indonesia a good market for industry activities. Several industries are growing rapidly, one of which is the banking sector. The banking sector has been used to indicate the ongoing progress of the country's economy. The banking industry has grown due to the increasing population as well as a change in the mindset of the community to become more modern, like depositing money in the bank.

However, for the past few years, there was a huge pandemic well known as COVID-19 which affected all industrial activities in Indonesia. To deal with that, the government turned down most industry activities and minimized the cycle of work which impacted economic growth in society, especially in Indonesia, which made the growth much weaker. Therefore, there must be possible differences regarding the level of assets owned by banks before and during the pandemic. Banking sectors are used in this research because previous studies have already analyzed the other sectors, such as manufacturing companies, mining companies, consumer goods industry companies, and others.

In Indonesia, most banks have registered their companies on the Indonesia Stock Exchange (IDX). It is known that in 2022, there are 47 banks registered on IDX. These include BBCA, BBRI, BRIS, BBTN, and many more. Banking is claimed to work well and excels from others when its financial performance improves and persists consistently to maintain its existence in society. One way to prove that is the party can pay debts including short-term debts. The financial statements of a bank are considered good if they can generate profits and the party is also able to meet short and long-term needs.

The measurement of banking performance is carried out using the method of observing the results achieved by companies with standards that have been determined by Bank Indonesia or the results of their average calculations.

The final result of the financial performance of a bank can be measured by a financial benchmark called a financial ratio.

Earning quality often use to measure the financial performance of banks by using financial ratios. According to Jaya & Wirama (2017), Nainggolan & Abdullah (2019), and Khatarina et al. (2021) measure the earning quality of banks by using capital structure, liquidity, profitability, profit growth, company size, leverage, earnings response coefficient, investment opportunity set, and profitability with the proxy of current ratio, return on asset, total asset growth, Lg. total asset and so on. Therefore, many factors can affect earning quality in the banking industry, including company size, liquidity, and leverage. These three ratios will then be attributed to the earning quality of each company.

Earning quality is one of the important things for the parties involved in utilizing accounting information from the bank as a basis for making decisions. The profit generated by the company is one of the measures of company performance that is often used as the basis for company decision-making (Nugroho & Radyasa, 2019). According to Salma & Riska (2019), earning quality is the information that is used to measure how earning influences decision-making. The earning quality is used to indicate the accuracy of the banking profit and can help to predict the profit in the next period of the year. Earning quality is one of the factors that investors consider to determine whether the investor will invest in the company concerned or not (Nugroho & Radyasa, 2019). The low earning quality can result in its users taking the wrong decision. The profit that does not show the accuracy of management performance information will have an impact on not maximizing the goals achieved by its users (Wati & Putra, 2017). According to Sutopo (2009) in Wati & Putra (2017) , earnings can be claimed to be of high quality if the reported profit can be used by users to make the best decisions, namely, the profit that has the characteristics of relevance, reliability, and comparability or consistency. In addition, earning quality is also a profit that can reflect the continuation of profit (sustainable earnings) in the future, which is determined by the accrual and cash components and can reflect the company's true financial performance (Djamaluddin, 2008 in Marsela & Maryono, 2017).

The measurement of company size can be classified in various ways including by size of income, total assets, and total equity (Brigham & J. Houston, 2001). The size of the company can be used to represent the financial characteristics of the company. It classifies commercial banks based on Core Capital and stipulates permitted activities for each classification or “BUKU” (Bank Umum berdasarkan Kegiatan Usaha — Commercial Bank Based on Business Activities). Here are the classifications:

1. BUKU 1: Core Capital less than Rp 1 Trillion
2. BUKU 2: Core Capital of Rp 1 – 5 Trillion
3. BUKU 3: Core Capital Rp 5 – 30 Trillion
4. BUKU 4: Core Capital at least Rp30 Trillion

Large companies that are well established find it easier to obtain capital in the capital market than small companies because the ease of access means that large companies have greater flexibility. The relatively good performance of the company will be seen by the public so the company will be more careful to report its financial condition. Company size can determine whether the performance of the company is good. Investors usually have more trust in large companies because large companies are considered capable of improving their performance by improving the quality of profits (Helina & Permanasari, 2017). According to Dira and Astika (2014) in Helina & Permanasari (2017), the size of the company is related to the earning quality because the larger the size of a company, the higher the company's business continuity will be in improving financial performance so that the company does not need to practice profit manipulation. Profits generated from assets owned by a banking company will usually be reused for investment diversification and lending. Banks with relatively large capital will use most of their assets to channel credit to productive business businesses as much as 70% of the total credit. The ratio used to measure the company size ratio is the natural logarithm (Ln) of the total assets of the company. The use of total assets is based on the consideration that total assets reflect the size of the company and the larger the size of the company, the more it will be known to the public, which means the easier it is to get information that can improve the company’s earning quality.

3

Liquidity is a company’s ability to pay off debts that are maturing within a year (Brigham & J. Houston, 2020:107). It is also known as a company measuring tool for paying off short-term debt on time. A company can be said to have good liquidity if the company can repay its short-term debt. However, when the company has short-term debt piling up, it can be a threat to the company's operations. Companies with high liquidity will have relatively little risk so creditors feel confident in providing loans to companies (Ardianti, 2018). A high level of liquidity attracts investors to investments decision. The less likely it is for a company to carry out profit manipulation practices if the liquidity of the company is greater. Because they can pay their short-term debt off, and also to increase the quality of the company’s profit, the liquidity must be high. The ratio used to measure the liquidity ratio is the current ratio (CR). The current ratio is one of the financial ratios that measure the size of a company's ability to meet short-term obligations with current assets owned by the company. It can be said that the higher the current ratio (CR) is, the greater the company's ability to meet its short-term obligations. However, it will be inversely proportional if the current ratio (CR) value is low. The lower of current ratio in the company, the smaller the company's ability to pay its short-term debt will be.

According to Brigham & J. Houston (2010), financial leverage is a measurement that shows how far debt is used in a company’s capital structure. It is also known as the amount of debt used to fund or buy a company’s assets that will be used to maximize the profits of a company. A company is considered unable to maintain a financial balance in managing funds if most of the company’s assets are funded by debt compared to its capital. Leverage itself is considered to influence the earning quality. According to Wati & Putra (2017), a high leverage ratio level means that the company uses high debt as well and this means that the company's profitability will increase, but on the other hand, high debt will increase the risk of bankruptcy. Meanwhile, shareholders expect a large level of leverage with the aim that profits will be increased. A company will carry out large profit management if the level of leverage is high, so that the earning quality generated becomes low. The ratio used in measuring the leverage of a company is the Debt-to-Equity Ratio (DER). Debt to

Equity Ratio can be interpreted as a financial ratio that compares the amount of debt a company owes to the equity holders and also serves to show the extent to which a company is financed by debt. Using this ratio can describe the company's ability to manage its assets and how much of those assets are financed by debt.

Previous researches have shown many different results regarding what factors can affect this level of earning quality. For company size, the research result is different, where Jaya & Wirama (2017) stated that company size has a positive effect on earning quality and Wati & Putra (2017) stated that company size has a negative effect on earning quality. For liquidity, Khatarina et al. (2021) stated that liquidity has no effect on earning quality and Yusra (2016) stated that liquidity has a positive effect on earning quality. For leverage, Wati & Putra (2017) stated that leverage has a positive effect on earning quality and Murniati et al. (2018) stated that leverage has no effect on earning quality. What makes this research different is that the researcher will analyze the effect of company size, liquidity, and leverage on the banking sector industry on the Indonesia Stock Exchange (IDX) for the 2018 - 2021 period.

1.2 Research Problem

Based on the background of the research, the problem on which this research is based is how company size, liquidity, and leverage affect earnings quality in the banking sector industry listed on the Indonesia Stock Exchange IDX in the 2018 – 2021 period of time. Therefore, here are the research questions:

1. Does company size affect the earning quality of the banking sector industry listed on the IDX in 2018 - 2021?
2. Does liquidity affect the earning quality of the banking sector industry listed on the IDX in 2018 - 2021?
3. Does leverage affect the earning quality of the banking sector industry listed on the IDX in 2018 - 2021?

1.3 Research Objective

Based on the research questions that have been stated, here are the objectives of this research:

1. To analyze the effect of company size on earnings quality in the banking sector industry listed on the IDX in 2018 - 2021
2. To analyze the effect of liquidity on earning quality in the banking sector industry listed on the IDX in 2018 – 2021
3. To analyze the effect of leverage on earnings quality in the banking sector industry listed on the IDX in 2018 – 2021

1.4 Research Contribution

By conducting this research, it is expected to give benefits and contributions both theoretically and practically, such as:

1.4.1 Theoretical Contribution

1. The result of this research is expected to enhance insight into the factors that can affect earning quality at each bank.
2. It is expected to add to the literature review for further researchers and become a reference in further research conducted by other academics

1.4.2 Practical Contribution

1.4.2.1 Researcher

This research expected the researcher will be able to determine what factors could significantly affect banks' earning quality. This research is also expected to help and provide information for corporation banking with other alternatives if a factor is believed not to significantly affect a bank’s earning quality.

1.4.2.2 For Company Managers

This research is expected to enhance the information about how the factors can affect earning quality. Therefore, the company will be able to make decisions based on the research resul