Chapter 12

Opportunistic Behavior and Financial Distress: The Case of Earnings Management

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Abstract

This study investigates the role of opportunistic behavior in earnings management. Using listed firms in the Indonesia Stock Exchange as the object of study, our examination shows that profitability's opportunistic behavior affects earnings management significantly. The higher the profitability, the higher the earnings management will be. Financial distress also affects the tendency of earnings management. The more severe financial distress, the higher the earnings management is. Another important finding is that bigger firms tend to perform more earnings management activities. This study contributes to earnings management and agency problems research in the context of go public firms in emerging markets since opportunistic earnings management will prevent investments, which will hamper the country's economic growth. This study also contributes to entrepreneurial studies. The manager is considered an entrepreneur CEO, so all the management strategies affect company value, including how the manager communicates the earnings information to accounting information users.

Keywords: Earnings management; economic growth; entrepreneur; financial distress; monitoring mechanism; opportunistic behavior

JEL Classification: L21; L26; M40; O16

1. Introduction

Earnings management is a fascinating study in terms of motivation, behavior and techniques to implement it. The high level of competition creates an impetus or pressure on companies to compete to show good quality and performance. The

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study by Leuz, Nanda, and Wysocki (2003) shows evidence that the practice of earnings management in countries with weak (strong) investor protection tends to be more (less) intensive. Indonesia is one of the emerging countries whose investors' protection is considered weaker than in developed countries. In the study, Indonesian firms report higher earnings management levels compared to other countries.

The phenomenon of earnings management is critical to be investigated. Earnings are a significant representation of accounting information, as many companies contract based on variables in the financial statement, particularly earnings. Therefore, we use earnings management to represent financial information quality (Li, Abeysekera, & Ma, 2011; McNichols, 2002; Schipper & Vincent, 2003). If investors consider the average quality of financial reports on a capital market relatively poor, this condition will prevent investors from investing in a capital market. Consequently, trading on the capital market becomes thin, and the capital market will lose its ability as financial intermediaries. This condition will affect economic growth in the country. Various studies have shown that opportunistic earnings management behavior will harm a country's economy. Filip and Raffournier (2014) find a direct connection between the magnitude of earnings management and the country's economic growth rate.

Earnings management is often associated with the opportunistic behavior of managers in a company. One of the factors that trigger opportunistic behavior is free cash flow; higher free cash flow stimulates agency problems because managers and shareholders have different interests. High free cash flow can lead to managers' tendency to focus on projects and investments that generate high returns in the short term rather than maximize shareholder welfare by investing in profitable projects for the long term. By investing in short-term projects, the manager will immediately receive compensation or bonuses on the profits of those projects.

Chung, Firth, and Kim (2005) investigate how FCF creates agency problems that trigger earnings management. They find that earnings management is more (less) pronounced in firms with higher (lower) free cash flow and lower (higher) growth opportunities. On the contrary, White, Sondhi, and Fried (2002) argue that more free cash flow means more cash available to pay dividends, debt, and growth opportunities. That is why investors tend to focus on company-free cash flow information. Consequently, it is more difficult for firms to manage earnings.

The opportunistic behavior of management is also proxied by profitability. The company's profitability can also trigger earnings management because investors tend to fixate on earnings to assess its performance. Profitability encourages management to practice earnings management because management wants to show good performance to investors. High profitability will trigger managers to behave opportunistically to exploit the company's resources and get maximum bonuses or compensation. However, if the profitability is low, managers tend not to behave opportunistically because the manager's ability to exploit the company's wealth becomes less flexible.

Hamza and Lakhal (2010) found a positive effect of profitability on earnings management. Performance appraisal based on profits will encourage management to exhibit good performance to owners and the public, hoping that the manager will get personal benefits in the form of more significant compensation and bonuses or even a promotion. However, Tahir, Sabir, and Shah (2011) show that the better firms' performance, the lower the earnings management action. In this case, a manager has no more reason to perform earnings management since its performance has met or even exceeded expectations.

Earnings management practices are also related to monitoring mechanisms. The right level of monitoring will prevent managers from reporting excessive earnings. External monitoring (such as monitoring by creditors) can detect managers' earnings management practices. The research by Rodríguez-Pérez and Van Hemmen (2010) shows that leverage can decrease earnings management practices. Rodríguez-Pérez and Van Hemmen (2010) state that the higher the debt leads to higher external monitoring by creditors. Creditors who have lent their funds to the company will supervise the use of these funds. Tight supervision within the company can reduce the opportunities for management to perform earnings management. However, this study contradicts Klein's (2002) findings, stating that leverage positively affects earnings management. If the company has a high debt ratio, the manager will manage earnings to attract investors or creditors to provide more funds or contract extensions.

Earnings management practices also occur in companies experiencing financial distress. In financial trouble, managers will experience bonus cuts, possible rotation, and layoffs. Therefore, managers will take the opportunity to hide poor company's performance by choosing an accounting method that increases income and hides losses (Habib, Bhuiyan, & Islam, 2013). Jaggi and Sun's research (2006) finds that management is more motivated to boost their profit in financial distress. However, Demirkan and Platt (2009) find the contrary that financial distress negatively affects earnings management. According to Demirkan and Platt (2009), these distressed companies have run out of ways to manipulate earnings and perhaps they do not see the benefits of such manipulation.

Earnings are crucial accounting information. Even though there is competing information, earnings are still highly anticipated information by the market. This study takes the object of go public companies on the Indonesia Stock Exchange. The choice of this object has contextual reasons, in which Indonesia is one of the emerging stock markets, so that this study will compare the results with previous studies on more developed stock markets. Research on the importance of earnings information in Indonesia is conducted by Sulistiawan (2015), who found that the market reacts to earnings information.

The second reason is that investor protection in Indonesia is relatively weak, making Indonesia report higher earnings management (Leuz et al., 2003). With these characteristics, understanding Indonesia's earnings management patterns will greatly benefit investors and potential investors. We believe that this study can contribute to empirical research on earnings management.

Research on earnings management has attracted various parties, be it investors and potential investors, regulators, other users of financial statements, and entrepreneurs. Top managers or CEO is, no doubt, an entrepreneur. CEO or top management sets the company's strategy, including how to present the information to the outsiders; in this case, the information is earnings figure. In determining the earnings figure, managers have the personal motivation that can be in line with or against the company's goals. The manager's motivation can trigger him/her to act opportunistically in determining the number of earnings, because the manager's bonus and compensation are determined by the number of earnings generated by the company. As an entrepreneur who runs a company, the manager will also decide on the company's funding strategy. As an entrepreneur, the manager is also obliged to take the steps necessary to take the company out of a financial distress.

This chapter is organized as follows. In the first part, we present the introduction of the study. Section 2 builds hypothesis. Section 3 presents data and methodology. Section 4 provides the findings. In the final part, we conclude.

2. Literature Review and Hypothesis Development

Managers tend to act opportunistically in managing financial reports by disguising negative business entity performance. In this study, managers' opportunistic behavior is discussed regarding free cash flow and company profitability. According to Ross, Westerfield, and Jordan (2019), cash flow that is available to be distributed to creditors and shareholders refers to free cash flow. This cash flow is "free" since the company has enough cash for working capital and investment. According to Ross et al. (2019), cash usually creates a conflict of interest between managers and shareholders. Managers prefer that these funds be reinvested in profitable projects because this alternative will increase their incentives. Investments chose by managers also tend to be short-term investments so that managers can immediately enjoy the incentives from these investments. On the other hand, shareholders expect the remaining funds to be distributed to increase their welfare. Indeed, the funds are invested, shareholders want long-term investments because it will increase the value of their shares (Chung et al., 2005).

In reality, shareholders do not fully access the company's internal operations (Chung et al., 2005). This condition makes it easier for managers to carry out earnings management. Even though the available free cash flow is not maximally invested, the company's profits still look good because investors find it difficult to access information about prospects and the profit or loss of the manager's projects. In their study, Chung et al. (2005) present evidence that higher free cash flow and lower growth opportunities firms are more likely to carry out earnings management that increases earnings compared to other companies.

The management's opportunistic behavior is also proxied by profitability. A company's profitability can also trigger earnings management because investors tend to fixate on earnings (profit) information to assess the company's performance (Sloan, 1996). Profitability encourages management to conduct earnings

management because many management incentives are associated with this profitability (Kothari, Leone, & Wasley, 2005). With high profitability, managers expect to get personal benefits by being awarded more compensation, bonuses, or promotions. Conversely, if the profitability level is low, the manager's opportunistic behavior will be more limited because he cannot get maximum wealth by whatever means the manager takes.

H1: Opportunistic behavior affects earnings management.

Earnings management is also related to the monitoring mechanism. The monitoring mechanism is proxied by the level of leverage of a business entity. Besides financing the business operation, debt or leverage can serve as an external monitoring mechanism. Creditors will ensure that management uses the loan properly. For creditors, leverage can serve as an efficient monitoring mechanism to prevent excessive earnings management that will eventually harm the company. Firth and Smith (1992) explain that the greater the company's debt, the tighter the supervision is carried out by creditors, so that management flexibility to perform earnings management decreases. This condition indicates that leverage is negatively correlated with earnings management.

Nevertheless, the use of debt as leverage for business is not without any cost. Higher leverage also means higher financial risks, including financial difficulties, inability to pay off debt and bankruptcy risk (Ghosh, Cai, & Li, 2000). Without careful supervision, higher leverage will lead to opportunistic action, such as inappropriate earnings management behavior. Klein (2002) states that leverage has a positive effect on earnings management. When a company has a high leverage ratio, it tends to carry out earnings management to avoid debt violations. Because previous studies still provide different results, we leave the hypothesis regarding this monitoring mechanism in an open direction.

H2: Monitoring mechanism affects earnings management.

Platt and Platt (2002) define financial distress as a condition in which the company's finances are in a crisis. Platt and Platt (2002) describe financial distress as the stage of deteriorating financial conditions before bankruptcy or liquidation. Business entities experiencing financial distress generally take immediate actions to respond to these conditions by implementing earnings management.

Chen, Wang, and Zhao (2009) state that companies experiencing financial distress have a greater incentive to perform earnings management. Their results are consistent with Jaggi and Sun (2006) research, which states that when financial distress hits the company, it will further motivate managers to manipulate their earnings to provide positive signals to external parties. We propose the third hypothesis:

H3: Financial distress has a significant effect on earnings management.

3. Research Methodology

The object of this study is publicly traded business entities listed on the Indonesia Stock Exchange (IDX) for three consecutive years from 2012 to 2014. We use this period as the three first-year since Indonesia fully adopted IFRS in the financial

reporting standard. We think that the early years of this standard transition were crucial for financial reporting. Many items will be affected. Besides, there is a concern that managers will recognize all bad news into earnings and will be excused because of adjustments to the new standard.

We use the regression in Eq. (1) to test our hypothesis:

$$\mathrm{DACC}_{i,t} = \beta_0 + \beta_1 \mathrm{FCF}_{i,t} + \beta_2 \mathrm{PROFIT}_{i,t} + \beta_3 \mathrm{LEV}_{i,t} + \beta_4 \mathrm{FDISTRESS}_{i,t} + \beta_5 \mathrm{SIZE}_{i,t} + \varepsilon_{i,t} \quad (1)$$

where:

$\mathrm{DACC}_{i,t}$ = discretionary accruals
$\mathrm{FCF}_{i,t}$ = free cash flow
$\mathrm{PROFIT}_{i,t}$ = profitability
$\mathrm{LEV}_{i,t}$ = leverage
$\mathrm{FIN\_DISTRESS}_{i,t}$ = financial distress
$\mathrm{SIZE}_{i,t}$ = size
i = firm i
t = period t

Measurement of earnings management is carried out using the discretionary accruals (DACC) by Kothari et al. (2005). First, we calculate total accruals (TACC) as follows:

$$\mathrm{TACC}_{i,t} = \mathrm{NI}_{i,t} - \mathrm{CFO}_{i,t} \quad (2)$$

TACC = total accrual, NI = net income, CFO = cash flow from operation.

Next, we perform cross-section regression to obtain parameter estimates with the following regression equation:

$$\frac{\mathrm{TACC}_{i,t}}{\mathrm{TA}_{i,t-1}} = \delta_0 + \delta_1 \left(\frac{1}{\mathrm{TA}_{i,t-1}}\right) + \delta_2 \left(\frac{\Delta \mathrm{REV}_{i,t}}{\mathrm{TA}_{i,t-1}}\right) + \delta_3 \left(\frac{\mathrm{PPE}_{i,t}}{\mathrm{TA}_{i,t-1}}\right) + \delta_4 \left(\frac{\mathrm{NI}_{i,t}}{\mathrm{TA}_{i,t-1}}\right) + \varepsilon_{i,t} \quad (3)$$

where ΔREV denotes a change in revenue and PPE represents gross plant property and equipment. All variables in the equation are divided by total asset at the beginning of the period.

By using the regression coefficient derived from Eq. (3), the value of non-discretionary accruals (NDAC) can be calculated with the formula:

$$\frac{\mathrm{NDACC}_{i,t}}{\mathrm{TA}_{i,t-1}} = \delta_0 + \delta_1 \left(\frac{1}{\mathrm{TA}_{i,t-1}}\right) + \delta_2 \left(\frac{\Delta \mathrm{REV}_{i,t} - \Delta \mathrm{REC}_{i,t}}{\mathrm{TA}_{i,t-1}}\right) + \delta_3 \left(\frac{\mathrm{PPE}_{i,t}}{\mathrm{TA}_{i,t-1}}\right) + \delta_4 \left(\frac{\mathrm{NI}_{i,t}}{\mathrm{TA}_{i,t-1}}\right) + \varepsilon_{i,t} \quad (4)$$

In this equation, ΔREC is the change of receivable in period t.

Finally, *discretionary accruals* (DACC) can be calculated by:

$$\mathrm{DACC}_{i,t} = \mathrm{TACC}_{i,t} - \mathrm{NDAC}_{i,t} \quad (5)$$

DACC denotes discretionary accruals as a measure of earnings management.

Opportunistic behavior is proxied by free cash flow and profitability. Free cash flow (FCF) is calculated following Chung et al. (2005):

$$\mathrm{FCF}_{i,t} = \left(\mathrm{OI}_{i,t} - \mathrm{TAX}_{i,t} - \mathrm{INTEREST}_{i,t} - \mathrm{DIV}_{i,t}\right)/\mathrm{TA}_{i,t-1} \tag{6}$$

FCF is free cash flow, OI is an operating income before depreciation expenses, TAX represents tax expense, INTEREST represents interest expense, DIV is Dividend and TA is total assets, while i and t represent firm i and period t, respectively.

Profitability is calculated using return on assets (ROA). ROA shows the company's ability to generate profits from the assets used. ROA is calculated as earnings before interest and taxes (EBIT) in period t divided by total asset in period t.

$$\mathrm{ROA} = \frac{\mathrm{EBIT}_{i,t}}{\mathrm{Total\ Asset}_{i,t}} \tag{7}$$

Monitoring Mechanism is represented by leverage (LEV). In this study, LEV is calculated as the proportion of debt to total assets.

$$\mathrm{LEV} = \frac{\mathrm{Total\ Debt}_{i,t}}{\mathrm{Total\ Asset}_{i,t}} \tag{8}$$

Financial Distress (FDISTRESS) is calculated based on Altman Z-Score (Altman, 1968):

$$Z = 1.2\,\mathrm{WC} + 1.4\,\mathrm{RE} + 3.3\,\mathrm{EBIT} + 0.6\,\mathrm{MVE} + 0.999\,\mathrm{SALES} \tag{9}$$

All variables are divided by total assets, except for MVE. WC denotes working capital, RE refers to retained earnings, and MVE is the proportion of market value of equity to total book value of debt. Z is the overall index that indicates:

- $Z > 2.99$ = nonfinancial distress area
- $1.81 < Z \leq 2.99$ = gray area
- $Z \leq 1.81$ = financial distress area

We use natural logarithm of total asset that represents size of the firm as a control variable in this research.

4. Discussion and Analysis

Table 1 exhibits the sample selection used in this study. The total sample that fits the criteria in this study is 919 firm-year, but some data outliers are eliminated so that the data used in the study are normally distributed.

Table 2 exhibits the descriptive statistics of variables used in this study.

The DACC standard deviation represents a wide distribution of values. A negative DACC indicates a company experiencing income decreasing earnings

Table 1. Sample Selection.

Descriptions	**2012**	**2013**	**2014**	**Total**
Firms listed on the IDX (other than the financial sector)	374	409	425	1,208
Firms whose accounting period do not end on December 31	(1)	0	(2)	(3)
Firms that do not use Rupiah as reporting currency	(39)	(80)	(84)	(203)
Firms with incomplete data	(40)	(24)	(19)	(83)
Total observations during the three years	294	305	320	919
Outliers				(89)
Total observation used				**830**

Source: Processed by authors.

Table 2. Descriptive Statistics.

	N	**Minimum**	**Maximum**	**Mean**	**Std. Deviation**
DACC	830	−0.860	0.326	0.007	0.125
FCF	830	−11.218	23.029	0.085	0.894
PROFIT	830	−1.136	1.569	0.023	1.856
LEV	830	0.003	11.844	0.534	0.680
FDISTRESS	830	−74.757	134.117	3.647	21.143
SIZE	830	20.659	33.095	28.101	1.751

Source: Processed by authors.

management and vice versa if a positive DACC indicates the company is taking income increasing earnings management. The FCF has an extremely high spread between its minimum and maximum values. The profitability based on ROA shows that the research object consists of companies that can manage their assets productively to companies that cannot manage assets effectively (ROA is negative). FDISTRSS shows that research objects are scattered from companies that are very far from financial difficulties to companies experiencing financial difficulties.

Table 3 shows the Pearson correlation between variables. Profit is positively related to DACC. FDISTRESS and SIZE are negatively related to DACC. FCF is positively correlated with PROFIT and FDISTRESS. This condition indicates that companies that do not have high free cash flow also have high profits and are far from financial distress. We can see in Table 3 that size has a significant correlation with other variables.

Table 3. Correlation Matrix.

	DACC	FCF	PROFIT	LEV	FDISTRESS	SIZE
DACC	1.000	0.054	0.0870*	0.016	−0.221**	−0.081*
		0.122	0.012	0.646	0.000	0.020
FCF	0.054	1.000	0.503**	−0.018	0.081*	−0.176**
	0.122		0.000	0.610	0.020	0.000
PROFIT	0.087*	0.503**	1.000	0.115**	0.110**	−0.193**
	0.012	0.000		0.001	0.001	0.000
LEV	0.016	−0.018	0.115**	1.000	0.000	−0.176**
	0.646	0.610	0.001		0.997	0.000
FDISTRESS	−0.221**	0.081*	0.110**	0.000	1.000	−0.009
	0.000	0.020	0.001	0.997		0.792
SIZE	−0.081*	−0.176**	−0.193**	−0.176**	−0.009	1.000
	0.020	0.000	0.000	0.000	0.792	

Note: Two tailed test. *, ** Correlation is significant at α = 10% and 5% respectively.
Source: Processed by authors.

Table 4 shows the results of regression testing to answer the hypothesis. To deepen the analysis, we also investigate the effect by breaking down the sample based on the company's size. The small size means that the company's size is below the average, while the large size indicates a group of companies with the same size or above average.

Table 4 shows that free cash flow has an insignificant effect on earnings management. Thus, opportunistic behavior, which is proxied by the amount of free cash flow, cannot explain the company's earnings management behavior. The results of this study support Kangarluei, Motavassel, and Abdollahi (2011), which states that free cash flow does not affect earnings management. These results are consistent across the sample: full sample, large and small sizes sample.

Furthermore, based on hypothesis testing results, the profitability variable (PROFIT) has a significant positive effect on earnings management. These results indicate that profitability as a proxy for opportunistic behavior affects earnings management. High profitability will trigger managers to behave opportunistically. This result is in line with the rationality theory that individuals rationally always want to maximize their wealth so that with high profits, managers tend to behave opportunistically to rake in company wealth and get maximum bonuses or compensation. This study's results support Hamza and Lakhal (2010), who find a positive effect of profitability as proxied by ROA on earnings management. The finding shows that the higher the level of company profitability, the higher the chance the manager must take earnings management actions, especially those that benefit him/her.

Interesting findings can be seen when testing the regression based on the large size group. All attention will be focused on large companies; there are investors, potential investors, security analysts, government and regulators, and the media. Greater media attention will increase monitoring levels (Abdolmohammadi, DeSimone, Hsieh, & Wang, 2017). As a result, large companies have instead tried to avoid the media and other parties' attention. Therefore, large companies' earnings management patterns are different; they tend to take earnings management by preventing profits from being too high. Thus, the higher the profitability level in large-size companies, they will take income decreasing management strategies.

This study finds that leverage does not affect earnings management. Peasnell, Pope, and Young (2005) state that leverage does not affect earnings management because the company can still meet its needs by using its resources so that creditors also have no control over the entity. *H2* is not supported.

Different results are shown in the regression results for large firms. Based on Table 4, it can be seen that in large companies, the higher the debt, the higher the earnings management will be. This result follows the debt covenant hypothesis (Watts & Zimmerman, 1986), which states that if the company is getting closer to debt covenant violations, it is likely that company managers will choose accounting procedures to shift future earnings to the present. It is done because the reported increase in net income will reduce the possibility of failure to pay its debts in the future (Scott, 2015). Violation of covenants can incur costs. Therefore, the company has a motive to perform earnings management to avoid such

Table 4. Regression Result for the Main Hypothesis and Additional Analysis.

Variable	Full Sample (N = 830)	Large Size (N = 431)	Small Size (N = 399)
(Constant)	0.135	−0.012	0.025***
	(1.905)	(−0.93)	(3.651)
FCF	<0.001	−0.013	0.001
	(0.358)	(−1.260)	(−0.288)
PROFIT	0.002**	−0.156***	−<0.001
	(2.363)	(−3.156)	(−0.013)
LEV	−0.001	0.043**	−0.006
	(−0.165)	(2.111)	(−0.866)
FDISTRESS	−<0.001***	−<0.001***	<0.001
	(−6.869)	(−5.483)	(1.455)
SIZE	−0.005*		
	(−1.813)		
Adj.R^2	0.060	0.127	0.013
F-statistic	11.529***	16.573***	2.312*
	(0.000)	(0.000)	(0.057)

Note: Dependent variable: *discretionary accruals* (DACCs). Two-tailed test. *, **, *** Significant at α = 10%, 5% and 1% respectively.
Source: Processed by authors.

violations. This leverage shows how much of the assets are used to guarantee the debt. High leveraged companies are suspected of engaging in earnings management that increases revenues and earnings. Based on previous studies (Nanda, Schneeweis, & Eneroth, 1996), it is shown that company size is a major determinant of a company's reputation. Therefore, large-scale companies have a higher pressure to avoid debt covenant violations due to demands of reputation that must be maintained. In small companies, it is proven that the level of leverage does not significantly affect earnings management.

The results of the third hypothesis show that financial distress has a significant negative effect on earnings management. These results indicate that the more severe the company's financial distress (indicated by the lower the Z-Score), the higher the tendency to take earnings management actions. Thus, the hypothesis that financial distress significantly affects earnings management (*H3*) is accepted. This result supports Chen et al. (2009) and Jaggi and Sun (2006). Chen et al. (2009) provide evidence that companies experiencing financial distress have a greater incentive to carry out earnings management. Jaggi and Sun (2006) state that when financial distress hits the company, it will further

motivate managers to increase earnings management to reduce negative financial distress signals.

The same result can be seen in a sample of large companies. In large companies, low financial distress (high z-score) tends to perform smaller earnings management. Usually, along with the company's size, financial distress tends to be lower, so the need for earning management decreases.

In small companies, financial distress cannot explain earnings management behavior. The effectiveness of using company assets makes the small company have sufficient funds to run its business. So, for small companies, financial distress is not a factor that can trigger earnings management.

This research has implications for the quality of accounting information. Users of financial reports, especially investors, must be aware that earnings information contains management's judgment and discretion. Managerial judgment and discretion are strongly influenced by the motivation of the financial statements' preparer, which is the manager. Investors must be careful in capturing the information presented in financial statements to detect manipulative attempts to hide the actual financial condition.

At the individual firm level, management as the financial report's preparer must realize that opportunistic earnings management harms a company's survival. Opportunistic earnings management actions can reduce external parties' confidence in management performance, resulting in decreased investor interest to invest in companies.

At the country level, the government needs to make a regulation that can prevent opportunistic earnings management practices carried out by go public companies in Indonesia to create a transparent capital market accompanied by strong law enforcement. The government's role as regulator is urgently needed so that the role of the capital market as an institutional infrastructure works optimally, which will encourage economic growth.

This research also has implications for entrepreneurship studies. The findings indicate that opportunistic earnings management cannot be separated from managers' motivation to gain personal benefits. A manager is an entrepreneur CEO who runs the company. Top management determines the final decision of the company's strategy, which covers many things, from vision to winning the market competition. Even though the company has an advisory board, it is still the entrepreneur CEO who makes decisions about budgeting, builds cooperation, forms a team, and directs the company (Robbins, 2010). Therefore, there needs to be a supervisory mechanism for managers. Weak supervision is dangerous for the company's survival because it relies too much on the abilities and goodwill of the manager.

5. Conclusion

Based on the results and analysis, opportunistic behavior and financial distress significantly impact earnings management behavior. Profitability as a proxy of opportunistic behavior has a positive and significant effect on earnings

management behavior. The higher the profitability, the higher the earnings management. Financial distress significantly affects earnings management. The more severe the financial distress experienced by the company, the higher the earnings management.

Managers need to realize that all the decisions and strategies they make will attract various parties' attention as an entrepreneur CEO. Therefore, a monitoring mechanism is needed for entrepreneur CEOs to assist and direct managers so that their strategies and behavior align with the owner's interests and maximize company value.

Managers as top management in the company need to be aware that the actions and strategies they choose will affect company value, including their discretion in determining the amount of earnings information. Good earnings management can provide the right signal to the market regarding the company's condition and prospects; conversely, bad earnings management contains opportunistic motivation from the financial statements' preparer. As an entrepreneur, managers are expected to take appropriate strategic actions to maximize company value, including strategic decisions regarding funding and corporate financial management. Managers as entrepreneurs must be able to manage company resources properly and choose the right strategy to prevent the company from financial distress. Hiding the company's bad condition through earnings management is not a good strategic option.

The exciting findings in this study is a unique effect of profitability and monitoring mechanism in large companies. Profitability has a negative effect on earnings management for the full sample, whereas, in large-size companies, profitability positively affects the level of earnings management. The monitoring mechanism carried out by creditors has no effect on earnings management in the full sample; however, in large companies, earnings management increases as creditors' monitoring increases. Large companies have much pressure that causes them to behave differently from companies in general because of the political costs and the company's reputation. Earnings management in small firms is influenced by other variables outside the scope of this study. These findings suggest that company characteristics have different effects on earnings management behavior.

This study brings practical contributions to managers and investors. Managers need to determine company management's right strategy rather than just presenting good earnings through accrual discretionary earnings management. Earnings management by accrual will definitely face an accrual reverse, so bad news in this period must be disclosed in the future. This study also presents a practical contribution to investors as the primary users of financial reporting. Earnings are influenced by managerial discretion, which investors need to consider in making investment decisions.

This study has several limitations, which also serve as suggestions for further research. In responding to various challenges and changes related to regulatory changes, technological developments, and how they have implications for business and the structure of business competition, the company will surely respond with strategic steps in the form of mergers, acquisitions or even divestments

(Sergi, Owens, & Alexander, 2019). All of the corporation's strategic efforts will trigger earnings management to present the targeted earnings figure in response to this corporate action's existence. Further research needs to consider the pattern of earnings management related to the company's strategic action. The next study can add a free cash flow condition that can explain earnings management behavior, for example, free cash flow for companies in growth and stable conditions. It is also crucial that future research consider market aspects that can explain earnings management behavior.

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