






“Earnings management and initial public offerings among Indonesian manufacturing companies”

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EARNINGS MANAGEMENT AND INITIAL PUBLIC OFFERINGS AMONG INDONESIAN MANUFACTURING COMPANIES

Abstract

Earnings management (EM) refers to the common use of accounting techniques in various economic settings, such as Initial Public Offerings (IPOs), to produce financial statements. This study, therefore, analyzes the effect of firm size, operating cash flow, the used IPO proceeds, earnings changes, and leverage on EM of manufacturing companies on the Indonesia Stock Exchange from 1989 to 2013. This sector comprises the essential chemical industry, miscellaneous organizations, and consumer goods, with 63 firms being used to meet the selection criteria. The regression analysis showed that the intended use of funds and leverage had a negative and significant impact on EM. Furthermore, the process is measured using Friedlan's (1994) Discretionary Current Accruals model with similar results found in each industry group and their insignificant differences used to regulate the level of discretionary accruals between the three sectors. This study implies that the EM level is qualitatively similar among IPO companies in the three sub-sectors examined.

Keywords

discretionary accruals, firm size, operating cash flow, use of proceeds

JEL Classification

M13, M41, G32

INTRODUCTION

The activity of purposely influencing the financial reporting process for personal gain is called earnings management (EM). This practice is common in IPOs and several capital markets, like the US (Teoh et al., 1998; Ducharme et al., 2001), the Netherlands (Roosenboom et al., 2003), Malaysia (Ahmad-Zaluki et al., 2011), France (Cormier & Martinez, 2006), China (Huang & Xie, 2014), and Indonesia (Kusumawardhani & Siregar, 2010). Previous studies have also reported that it is rampant in countries that discharge earnings forecasts, including France (Cormier & Martinez, 2006), Taiwan (Jaggi et al. 2006), and Indonesian IPOs, which has a limited impact on the capital market (Hutagaol et al., 2012). Liu and Lyu (2016) carried out a case study in China and discovered that a firm was unable to enhance its performance after the use of IPOs. On the contrary, Sletten et al. (2019) stated that it was used to manage excessively generated funds. In Nigeria, EM affects stock prices, as well as the performance of accounting numbers, therefore, it is relevant for the success of an IPO firm (Ubesie et al., 2019).

This study focuses on the proposed utilization of the Indonesian proceeds or funds, which serves as a determinant of EM. Firms that decide to go public have to provide a disclosure on the proposed use of proceeds in a bid to reduce information asymmetry among issuers and potential investors (Leone et al., 2006; Balabat & Bertinshaw, 2008). Amor and Kooli (2017) stated that post-IPO performance is utilized by

managers when making financial decisions. Balatbat and Bertinshaw (2008) researched 174 Australian IPOs and discovered that it was extremely relevant when making investment decisions. Meidiaswati et al. (2019) reported that using proceeds related to the performance of IPOs in the Indonesian market is also utilized during decision-making concerning investment.

Leone et al. (2006) and Balatbat and Bertinshaw (2008) reported that the use of funds caused a decline in information asymmetry among issuers (managers) and third parties such as investors and other fund providers. These firms are strongly encouraged to sell new shares for prospective purposes, including EM's execution to show that they possess strong financial performance. According to Healy and Wahlen (1999), IPO setting provides firmly motivated EM, irrespective of the fact that the proposed use of proceeds affects the IPO issuance. Badru (2021) asserts that use of proceeds is used as signal in selling the stock of IPOs in Malaysia.

Some studies on EM of Indonesian IPOs have been conducted. Yet, they failed to examine EM among IPOs in specific industries or specific sectors (Warganegara & Indriastari, 2009; Kusumawardhani & Siregar 2010; Hutagaol-Martowidjojo & Widyanto, 2018). Examining the determinants and the level of EM in specific industries helps to simplify one's understanding and encourages issuers. Besides, this study adds value and tends to ascertain sectors associated with EM and those classified in a relatively similar industry.

Further examination is needed to determine specific factors due to the wide variety of EM among IPOs. This is affected by both fundamental and non-fundamental factors of a company. A potential factor associated with EM among IPOs is the proposed utilization of proceeds. Therefore, this study was carried out to strengthen the contention that the proposed utilization of proceeds is related to an IPO's success (Wyatt, 2014). Andriansyah and Messinis (2016) state that the performance of post-IPO is linked to the proposed utilization of proceeds. Apparently, Amor and Kooli (2017) state that the proceeds primarily play a significant role in a company's timing to realize an IPO. McGuinness (2019) reports that an IPO's success is related to the proceeds on investment (debt repayment) purposes. Ahmad-Zaluki and Badru (2020) further state that the proposed proceeds are related to initial returns.

This study analyzes the factors that influence the EM level in numerous IPO companies. The data were obtained from 63 companies in the manufacturing sector, namely, miscellaneous, basic, and chemical, including consumer goods subsectors, from 1989 to 2013. It was reported that out of five independent variables, the utilization of funds from IPOs and leverage negatively and significantly affect the level of EM. Furthermore, operational activities' cash flows, earnings changes, and company size have an insignificant impact on discretionary accruals in the miscellaneous sector.

1. LITERATURE REVIEW

The information about the use of funds generated from IPOs is relevant as they are generally used for acquisitions, expansions, debt payments, and strengthening working capital. Investors are expected to use this information for strategic purposes to ensure that the consequences reflect the risks encountered by the management. Leone et al. (2007) state that information on the clarity of fund usage is a factor that suppresses uncertainties.

However, analyzing the use of funds is a relevant tool for financial managers and investors. This

also monitors the utilization of IPO funds and motivates investors to make better financial decisions. They also need to have an insight into the firm's future performances, namely the willingness to handle risky projects. Previous studies by Beatty and Ritter (1986), Amor and Kooli (2016), Ljungqvist and Wilhelm (2003), Wyatt (2014), and Hanley and Hoberg (2012) stated that financial managers also play a relevant role in evaluating this information.

Furthermore, potential investors also oversee and regulate the use of assets, which are described as potential resources that offer economic benefits

for future purposes. Kim et al. (1993) were the first to carry out the study investigating the proposed use of funds as a relevant factor that influences investors' perceptions. Previous studies reported that it limits information asymmetry among both issuers and investors (Leone et al., 2006; Balatbat & Bertinshaw, 2008).

Previous studies have stated that IPO setting provides an opportunity to manage accounting numbers. However, companies need to ascertain that their financial reports are attractive to maximize the acquisition of funds (Healy & Wahlen, 1999; Scott, 2014). In these companies, the accounting number's performance is a significant source of assessment due to the lack of crucial information, which aids in determining the selling price of the primary market. Buck (1990) stated that the relevant sources of information used in assessing companies that decide to go public with their financial statements are reported in the prospectus. According to Chen et al. (2005), Friedlan (1994), Wongsunwai (2012), Hutagaol et al. (2012), Miloud (2013), Alhadab (2018), Sletten et al. (2018), and Kalgo et al. (2019), there are many factors related to the degree of EM, nevertheless, these are contradictory due to dissimilarities in the characteristics and regulations of these firms.

Consequently, other variables were detected to affect these factors. According to Ball and Shivakumar (2008), EM is negatively affected by cash flow from operational activities, while Alzoubi (2016) reported that leverage and level of profitability have a positive effect on companies. In addition, Aharony et al. (1993) reported that it is inversely related to the size of a company.

Based on empirical studies, EM in Indonesian corporations was reported in various settings. Setiawan et al. (2019) stated its existence in the banking sector, while Kumala and Siregar (2020) reported the occurrence of this practice in the Indonesia Stock Exchange listed mining companies. Savitri et al. (2020) stated the existence of EM in the financial services of sharia banking. According to Mahrani and Soewarno (2018), several industries are involved in EM. On the contrary, Warganegara and Indriastari (2009) stated that Indonesia's IPO firms tend to inflate their earnings report before it is published. It is, there-

fore, evident that these are common practices in Indonesian companies.

This study accumulates the research conducted by Wyatt (2014) that reported that utilization of proceeds and the firm's value are significantly related after the development of the Australian IPOs. Moreover, three proxies, namely growth (research, development, and exploration), investment (acquisitions and capital expenditures), and financing transactions (working capital, cash outs, repay debt, and purchase of securities) carried out in dollars, were utilized. The 'use of proceeds' for exploration, acquisitions, and capital expenditures are inversely related to equity, as stated in the early listing period.

According to Myers (1977), companies involved in developmental activities usually experience enormous significant uncertainties regarding the expected cash flows from their investments. This means that it encounters greater risks, so a firm intention is needed to show that its financial performance is attractive and achieved through EM.

The proposed use of IPO funds is among the variables used to determine EM because the company's desire to obtain positive values from the market serves as an incentive for managers to organize attractive prospectuses and financial reports. Unfortunately, a decline was detected in EM practice, especially when the funds were used for investment-related purposes. Cheng (1995) reported that issuers that usually invest do not underperform. Hertz and Li (2007) and Autore et al. (2009) reported that investment purposes of these proceeds are considered profitable and do not underperform in the long term. On the contrary, Jeanneret (2005) carried out a study on French SEOs and subsequently stated that companies' quoting investment needs were indicated to be underperforming in the long term. Interestingly, Ljungqvist and Wilhelm (2003) reported that firms proposing to use their proceeds for investment were less liable to risks. The utilization of IPO funds for investment purposes is also an ideal indicator. Investors with clear investment goals perceive the company's future development, compared to the issuer that utilizes the proceeds to pay debts (Kim et al., 1993). In addition, companies that use part of their proceeds in investment

are considered to be of good quality, thereby increasing their values and reducing the risks encountered. The use of proceeds also serves to limit asymmetric information between an IPO firm and external investors (Leone et al., 2006; Balatbat & Bertinshaw, 2008). Therefore, the use of IPO funds for investment purposes tends to attract investors as it yields greater returns in the future.

Previous studies stated that proceeds from issues determine the success and future performance of IPOs. According to Andriansyah and Messinis (2016), these proceeds influence the IPOs' future performance, the issue timing (Amor & Kooli, 2017), subscription level (McGuinness, 2019), and initial returns (Ahmad-Zaluki & Badru, 2020). Leone et al. (2006) and Balatbat and Bertinshaw (2008) stated that companies desiring to go public need to reveal the proposed use of proceeds to prohibit information asymmetry. Therefore, this needs to be considered by issuers for it to be successful.

Consequently, a manager makes a relevant contribution to the usefulness of financial information because the possibility of gaining management practices is not prohibited. In general, investors are attracted to companies that utilize IPO funds for investment purposes (Cheng, 1995; Autore et al., 2009). It was further concluded that its use negatively impacts the EM level. Accordingly, it is hypothesized that the intended use of funds from the offering is negatively related to the level of EM.

Besides the use of proceeds, this study elaborated on four other variables, namely cash flows, leverage ratio, company size, and change in profit levels. Cash flows result from revenue-producing exercises of the operational activities. The amount obtained determines the ability of the company's operational activities yield cash flows amount sufficient to pay off loans, dividends, and maintenance of the firm's operational capability, including new investments, without the need for external funding. Alzoubi (2016) stated that cash flow obtained from operational activities is positively related to the EM of firms listed on the Amman Stock Exchange.

Cash flows also reflect on acceptable financial conditions that are difficult to be fixed by applying an

accounting approach. Chen et al. (2005), Dechow et al. (1995), and Aussenegg et al. (2009) stated that it indicates the occurrence of EM. A study by Chen et al. (2013) in China reported that IPO also negatively impacts the level of EM. Aussenegg et al. (2009) carried out a study, using 4,745 data obtained from various companies in Europe from 1995 to 2005, and discovered its ability to limit EM. Ball and Shivakumar (2008) stated that cash flows generated from operational activities negatively impact the accruals EM of IPOs in England. Mashayekhi et al. (2005) reported that a decline in cash flows causes an increase in public firms' discretionary accruals in Iran. Mashayekhi and Safari (2006) stated that companies adopt strategies to trigger profits through accruals EM whenever cash flows from operations are weak. Hutagaol-Martowidjojo and Widyanto (2018) reported that cash flow level, one year before the firm decides to go public, has a positive relationship with the accruals' quality of Indonesian IPOs. An increase in cash flow causes a decline in EM because the company can generate sufficient funds to enhance its performance. Therefore, it is predicted that operating cash flows negatively affect the EM level in the IPOs.

Leverage refers to the proportion of debt allocated to finance a firm's investment, thereby leading to a higher demand for profit. The degree of leverage discerns the extent to which external parties finance companies, thereby causing them to perform exceptionally to attract potential investors. This agrees with the debt covenant hypothesis, which proves that managers are encouraged to engage in EM to avoid violating the debt agreement. DeFond and Jimbalvo (1994), Jiang et al. (2010), and Ye (2014) reported that companies with high leverage usually engage in EM. Beatty et al. (2008) stated that companies with higher leverage engage in EM to avert the violation of debt covenants. Conversely, Gu et al. (2005) indicated a positive relationship with accruals' variability. Alzoubi (2016) stated the existence of a positive relationship between EM and leverage in public firms in Jordan.

Interestingly, studies based on IPO settings reported that these findings are dissimilar. Kalgo et al. (2019) stated that there is a positive relationship between leverage and EM in Malaysian IPOs.

Wang et al. (2018) carried out a study in China and reported similar evidence. However, Gosh and Mood (2010) reported that EM is negatively related to the firms' debt financing. Alhadab (2018) applied the Ball and Brown Model and revealed that leverage and EM are negatively related in Jordanian IPOs. Miloud (2014) stated that in France, a negative and insignificant relationship exists. Conversely, Gumanti et al. (2015) reported a similar finding in Indonesia. Generally, companies with high debt burdens are motivated to show that they possess good financial performance. However, an increase in the leverage level results in a rise in the possibility of engaging in EM. Therefore, it is hypothesized that leverage positively affects the EM level in the IPOs.

According to Stice et al. (2009), the ideal indicator of performance is profit, therefore, an understanding of its components is essential in interpreting the company's financial statement. Burgtähler and Dichev (1997) carried out research on companies in the United States and discovered that managers engage in EM to prevent losses, as well as a decrease in profits. These companies are further encouraged to engage in EM due to resource decline.

Interestingly, Ball and Shivakumar (2008) reported that in England, IPO companies usually avoid inflating their reported earnings, and the net income is not restated. However, Alhadab (2018) adopted Ball and Shivakumar's model to indicate that the accrual management level is positively related in Jordan. This simply means that companies experiencing loss engage in EM to hide their poor performance prior to taking their firm public. Sletten et al. (2018) reported that return on assets positively relates to abnormal accruals from 2,648 IPOs in the USA during the lockup expiration period. According to Alzoubi (2016), this issue positively affects EM of Jordanian firms. Also, changes in earnings affect its management and tend to be beneficial to the company.

Gumanti et al. (2015) stated that changes in earnings have a positive and insignificant effect on its management practices. Therefore, these changes are an indication of EM. However, based on these reviews, it is predicted that changes in earnings positively impact the EM level in IPOs.

According to the political cost hypothesis, a company's size is related to the incentive to manage accounting numbers. Moreover, small companies are interested in increasing reported earnings, while large ones target public scrutiny and also cause a decrease in discretionary accruals (Watts & Zimmerman, 1986). Wang (2000) reported that when their financial controls are under strict supervision, they tend to have a lesser incentive to manipulate their accounting policies. Additionally, company size is expressed in various ways, such as profit, total assets, stock market, and sales values.

Large companies attract prospective investors through securities sold in the capital market to realize the expected benefits. Aharony et al. (1994) reported that EM was readily discovered in small-scale companies in the US capital market. On the contrary, Llukani (2013) reported that a firm's size significantly and positively impacts the EM. Ye (2014) and Chen et al. (2013) assumed that EM and firm size are positively related in China. However, Jiang et al. (2010) reported that EM and the extent of discretionary accruals are negatively related. Miloud (2014) stated that firm size positively and insignificantly affects the level of EM. Wongsunwai (2012) carried out a research on 1,226 companies in the USA and reported that return significantly and positively impacts the abnormal accruals during the lockup period. Sletten et al. (2018) carried out a research on 2,648 US companies and discovered that larger firms are characterized by a lower level of abnormal accruals. Therefore, it is predicted that a company's size tends to negatively affect the EM level in the IPOs.

2. RESEARCH METHODS

2.1. Data and samples

This study's population involves all manufacturing companies, including miscellaneous consumer goods, basic and chemical industries that engaged in IPOs from 1989 to 2013. The year 2013 was set up as the last year for IPOs because the Indonesian government issued the Law number 21 of 2011 called the Financial Service Authority (FSA), which was in effect in 2012. The FSA replaced the previously existed governing body of the capital market, the Capital Market Supervisory

Agency. It should be noted that this replacement had affected many aspects of the capital market functioning, as well as the prospective IPO issuers' analysis concerning the new offering. Given that the process of IPO could take years, limiting to year 2013 would give better range for the analysis as this study needs a three-year financial reporting period available in the prospectuses.

The sample was determined using the purposive sampling method, based on three criteria. First, there is a need to possess a minimum financial report for at least three years, which is the required period for estimating total accruals. Secondly, a company needs to possess a positive equity value, which tends to affect leverage. Thirdly, a company did not experience persistent losses before going public, since it is regarded as an indication of poor management, which is less attractive to investors.

The manufacturing industry consists of three sub-sectors, namely basic and chemical, consumer goods, and miscellaneous firms. Besides, during the analysis phase, six out of 69 manufacturing firms used to produce IPOs, failed to meet the sampling criteria, thereby yielding a total of 63 usable data. The basic and chemical, consumer goods, and miscellaneous sub-sectors had 15, 33, and 15 firms, respectively.

2.2. Variable definitions and model specification

Friedlan (1994) utilized the Current Accrual Discretionary to measure the earning management as follows:

$$DAC_{pt} = \frac{TAC_{pt}}{SALE_{pt}} - \frac{TAC_{pd}}{SALE_{pd}}, \quad (1)$$

where DAC_{pt} is discretionary accruals within the test period, TAC_{pt} is total accruals within the test period, TAC_{pd} is total accruals in the base period, $SALE_{pt}$ and $SALE_{pd}$ are sales within the test and base periods, respectively.

Total accrual (TAC) represents the difference between cash flow from operation and net income. Moreover, net income is described as profit after tax. Operating cash flow is calculated as the cash flow ratio from operating activities to total assets.

The company size is the total asset natural logarithm with IPO funds used to calculate a dummy variable. The score of (1) is obtained assuming 50% of the funds are used for investment-related activities, and (0) when the reverse is the case.

Leverage represents the total debt ratio to previously recorded total assets in a company's financial statements before the completion of one-year IPO. Furthermore, changes in earnings are calculated using a dummy variable. The score of 1 is obtained assuming the profit realized in the research year is higher than the previous one, and 0 when the reverse is the case (Chen et al., 2005).

The multiple regression equation in this study is stated as follows:

$$DCA_{i,t} = \beta_0 + \beta_1 IUF_{i,t} + \beta_2 OCF_{i,t} + \beta_3 LEV_{i,t} + \beta_4 EC_{i,t} + \beta_5 CS_{i,t} + e, \quad (2)$$

where DCA is discretionary current accruals, IUF is the intended use of funds, OCF is operating cash flow, LEV is financial leverage, EC is earnings change, and CS is the company's size.

3. RESULTS AND DISCUSSION

3.1. Descriptive statistics of variables

Descriptive statistics for an average discretionary current accrual (DCA) value of 0.0127 are shown in Table 1. A positive DCA value implies that there is an increase in income. However, 27 out of the 63 companies studied had negative DCA values. On the contrary, 36 of them have a positive DCA value. In conclusion, more companies have a positive DCA value.

Table 1. Descriptive statistics of variables ($n = 63$)

Source: Authors' elaboration.

Description	DCA	OCF	LEV	CS
Mean	0.0127	0.0294	0.5299	25.7648
Median	0.0048	0.0488	0.5753	25.6061
Stand. Dev.	0.1977	0.1549	0.1913	1.3597
Minimum	-0.7316	-0.4191	0.1387	23.3485
Maximum	0.5435	0.3785	0.9143	30.3637

Note: DCA is discretionary current accruals, OCF is cash flows from operations, LEV is leverage, and CS is a firm's size.

The average ratio of the operating cash flow to total assets is 0.0294, therefore, 43 IPOs are positive. This means that most of the companies studied functioned effectively and were able to generate cash flows from productive operational activities. However, the existing data show a high variation in its size. This implies that the diversification is relatively high.

Subsequently, only 19 companies (30.16%) used approximately 50% of the IPO-generated funds for non-investment purposes. Therefore, the majority of the companies that went public used relatively 50% of the funds for investment or business development purposes, which implies that they are dedicated to productive activities.

On average, the total debt-to-total assets ratio is quite high, approximately 52.99%. Consequently, half of the assets are funded by debts. The value of the highest ratio obtained is 91.34%, while the least is 13.87%. This implies that the company's debt burden in the prior period was relatively high. In other words, the financial risk of companies engaged in IPOs during the analysis period is relatively high.

Conversely, 44 or 69.8% of the companies dedicated the IPO's gross proceeds to investment-related purposes. This indicates that about two-thirds of the companies utilized their funds productively. In addition, a total of 15 IPOs, or 23.81%, experienced persistent losses in the previous year before going public. Meanwhile, the remaining 48 companies, or 76.19%, experienced an increase in profits. This is an interesting condition that needs to be addressed, given the impression that companies experienced an increase in profits before the inception of IPO.

Table 2 shows the correlation matrix indicating the five independent variables. The intended use of funds and leverage negatively correlates with the discretionary current accrual. On the contrary, the other three variables insignificantly correlate with the Discretionary Current Accrual.

3.2. Findings and discussion

Table 3 shows multiple linear regressions. In Panel A, only one hypothesis is accepted, namely the intended use of funds negatively and significantly impacts EM. The basic industry and chemical sub-sector in Panel B and the consumer goods sector in Panel C showed a consistent outcome. Unfortunately, Panel D illustrates that the use of funds has a negative and significant impact on the conventional level ($p < 10\%$). Conversely, leverage has an insignificant effect on EM.

As shown in Table 3, the intended use of IPO funds negatively and significantly impacts the EM practices for the entire sample. This effect was also detected in each of the sectors during the simultaneous test. It shows that using funds for investment is a determining factor for firms' EM practices in the Indonesian capital market. This implies that companies utilizing proceeds for investment purposes tend to have a low EM level, and vice versa. Therefore, the excess funds used for investment are in accordance with a lower EM level.

The negative relationship between the use of proceeds for investment and EM implies that the companies are exposed to less risk. Generally, when a company is exposed to less risk, it does not tend to manage the reported earnings. The research finding agrees with the studies carried out by Hertz and Li (2007) and Autore et al. (2009). However, this does not imply that a company tends to un-

Table 2. Correlation matrix of research variables

Source: Authors' elaboration.

Variables	IUF	OCF	LEV	EC	CS
OCF	0.0949				
LEV	-0.2242	-0.3881a			
EC	0.2011	-0.1446	-0.2468		
CS	-0.0102	-0.0103	0.0879	-0.1427	
DCA	-0.2542b	0.0533	-0.2875b	0.0042	0.0592

Note: a and b show a significant level at 1% and 5%, respectively. IUF is the intended use of IPO Funds, OCF is operating cash flow, LEV is leverage, EC is earnings change, CS is company size, and DCA is discretionary current accruals.

Table 3. Summary of statistical test results

Source: Authors' elaboration.

Variable	Panel A Full Samples (n = 63)		Panel B Basic Industry and Chemical Sub-Sector (n = 15)		Panel C Consumer Goods Sub- Sector (n = 33)		Panel D Miscellaneous Industry Sub-Sector (n = 15)	
	IUF	-0.109 (-2.053b)	-0.142 (-2.693a)	-0.261 (-1.683c)	-0.454 (-3.424a)	-0.097 (-1.492c)	-0.144 (-2.718a)	-0.105 (-1.029)
OCF		-0.096 (-0.568)		0.524 (0.966)		-0.831 (-4.321a)		0.466 (1.384)
LEV		-0.419 (-2.946a)		-0.913 (-2.655a)		-0.311 (-2.590a)		-0.881 (-1.186)
EC		-0.013 (-0.215)		-0.351 (-1.511)		0.027 (0.515)		0.219 (1.189)
CS		0.012 (0.724)		-0.056 (-1.136)		0.014 (0.904)		0.052 (0.947)
F-Stat	4.215	2.884	4.215	3.679	4.215	5.303	4.215	1.085
(Adj. R ²)	(0.049)	(0.132)	(0.049)	(0.489)	(0.049)	(0.402)	(0.049)	(0.029)

Note: a, b, and c show 1%, 5%, and 10% significance levels, respectively, in the two-tailed tests. The level of *DCA* is the dependent variable. *IUF* is the intended use of IPO funds, *OCF* is operating cash flows, *LEV* is leverage, *EC* is earnings change, and *CS* is company size.

derperform when it utilizes more of the funds issued for investment purposes (Cheng, 1995). In addition, the use of proceeds reduces information asymmetry between investors and issuers in an IPO setting.

Financial leverage was discovered to negatively and significantly affect EM during the IPO period. Irrespective of the fact that the regression coefficient is significant, it is inconsistent with the prediction of a positive effect. The findings reported in this study are inconsistent with the study carried out by Wang et al. (2018), which reported that leverage and EM are positively and significantly related during the IPO period. Fortunately, financial leverage was discovered to be significant in the basic industry and chemical sector (Panel B), including consumers (Panel C).

Besides, three other variables, namely cash flow from operational activities, company size, and changes in earnings, have an insignificant effect on IPOs (Panels A, B, C, and D of Table 3). Previous studies stated that these variables significantly impact the level of EM. Cox (2020) stated that cash flow from operating activities positively and significantly influences the EM of IPOs in the USA. Liu et al. (2014) reported that company size positively and significantly impacts EM of IPOs in China. Meanwhile, Gumanti et al. (2015) stated that changes in earnings positively and signifi-

cantly influence the EM of Indonesian IPOs.

In the entire sample, operating cash flow was discovered to negatively and insignificantly impact EM. It was also discovered to have a significant effect on the consumer goods sector, and a negative directional coefficient in accordance with prediction. Furthermore, it had an insignificant effect on the other two sectors.

The negative coefficient of cash flow from operational activities shows that an increase in *DCA* results in a decrease in EM, and vice versa. An effective operating cash flow reduces the level of a company in terms of profit generation. Conversely, when there is a decrease in cash flow, a company tends to increase the EM level as it is unable to finance operational activities. Therefore, it is motivated to engage in management. This result is consistent with the findings of a study by Gumanti et al. (2015), which stated the negative and significant effect of EM on Indonesian firms from 2000 to 2006.

This study discovered that leverage has a negative and significant effect on the entire sample's EM practices. A similar outcome was found in the consumer goods, as well as the basic industry and chemical sector. This study's results are consistent with the study by Gumanti et al. (2015), which stated that leverage negatively affects the EM prac-

tice. However, the findings from this study are inconsistent with research conducted by DeFond and Jiambalvo (1994), Chen et al. (2005), and Yu (2014), which stated that firms with high leverage levels tend to trigger reported EM, and this implies the existence of a positive relationship between them. These findings need to be further explored to discover IPO companies with high debt burden, which reduces their profits by desired accounting methods. One of the allegations put forward is that an IPO company with high debt burden does not want to be perceived as a firm striving to increase the amount of profit. However, this assertion needs to be supported or strengthened by further analysis.

This study has found that changes in earnings negatively and insignificantly impact EM practices in the entire sample. This is consistent in the consumer goods industry and inconsistent in the basic and chemical, including the miscellaneous industries. The results from this study are different from the research carried out by Burgstahler and Dichev (1997) in the US capital market, which reported that managers avoid losses by engaging in EM. The hypothesis that leverage negatively affects the EM of IPO companies is accepted in this study.

This study stated that an increase or decrease in corporate profits in a year (t) compared to the previous year ($t-1$) failed to affect the unanticipated EM practices. In this study, the empirical evidence implies that an increase in changes does not result in a decrease in EM. Therefore, IPO companies tend not to engage in its practices because the coefficients are insignificant.

Company size has a positive and insignificant coefficient. It is not a determinant of EM variation. A positive coefficient implies that smaller firms engage in EM to maximize profits. The size of a firm's total assets does not affect EM. However, in the consumer goods sector, it was discovered to have a negative and insignificant ratio.

The results are inconsistent with the study by Gumanti et al. (2015) on Indonesian IPOs that decided to go public from 2000 to 2006, which reported that it significantly and positively impacted the EM level. To ensure that EM between the three sectors is consistent, this study analyzes the differences in the average DCA magnitude. The aim was to examine whether each of the sectors studied has similar characteristics with the DCA, given that the risk factors between them are certainly dissimilar.

CONCLUSION

This study explores the use of IPO proceeds and EM level by analyzing 63 manufacturing firms listed on the Indonesia Stock Exchange from 1989 to 2013. According to previous research, companies that utilize a larger portion of funds for investment purposes have lower EM levels. It was also found that leverage has a negative and significant impact on EM, while operating cash flow, changes in profit, and size have an insignificant impact. Generally, this study assumes that a firm's disclosure of the use of proceeds from the issue is a credible signal.

Some interesting facts are considered as the limitations of this study. First, it lacked differentiation in the amount of EM during the multi-dimensional and global financial crisis from 1997 to 1998 and from 2007 to 2008, respectively. In addition, unfavorable economic conditions tend to affect management motivation. Based on these limitations, future research needs to be done by testing whether there are differences in EM levels before, during, or after the financial crisis.

Secondly, a dummy variable proxy was used to determine the change in earnings and the intended utilization of IPO funds. This study was able to determine the percentage of funds allocated for investment purposes. It also specifically compared the number of discretionary accruals between companies that used the majority of the funds from the IPO for both investment and non-investment purposes.

Finally, the number of observations in this study is few, particularly when samples are divided into sub-samples to check for inconsistencies. This led to certain bias and its interpretation in order to obtain

larger samples and robust findings. It further examined other factors that affect EM's degree in IPOs, such as corporate social responsibility disclosures or corporate governance mechanisms.

The findings reported in this study are beneficial to some parties. Therefore, issuers need to consider including detailed information on the use of proceeds and are encouraged to use them for investment activities. Investors pay more attention to the use of IPO proceeds as it provides value-added information about the quality of financial reports.

AUTHOR CONTRIBUTIONS

Conceptualization: Andreas, Enni Savitri, Tatang Ary Gumanti, Nurhayati.

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