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# Analysis of The Market Reaction and Risk of Investment to Earnings Information Asymmetry of LQ 45 Companies Listed at Indonesian Stock Exchange

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***Abstract:*** *The research aims to: 1) Analyzing is there any difference of market reaction between earnings asymmetry informasi (income smoothers) and non earnings asymmetry informasi (income smoothers) companies. 2) Analyzing is there any difference of investment risk between the earnings asymmetry informasi (income smoothers) and non earnings asymmetry informasi (income smoothers) companies. The research was done to LQ 45 companies listed in BEI. Among 24 manufactures companies listed in BEI, 24. Using Eckel Index, the sample were divided into two type, 11 income smoothers and 13 non income smoothers. Documentation technique was used to gather data. Independent sample t-test was used to analyzed data if it has normal distribution in Kolmogorov-Smirnov test. The result show that there was no difference of the market reaction between income smoothers and non income smoothers companies, and there was difference of investment risk between income smoothers and non income smoothers companies. It's because the result of independent sample t-test show the probability of amount market reaction and investment risk were not significant in 5%.*

***Keywords:*** *Earnings Information Asymmetry Income Smoothing, Market Reaction, Investment Risk*

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## I. Introduction

Increasingly tight competition in the business world requires company management to always display the best performance of the company they lead because the bad performance of the company will have an impact on the company's market value and affect investors' interest in investing and withdrawing their investment from a company.

In addition to displaying the best performance management is also responsible for providing financial reports to stakeholders / parties with an interest in the company's financial information. Financial statements are the main communication medium between company management and stakeholders.

Earnings information is often used as a benchmark for evaluating company performance. Earnings information is information that is important to be seen by stakeholders in making decisions and evaluating company performance. The tendency to pay attention to profits contained in financial statements is what drives the occurrence of information asymmetry or company management to provide information that is limited and not appropriate to stakeholders. Asymmetrical information in this case is that managers have a tendency to reduce reported earnings fluctuations to suit the desired target or often called income smoothing.

In Indonesia, it was found that several companies indicated that income smoothing was at PT. Indofarma Tbk in 2004, PT Kimia Farma Tbk in 2002, and PT Ades Alfindo Tbk in 2004. In this study using data from LQ 45 companies because the issuer's stock shares included in the LQ 45 Index calculation were active stocks and included in the blue chips. interested in investors in investing in shares in the Indonesia Stock Exchange.

Corporate earnings announcements are important information that reflects the company's performance for market participants. From this information, the actor will make predictions and determine investment decisions. The information contained in profit figures is very useful, that is, if the actual earnings differ from the investors' profit expectations, then the market reacts which is reflected in the movement of stock prices around earnings announcements. Stock prices rise if reported earnings are greater than expected profits and vice versa. The following will be presented a table of comparison of net income and stock price a day after the publication of financial statements on the Indonesia Stock Exchange four LQ 45 companies.

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According to Riahi and Belkaoui (2011) income smoothing is seen as a deliberate process of profit normalization in order to achieve a trend or desired level. The concept of income smoothing uses the agency theory approach. This theory states that earnings management is influenced by a conflict of interest between management (agent) and the owner (principal). This agency problem arises because there are parties who prioritize personal interests even if they harm others. Even in the development of the agency also becomes a problem between management and other parties who have interests, namely potential investors, creditors, suppliers, regulators, and other stakeholders.

Basically, reported earnings information is a signal for investors and potential investors about future profits. With income smoothing investors can predict future profits relatively more precisely because it will tend to be more stable. Companies that report earnings that tend to be more stable in general will not attract large enough market reactions around the date of earnings announcements.

Data can be seen in stock price movements five days after the publication of fluctuating financial statements. This is a fairly large market reaction around the date of publication of financial statements while fluctuating stock price movements will be perceived as stocks that are full of investment risk. This also happens to ADRO companies that have no indication of income smoothing. This phenomenon is different from the theory which states that companies that report profits that tend to be stable will not invite many market reactions and have a small risk around the date of publication of financial statements. This happens with inconsistency with the theory so that researchers will examine more about differences market reaction and investment risk between income smoothing companies and non income smoothing.

**Benefits of Research**

The results of this research are expected to provide benefits for:

**1. For investors and potential investors**

The results of this study are expected to illustrate the phenomenon of income smoothing in LQ 45 Index companies on the Indonesia Stock Exchange, so that investors not only focus on earnings information, without paying attention to the procedures used by companies to obtain earnings information, so there will be no mistakes in making investment decisions. .

**2. For researchers**

This research adds to the knowledge of researchers regarding the analysis of market reactions and investment risk between companies that do income smoothing and do not do income smoothing.

## II. Theoretical Review

### 2.1 Agency Theory

Agents are people who are given the power to act on behalf of others, known as principals. Agency relationship is a contract between the principal and the agent where the principal delegates his authority over the agent company, including the authority in terms of decision making. In the context of a company, shareholders are principals, while the board of directors, CEOs, and company executives are agents (intermediaries) of shareholders (Keown, et al, 2008: 18).

### 2.2 Information Asymmetry

Sulistyanto (2008: 20) says that managers as managers of the company are the only parties who master all the information needed to prepare financial statements. Managers can explain in detail the relationship between one information and other information. While other parties outside the company, namely owners, potential investors, creditors, suppliers, creditors, regulators, governments and other stakeholders, who have limited resources and access to obtain information about the company. These parties can only rely on the information presented by the manager if they want to know the company's performance and conditions.

### 2.3 Asymmetrical Information Profit

The problem that arises due to information imbalance is earnings management. The purpose of earnings management is management to normalize profits to be more stable. Ricardson (2002) in his research stated that asymmetric information is the main cause of company managers to do earnings management.

### 2.4 Profit Management

The asymmetrical form of earnings information in this study is earnings management. Earnings management according to the National Association of Certified Fraud Examiners (in Sulistyanto, 2008: 49) is an intentional error or negligence in making financial statements regarding material facts or accounting data so that it is misleading when all information is used to make judgments that will eventually cause people to read it will replace or change his opinion or decision.

### 2.5 Income Smoothing

One of the asymmetrical patterns of earnings information in this case earnings management is income smoothing. Income smoothing (in Sulistyanto 2008: 177) is an attempt by the company to regulate the relative profit for several periods. This effort is done by playing with real income or costs. Income smoothing is a deliberate reduction or fluctuation in some levels of profit that is currently considered normal by the company. In this sense, income smoothing reflects an attempt by the management of the company to reduce abnormal variations in earnings to the extent permitted by good accounting and management principles.

### 2.6 Market Reaction

According to Assih and Gudono (in Noviant & Marsono, 2013), basically the reported earnings information is a signal for investors and potential investors about future profits. Companies that report earnings that tend to be stable in general will not attract much market reaction at the date of earnings announcement. This is because the reported earnings can basically be predicted by the market through previous earnings information. In contrast to companies that have stable profits, companies with high earnings variability will invite considerable market reactions because reported earnings cannot be accurately predicted by investors.

### 2.7 Investment Risk

The concept of income smoothing according to Tirole and Fudenberg (1995) in Mursalim (2005) assumes that investors are people who reject risk. Therefore, investors prefer stable earnings flows. Such investor behavior causes management to do income smoothing.

## III. Materials and Method

### 3.1 Types of Research

The type of research used in this research is descriptive comparative research. Comparative research is a study that is comparing two or more variables with different samples or at different times (Sugiyono, 2000).

### 3.2 Location and Time of Research

This research was conducted at the Indonesia Stock Exchange using the internet to access the site www.idx.co.id. The time of research starts from October 2018 to January 2019.

### 3.3 Data Analysis Technique

Parametric statistical tests requiring data to be used must be normally distributed. The normality test can be done with the Kolmogorov Smirnov test. The Kolgomorov Smirnov test is the basis for decision making, that is if the 2-tailed value is greater than 0.05 then the data is normally distributed. If the value of 2 - tailed is less or equal to 0.05 then the data is not normally distributed.

In this study will be tested the differences in stock returns and stock risk in companies that do income smoothing and do not do income smoothing. If the data is normally distributed, the Independent Sample T Test can be used. The hypothesis testing of the Independent Sample T test is based on the decision making if the value of sig 2 tailed is less or equal to 0.05 then Ha is accepted which means there are significant differences in the data of the two groups and vice versa

But if the data is not normally distributed then the nonparametric statistical test used is the U Mann Whitney Test. The basis of decision making is if the value of sig 2 tailed is less or equal to 0.05 then Ha is accepted which means there are significant differences in the data of the two groups and vice versa.

## IV. Results and Discussion

### 4.1 Descriptive Statistics Analysis

In the abnormal return of ADRO, AKRA and BBCA companies which indicated income smoothing, the maximum return value obtained by investors is 0.03200, 0.04797, and 0.03520 while the minimum value is -0.05267, -0, respectively. 03291, and -0.02273 which means that the return obtained by investors is lower than the expected return. The average abnormal return of ADRO and BBCA is -0.00950 and -0.00113 which means that the return obtained by investors is lower than the expected return and vice versa on the average AKRA abnormal return of 0,00024. The standard deviation is 0,02094, 0,02081, and 0,01109 this means that there is a deviation of 0,02094, 0,02081, and 0,01109 from the average abnormal return. The standard deviation of ADRO, AKRA and BBCA returns or investment risk obtained by investors maximum values are 0.03782, 0.02947, and 0.03292 while the minimum values are 0.01599, 0.01017, and 0.00698 respectively. The average standard deviation of return or risk that must be received by investors is 0.02372, 0.02198, and 0.01464 respectively. The standard deviation is 0.00843, 0.0079, and 0.01071 means that there is a deviation from the average standard deviation of returns of 0.00843, 0.0079, and 0.01071.

In the abnormal return of CPIN, INTP, LPKR and LSIP companies which indicated income smoothing, the maximum return value obtained by investors was 0.04758, 0.02330, 0.06326 and 0.067005 while the minimum values were respectively -0, 02857, -0.04231, -0.04736 and -0.03008 which means that the return obtained by investors is lower than the expected return. The average abnormal return of INTP and LSIP is -0.00604 and -0.00224 which means that the return obtained by investors is lower than the expected return and vice versa on the average abnormal return of CPIN and LPKR of 0.00287 and 0.00189. The standard deviation is 0.02002, 0.01668, 0.02556 and 0.02196 respectively, this means there is a deviation of 0.02002, 0.01668, 0.02556 and 0.02196 from the average abnormal return. The standard return deviation of CPIN, INTP, LPKR and LSIP or investment risk obtained by investors maximum values are 0.03371, 0.02479, 0.03829 and 0.04166 while the minimum values are 0.01831, 0.01072, 0.01087 and 0.00996. The average standard deviation of return or risk that must be received by investors is 0.02546, 0.01823, 0.01946 and 0.0198 respectively. The standard deviation is 0.00664, 0.00652, 0.01107 and 0.01321 means that there is a deviation from the average standard deviation of returns of 0.00664, 0.00652, 0.01107 and 0.01321.

In the abnormal return of MNCN, PGAS, SMGR and UNTR companies which indicated income smoothing, the maximum return value obtained by investors was 0.03436, 0.04742, 0.04026 and 0.03770 while the minimum value was -0, 05757, -0.03613, -0.0291 and -0.02958 which means that the return obtained by investors is lower than the expected return. The average abnormal return of MNCN and PGAS is -0.00271 and -0,00082 which means that the return obtained by investors is lower than the expected return and vice versa on the average abnormal return of SMGR and UNTR of 0.00173 and 0.00237. The standard deviation is 0.02196, 0.02055, 0.01667 and 0.02083 respectively, which means there is a deviation of 0.02196, 0.02055, 0.01667 and 0.02083 from the average abnormal return. The standard deviation of MNCN, PGAS, SMGR and UNTR return or investment risk obtained by investors maximum values are 0.03266, 0.03995, 0.02671 and 0.02793 while the minimum values are 0.0472, 0.01013, 0.00906 and 0.00578. The average standard deviation of return or risk that must be received by investors is 0.02187, 0.02101, 0.01759 and 0.02178 respectively. The standard deviation is 0.01102, 0.01228, 0.00703 and 0.00908 means that there is a deviation from the average standard deviation of returns of 0.01102, 0.01228, 0.00703 and 0.00908.

The overall abnormal return of the company indicated by the maximum income smoothing on LSIP companies is 0.067005, the minimum value at MNCN companies is -0.05757. The average abnormal return in companies indicated that income smoothing -0.00128 is smaller than the standard deviation of 0.01977, so this result shows the distribution of data that is not normal. In the investment risk variable / standard company deviation return indicated income smoothing, the maximum value on LSIP companies is 0.04166 and the minimum value at MNCN companies is 0.0047. The average investment risk / standard deviation return in the company indicated that income smoothing 0.0205 is greater than the standard deviation of 0.0092, so this shows a normal data distribution.

**4.2 Results and Discussion**

Data on financial data presented in financial statements is a reflection of the efforts made by management in increasing the value of the company. The company's efforts will illustrate how well the company's management performance is, including performance in facing various economic challenges.

Economic growth in Indonesia is based on data from the Central Statistics Agency in 2013, 2014, 2015, 2016 and 2017, each at 5.56%, 5.02%, 5.02%, 4.79%, 5.02% and 5, 07%. The condition which had declined then increased was a challenge for the company's management to always be able to show the best performance. One of the efforts is by trying to display financial statements that reflect the company's best performance. In addition to having external economic pressure, management also has the pressure to be the main holder of responsibility in presenting financial statements. This is what makes the manager sometimes does not reach the company's target, so that asymmetrical information on profits occurs by doing income smoothing so that the performance looks stable by the stakeholders.

**a. Analysis of Differences in Market Reactions to Asymmetrical Information on Earnings**

Asymmetrical pattern of earnings information in this study is income smoothing. The results of the hypothesis test that there is no significant difference in market reaction between companies indicated as income smoothing and companies that have no indication of income smoothing. This result is contrary to the signal theory which states that basically the reported earnings information is a signal for investors and potential investors about future profits. Companies that report earnings that tend to be stable in general will not attract much market reaction at the date of earnings announcement.

It can be seen in descriptive statistics, where companies indicated that income smoothing maximum abnormal return value was 0.06700 and the minimum value was -0.05757 which fluctuated very large, so companies did not indicate income smoothing maximum abnormal return value was 0, 12036, the minimum value of -0.07995 which fluctuates very large. Possible causes of no difference in market reaction between indicated companies and companies that have no indication of income smoothing because investors already know of indications of income smoothing. Experienced investors know the information that in practice, companies also have the freedom to report net income in financial statements. Even though it does not violate the rules of the PSAK (Statement of Financial Accounting), but not infrequently the income statement is made so attractive to attract investors. With this, the market reaction to the company indicates that income smoothing will invite market reaction because income smoothing is bad news, while the market reaction in the company is not indicated that income smoothing will invite market reaction because reported earnings tend to be unstable. These results support the research of Harnovinsyah and Indriyani (2015), Sari (2013).

**b. Analysis of Differences in Investment Risk Against Asymmetrical Information on Earnings**

Asymmetrical pattern of earnings information in this study is income smoothing. The results of the hypothesis test showed that there were significant differences in investment risk between companies that indicated income smoothing and companies that did not indicate income smoothing. It can be seen that the average investment risk income smoothing company 0.0205 is greater than the average investment risk of the company non income smoothing 0.0168. This shows that income smoothing affects the risk perception by investors. With the existence of income smoothing, the investment risk will increase, where income smoothing information which is considered as a bad thing affects the investment risk assessment of the company.

This result is not in accordance with Heqworth's theory stating that investors feel more comfortable if management reports stable earnings, because companies with high profit variability will be perceived as a risky company. This happens because investors already know there are indications of income smoothing practices. Experienced investors know the information that in practice, companies also have the freedom to report net income in financial statements.

There are fundamental differences between practitioners and academics in looking at and understanding income smoothing. In general practitioners, namely investors, governments, professional associations and other economic actors consider income smoothing as managerial fraud. The reason for this managerial engineering activity is to mislead and harm other parties who use financial statements as a source of information to know everything about the company (Sulistyanto 2008: 102)

While academics including researchers assess income smoothing in accounting is not something that is prohibited because accounting standards do give freedom to choose and use accounting methods and procedures according to their needs. This freedom is one of the triggers for income smoothing which has been debated as fraud or not. In accounting, all reporting activities must be based on existing written regulations. This is because income smoothing is not actually a fraud. Income smoothing is included in the act of manipulating financial statements, but with due regard and adherence to the rules of accounting methods. But there is a view that states that the effort to eliminate income smoothing is to make corrections to accounting standards that are accepted and used in general (Sulistyanto, 2008: 105).

## V. Conclusion and Suggestion

**Conclusion**

Based on the results of research and discussion, it can be concluded as follows.

1. The test results on market reactions to earnings announcements/financial report publications using the cumulative abnormal return in the observation period at the time of the announcement up to five days after the earnings announcement/publication of financial statements reject the actual hypothesis. Thus there is no significant difference in market reaction between companies indicated to do income smoothing and companies that are not indicated to do income smoothing in LQ 45 companies on the Indonesia Stock Exchange.
2. The test results on investment risk on earnings announcements/financial statement publications using standard stock return deviations in the observation period at the time of the announcement up to five days after the earnings announcement/financial report publication accept the actual hypothesis. Thus there is a significant difference in investment risk between companies indicated to do income smoothing and companies that are not indicated to do income smoothing in LQ 45 companies on the Indonesia Stock Exchange.

**Suggestion**

Based on the results of this study there are several suggestions that can be given, namely:

1. The next researcher can use other sample classification methods such as the Michelson model because the Eckel Index method used in this study only refers to the variability of sales and profits, so that it is only able to detect income smoothing which is made permanently by the company while the company is not permanently do income smoothing, then the phenomenon is difficult to observe.
2. This research is only limited to the LQ 45 index, the next researcher is expected to conduct research in other sector sectors and the duration of the study is more extended, so that the results of the study will be able to get the accuracy of better research results.

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