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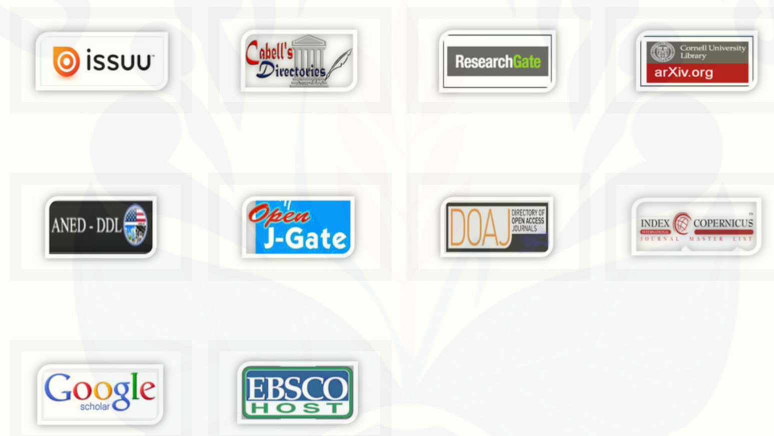

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Volume-4-issue-8

"August 2021"

1. **DETERMINANTS OF THE USE OF DIGITAL-BASED ACCOUNTING INFORMATION SYSTEMS MICRO, SMALL AND MEDIUM ENTERPRISES IN DENPASAR CITY**

   Anak Agung Ayu Erna Trisnadewi, Anak Agung Bagus Amlayasa

   Country : Indonesia
   Page : 01-07

   Download Full PDF

2. **The Effect of Liquidity and Management Ability on Market Performance with Earning Management as an Intervening Variable**

   Natalia IndrawatiTirtodjojo, Alwan Sri Kustono, Ahmad Roziq

   Country : Indonesia
   Page : 08-12

   Download Full PDF

3. **ACTIVE RESPONSE TO CLIMATE CHANGE FOR SUSTAINABLE DEVELOPMENT IN MEKONG DELTA**

   Dr Hoang Thu Trang, Dr Nguyen ThiThanh Thuong

   Country : Vietnam
   Page : 13-17

   Download Full PDF

4. **Analysis of students' perceptions of the evaluation methods for the written and oral baccalaureate exam in Gabon**

   Download Full PDF

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Mebrim Payos Mba Giscard

Country : Gabon
Page : 18-23

5 **Socioeconomic Determinants of Hypertension in the Democratic Republic of Congo: A Review of the Literature**

Antoine Ependja Towaka, Espérant Bolimbo Likwela, Projet du ciel Babaya Sengi, Alphonse Bebandela Maingolo, Zénon Baombolia Lokangu, Kombozi Etondo Bokambi

Country : Congo
Page : 24-31

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6 **Relevance of deliberative democratic evaluation in secondary education in Gabon. The case of elementary school transformed into colleges**

Louembet Onguele Christian

Country : Gabon
Page : 32-37

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7 **The Impact of Poverty for the Child Neglection**

Himalshi P. Serasinghe

Country : Sri Lanka
Page : 38-41

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8 **Freight Car Vehicle Brake System as A Traffic Safety Promoter inaccordancewith JBB inTheEra ofTechnologyDisruption**

Arista, I Putu Biru Bayu Nanda, Khafid Murtofik, Dr.AgusSahri, M.T.

Country : Indonesia
Page : 42-49

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9 **About the peculiarities of music in Ukrainian commercial cinema (on the example of music for the movie “The Guide”)**

Kuzmenko Anna

Country : Ukraine
Page : 50-54

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10 **The Creative Arts and Inevitability of Social Commitment**

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AFOLABI, John Adebayo

Country : Nigeria
Page : 55-60

11	**Understanding Perception of Sex Workers About Sexual Transmitted Diseases Using Health Belief Model: A Proposal** Ismail O. Suleiman Country : Nigeria Page : 61-65	Download Full PDF
12	**The mutations of the Black American identity under the impact of Islam: Case study, Baltimore, Maryland** Soumaya TIFNOUTI Country : Morocco Page : 66-74	Download Full PDF
13	**EXPLORING THE EFFECT OF INTELLECTUAL CAPITAL ANDINVESTMENT ON OPERATIONAL PERFORMANCE MEDIATED BY PRODUCTIVITY** Guntur Fitrah Phahensa, M. Thamrin2, Lira Agusinta Country : Indonesia Page : 75-80	Download Full PDF
14	**Investigation of Unemployment among University graduates in Swakopmund, Namibia** Lovisa Lugambo Ndagwedhwa Iyambo, Lukas Shikulo Country : Namibia Page : 81-87	Download Full PDF
15	**Discrepancies between Public Investments and Government Deficit and Debt** Nicoleta Andreea Savu Country : Romania Page : 88-95	Download Full PDF
16	**ACCOUNTING RULES AT MACRO AND MICRO LEVEL** Nicoleta Andreea Savu	Download Full PDF

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Country : Romania
Page : 96-102

17 **The Recruitment Mechanisms of Political Leaders: The Bases of Women's Poor Visibility in the Cameroon's Political Decision Making Structures.**
Dr TAOYANG WARAI Michael
Country : Cameroon
Page : 103-161
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18 **The Type of Motivation on Work Task among Special Education Teachers**
Rosilah Wahab, Siti Nurjuliana Idha Abdul Halim
Country : Malaysia
Page : 162-168
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19 **Information Technology Management And It Risks**
Asst. Prof. Dr. Bulent Gunceler
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20 **Successful Solutions In Prevention And Combat Of Covid-19 Pandemic In Vietnam**
Dr. Ha Sy Chien
Country : Vietnam
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The Effect of Liquidity and Management Ability on Market Performance with Earning Management as an Intervening Variable

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University of Jember, Indonesia

ABSTRACT: Banking companies are service sector companies that act as intermediary institutions whose existence is very crucial in each country. Competition between banking companies is getting tighter, making every company increasingly trying to improve its performance. This study aims to examine the direct and indirect effect of the liquidity and management ability variables on market performance with earnings management as an intervening variable. This research was conducted on banking companies listed on the Indonesia Stock Exchange in the 2016-2019 period. The sampling technique was purposive sampling. This study uses path analysis. The test results show that (1) liquidity has an effect on market performance, (2) management ability has a positive effect on market performance, (3) earning management has no effect on market performance, (4) liquidity has an effect on earnings management, (5) ability management has no effect on earning management, (6) liquidity has no effect on market performance through earnings management, and (7) management ability does not affect market performance through earnings management.

Keywords: Liquidity, Management Ability, Earning Management, and Market Performance.

I. INTRODUCTION

Economic life cannot be separated from the important role of financial institutions, such as banking. Banking is a service sector company that acts as an intermediary institution whose existence is very crucial in each country. In this era of globalization, competition between banking companies is getting tougher. This competition makes every company increasingly trying to improve its performance. Financial statements are records of a company's financial information in an accounting period that can be used to describe the company's performance. This financial report shows what management has done or is responsible for the resources that have been entrusted to it. These financial statements play an important role for users to make economic decisions, such as holding or selling their investment in the company, or the decision to change management.

Signal theory explains that companies have the urge to provide financial statement information to external parties. The company's urge to provide information is because there is information asymmetry between the company and outsiders, where the company knows more about the company and its prospects than outsiders.

For companies that go public, investors always pay attention to the trend of the company's stock price because the stock price will reflect how market participants expect the company's market value. If the stock price increases, the value of the company will also increase. This increased share price can provide high returns for shareholders. The company's ability to improve the performance and confidence of investors is called market performance. This situation causes profit to become one of the important components in making decisions so that management will try to present profits that are adjusted to the goals desired by managers, such as doing earnings management. Earnings management is a way of presenting earnings that are tailored to the goals desired by managers through the selection of a set of accounting policies or accrual management (Scott, 2009).

Management ability in managing finances and managing the company is an important thing to note. According to Pandia (2012:71), Net Interest Margin is a ratio that can be used to measure the ability of bank management to manage their productive assets to generate net interest income. The greater this ratio, the interest income on productive assets managed by the bank will increase so that the possibility of a bank in a problematic condition is getting smaller.

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The liquidity ratio is an indicator of the company's ability to pay all short-term financial obligations at maturity using available current assets. A bank can be said to be liquid if the bank concerned can fulfill its debt obligations, can repay all of its deposits, and can fulfill credit requests submitted without any suspension.

Christian (2014) in his research shows that the Net Interest Margin affects the stock value and the Loan to Deposit Ratio does not affect the stock value. This shows that the determination of loan interest rates is the main benchmark in Indonesian banking, considering that loans are still the main source of income from banks. This is contrary to Mahaputra's research (2016) which reveals that liquidity has a positive influence on stock prices.

Medyawicesar (2018) in his research reveals that Net Interest Margin does not affect stock prices. This shows that the Net Interest Margin information every year is not able to provide a signal for investors to make stock investment decisions. Then, Paramitha (2020) in his research revealed that liquidity affects earnings management. The high value of liquidity can reduce the occurrence of earnings management within the company. However, this contradicts research conducted by Wibowo (2019) which states that liquidity does not affect earnings management.

Syahadatina (2015) in her research reveals that earnings management affects firm value. Earnings management by managers can have an impact on the survival of the company, where investors will give an unfavorable reaction which has an impact on decreasing the value of the company which is reflected in the company's stock price. However, research conducted by Antula (2017) reveals that earnings management does not affect stock returns. This indicates that the size of the earning management carried out by the company's management does not affect the increase in the company's stock return.

The inconsistency of several research results that have been described previously became a motivation for researchers to conduct a study entitled "The Effect of Liquidity and Management Ability on Market Performance with Earning Management as an Intervening Variable".

II. LITERATURE REVIEW

2.1 Liquidity

The liquidity ratio is a ratio to measure the company's ability to meet short-term financial obligations. The liquidity ratio can be measured using the Loan to Deposit Ratio indicator. The formula for finding the Loan to Deposit Ratio is as follows.

$$\text{Loan to Deposit Ratio} = \frac{\text{Amount of Credit Disbursed}}{\text{Amount of Third Party Funds}}$$

A high Loan to Deposit Ratio means that the risk in investing is high because the company is not liquid and the company is considered not to have the ability to pay its obligations on funds from third parties in its operations. This has an impact on the loss of investor confidence in the bank and a decline in stock prices. Vice versa, if the Loan to Deposit Ratio is low, then the risk in investing is low and has an impact on increasing stock prices because the company is in a liquid state.

2.2 Management Ability

Net Interest Margin is a ratio used to determine the ability of bank management in terms of managing productive assets so that it can generate net interest. The higher the Net Interest Margin ratio, the higher the bank's profitability and will have a positive effect on stock prices. The formula for finding the Net Interest Margin is as follows.

$$\text{Net Interest Margin} = \frac{\text{Net Interest Income}}{\text{Average Earning Assets}}$$

2.3 Market Performance

Market performance is the achievement of a company in the capital market sector. This market performance is the company's ability to maintain and improve the performance and confidence of investors so that the company's share price on the Indonesia Stock Exchange can increase. The market performance variable in this study can be proxied by Tobin's Q with the following formula.

$$\text{Tobin's Q} = \frac{\text{Total Market Value} + \text{Total Book Value of Liabilities}}{\text{Total Book Value of Assets}}$$

Tobin's Q is used to measure market performance because it can provide an overview of the company's fundamental aspects and market views of the company, namely the extent to which outside parties including investors provide an assessment of the company. The total market value used refers to the market capitalization value of a company. In this case, to get the market capitalization value, the researcher can multiply between the number of outstanding shares and the company's stock price.

2.4 Earnings Management

Earning management is the manager's effort in presenting financial statements that are not following the actual situation for the benefit of the manager so that the manager's financial performance still looks good for the

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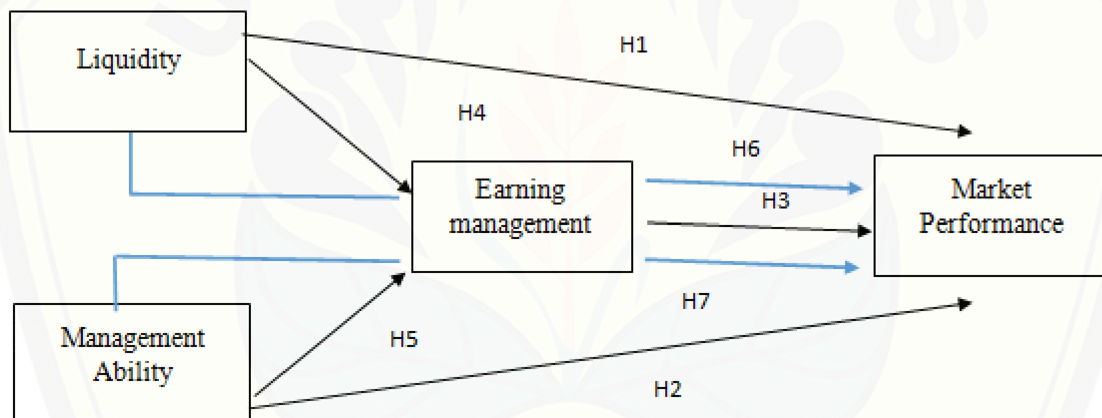
principal. Earning management in this study is calculated using the Eckel income smoothing index. The calculation of the Eckel index is as follows.
Income smoothing index = (CVΔI/CVΔS)
CVΔI and CVΔS can be calculated in the following way.

$$\frac{\sqrt{\dfrac{\Sigma(\Delta I - \Delta\overline{X})^2}{n - 1}}}{\Delta\overline{X}}$$

ΔI is the change in profit in a period, S is the change in income in a period, CV (Coefficient of Variation) of the variable, namely the standard deviation divided by the expected value, CVΔI is the coefficient of variation for changes in earnings, CVΔS is the coefficient of variation for changes in income, and X is the change in profit (I) or the change in income (S) between years n-1 to year n.

2.5 Conceptual Framework

Every company tries to maximize the value of its shares so that many investors are interested in investing their capital. Before investing, potential investors will look at the company's financial performance. Financial statements need to be analyzed to evaluate the performance achieved by the company's management in the past, and as material for consideration in preparing the company's plans for the future. This study emphasizes the analysis of the effect of liquidity ratios and management capabilities on market performance with earnings management as an intervening variable. The conceptual framework developed in this study is as follows:



2.6 Research Hypothesis

The research hypothesis is as follows:
H1: Liquidity affects market performance.
H2: Management ability affects market performance.
H3: Earning management affects market performance.
H4: Liquidity affects the tendency to do earnings management.
H5: Management ability affects the tendency to do earnings management.
H6: Earning management can mediate the effect of liquidity on market performance.
H7: Earning management can mediate the influence of management ability on market performance.

III. METHOD

The type of data used in this study is secondary data, in the form of annual financial statements of banks listed on the Indonesia Stock Exchange. The sampling technique was purposive sampling. Purposive sampling is a sampling technique with certain considerations. The criteria for determining the sample in this study are as follows.
a. Banks listed on the Indonesia Stock Exchange during 2016-2019.
b. Banks that submit continuous and complete financial reports that have been audited for the 2016-2019 period.
c. Companies that publish their financial statements in rupiah.
The data analysis method used in this study is path analysis which is operated through the SPSS program. Before testing the hypothesis, the data was tested using the classical assumption test consisting of normality,

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multicollinearity test, heteroscedasticity test, and autocorrelation test. Furthermore, partial hypothesis testing (t-test), coefficient of determination, and mediation testing using path analysis.

IV. RESULT

4.1 Instrument Test

The results of the classical assumption test in this study are as follows.

1. Normality Test

The Normal Probability Plot graph shows that the data points are in the same direction and follow the diagonal line. Based on the results of the Kolmogorov-Smirnov test, the significant value of the data is 0.193 so it can be concluded that the data in this study is normally distributed because the value of sig > (0.193 > 0.05).

2. Multicollinearity Test

The tolerance value in the Coefficients table for the liquidity variable = 0.899, management ability = 0.947, and earning management = 0.915. Then the value of Variance Inflation Factor (VIF) for the liquidity variable = 1.113, management ability = 1.056, and earning management = 1.092. Because the tolerance value is greater than 10% and the VIF value is less than 10, it can be concluded that these independent variables can be used in the study because there is no correlation between the independent variables.

3. Heteroscedasticity Test

The scatterplot graph shows that the points are spread out and do not form a certain pattern so that it can be concluded that in this regression model there is no heteroscedasticity or there is no variance inequality from one observation residual to another observation.

4. Autocorrelation Test

Based on the results of the autocorrelation test, the Durbin-Watson value is 1.086. To be able to find out whether this regression model is free from autocorrelation or not, it is necessary to know the values of Durbin-Watson Upper (dU) and Durbin-Watson Lower (dL) first. In this research test, there are 3 independent variables, meaning the value of k = 3 and the amount of data (n) in this study is 88 data so that the dL value is 1.60709 and dU is 1.69990. Because the value of DW (1.086) is in the range 0 < DW <dL, which means there is no positive autocorrelation.

4.2 Hypothesis Testing

The hypothesis used in this study is the t-test (partial). The t-test was carried out to determine the significant effect of the independent variable on the dependent variable partially. This test uses a significance level = 0.05 or 5% with the criteria if the sig > 0.05 then H0 is accepted and Ha is rejected, meaning that individually the independent variable has no significant effect on the dependent variable. Predict that if the sig < 0.05 then H0 is rejected and Ha is accepted. It means that individually the independent variable has a significant effect on the dependent variable.

Based on the hypothesis result, we concluded that:

1. Liquidity effects on market performance (sig = 0.00).
2. Management ability has a positive effect on market performance (sig = 0.028).
3. Earning management does not affect market performance (sig = 0.700).
4. Liquidity affects earnings management (sig = 0.021).
5. Management ability does not affect earning management (sig = 0.324).
6. Liquidity has no effect on market performance with earnings management as an intervening variable (sig = 0.434).
7. Management ability has no effect on market performance with earnings management as an intervening variable (sig = 0.225).

V. DISCUSSION

1. Liquidity affects market performance. In line with directives from Bank Indonesia regarding tightening rules for Net Performing Loans to reduce the number of non-performing loans, banks have become more effective in disbursing loans to third parties. This causes the value of the Loan to Deposit Ratio to decrease while the share price continues to rise in line with the increasing confidence of investors in the company.
2. Management ability has a positive effect on market performance. The higher the Net Interest Margin ratio in the banking sector, the greater the level of profit that can be obtained by the bank. The level of profit will affect the number of dividends to be paid to shareholders, so a high Net Interest Margin ratio can attract investors to invest in shares.
3. Earning management affects market performance. These results are following research conducted by Indrayanti (2017) which revealed that the size of earnings management that occurs does not affect the increase in stock returns.

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4. Liquidity affects earnings management. Paramitha (2020) in his research reveals that the higher the company's liquidity value, the lower the tendency to do earnings management. The high value of company liquidity can reduce the occurrence of earnings management.
5. Management ability does not affect earning management. This study proves that if the Net Interest Margin ratio increases or decreases, it does not affect the decision to perform earnings management.
6. Liquidity has no effect on market performance with earnings management as an intervening variable. Christian (2014) in his research shows that the number of loans and third-party funds owned by a bank is not a benchmark, and does not affect the good and bad valuation of the company. Investors are more focused on the profits that can be generated and can be received.
7. Management ability has no effect on market performance with earnings management as an intervening variable. Information on the Net Interest Margin of banking every year is not able to provide a signal for investors to make stock investment decisions. Investors are more focused on the profits generated and the dividends they receive.

VI. CONCLUSION

This study shows that the factors that can affect market performance are liquidity and management ability, as well as liquidity factors that can influence earnings management. This shows that the information contained in the company's annual financial statements are important things to pay attention to by investors in making decisions to invest in the company.

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