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Determinants of Profit Management in Banking in the Asian Region

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ABSTRACT: This research aims to determine the factors that determine earnings management in banking in the Asian region. The population in this research is 512 commercial banks in the Asian region for the period 2011 - 2022. Samples were taken using a purposive sampling method, namely based on certain criteria, so that a sample of 156 banks was obtained. The data analysis technique used in this research is panel data regression analysis.. The research results that show credit risk, profitability and company size have a significant effect on earnings management.

KEYWORDS: Credit Risk, Profitability, Company Size, Profit Management

INTRODUCTION

Earnings management is a problem for agents because there is manipulation carried out by managers to cover up the truth of performance. This is done to make investors interested in the data provided (Vo, Nguyen, & Phan, 2022). Earnings management is carried out by manipulating financial reports which is usually done by manipulating actual financial transactions and income smoothing to equalize profits from one period to the next (Bajra & Cadez, 2018) . The main driver for managers to manipulate profits is to shape the expectations of investors who often make decisions relying on income in this period (Kim & Sohn, 2013) , the bank will provide good information regarding finances to reduce the negative impact of investors, this is in line with agency theory in the form of differences in information that occur and can trigger conflict in which one party will look for loopholes to gain profits (Nainggolan & Karunia, 2022) . The success of the intermediation function of the financial and banking sectors is certainly related to efficiency in the economy. The better the level of intermediation of a bank, which is reflected in the collection and distribution of funds, the faster a country's economy will develop (Asngari, 2013)

The characteristics of banking are different from non-financial companies in general, thereby encouraging risk-taking behavior and requiring discipline (Sentral, A, & A, 2024) . Due to the high risk in banking companies, good managerial skills are needed. Events that occur when management makes considerations in the financial reporting process to change financial reports in order to impact stakeholders' trust regarding matters that depend on financial figures are referred to as earnings management (Healy, P. & Wahlen, 1999) .

Credit risk is defined as the risk that a loan will not be repaid (in part or in full) to the lender. Analysis of credit risk is very important because it can provide warning signs when the financial sector becomes more vulnerable to problems (Agnello & Sousa, 2012) . Credit risk is not an event that occurs momentarily but rather an event that materializes gradually (Doddy Ariefianto et al., 2024) . Understanding how credit risk evolves is critical, as it provides insight into the appropriate timing and scale of remediation policies.

Profitability is the company's ability to generate profits. One of the ratios in profitability is *Return On Assets* (ROA). Profitability ratio (ROA) is a metric used to reduce a bank's ability to fully realize the profits generated by its active assets. When a bank's ROA increases, the bank's profit margin also increases and its position in the asset usage strategy also increases (IP Sari et al., 2021) . Previous research also shows that managers may shrink assets temporarily to regain the ability to increase profits optimally in future periods (Barton & Simko, 2002) .

Large companies have more effective internal control systems and competent auditor teams than small companies (Suripto, 2023) . Larger companies have more funds to leverage the best technology and expertise to produce timely financial information to the public. Therefore, large-sized companies manage their revenues less than small-sized companies with the opposite view stating that large-sized companies manage their revenues more compared to small-sized companies (Abid et al., 2021) .

Determinants of Profit Management in Banking in the Asian Region

Research that has been conducted in relation to earnings management includes (Cohen, Cornett, & Marcus, 2011) examining the relationship between bank earnings management and risk during the financial crisis in a sample of banks in America. They found that earnings management had little predictive significance for the risk of decline during the financial crisis. periods of calm, but are highly predictive of such risks during a crisis. (Muhammadinah, 2016) the results of his research show that simultaneously Profitability, Credit Risk, Company Size, Growth, Managerial Ownership Structure and Dividend Payout Ratio do not have a significant effect on Profit Management. Meanwhile, partially only growth has a significant effect on earnings management variables.

The main problem in this research is How do Credit Risk, Profitability and Size Influence Earnings Management in the Asian Region?

LITERATURE REVIEW

Agency Theory was explained by Jensen & Meckling, (1976) who that stated agency theory is a theory of unequal interests between the principal and the agent. Based on this reason, bank managers carry out earnings management to convey private information about their bank's financial situation. Pressure from investors for high-quality information also provides incentives for banks to manage their accounts to reflect additional information about the bank's prospects (Jin, Li, Liu, & Nainar, 2023) .

Credit risk is one of the most obvious risks to be managed in the banking industry among the proxy indicators of banks' risk-taking activities (Alaoui Mdaghri, 2022; Hang, Ha, & Thanh, 2020; Vuong, Phan, Nguyen, Nguyen, & Duong, 2023) . Credit risk is not an event that occurs momentarily but rather an event that materializes gradually (Doddy Ariefianto, Trinugroho, & Yustika, 2024) . Credit risk is one of the most important factors affecting banking system stability and eroding bank profits and capital, and is positively correlated with macro-financial fragility. An increase in NPLs often brings economic crises and affects macroeconomic performance (Yuan, Zhong, & Lu, 2022) .

Profitability is a measure of a bank's ability to generate income over a certain period of time by allocating various daily assets, such as shares and bonds, efficiently and effectively. Return on assets reveals information about how efficient the bank is in operating. This is because it shows how much profit is generated for each dollar of assets used, according to (Ferdyant, ZR, & Takidah, 2014). The profitability ratio also shows the level of effectiveness of management of a particular bank. This is explained by the profit generated from investment receipts and sales. When a bank's profit margin increases, the company's efficiency ratio also increases. One of the ratios in profitability is *Return on Assets* (ROA).

Firm size (Size), measured by the log of total assets, is also considered, as large firms may have more accounting treatments for transactions. Thus, they are more able to manipulate income than small companies (Barka & Hamza, 2019; Lukani, 2013; Uygur, 2019) . This shows that large-sized companies are better able to manage their profits than Although the internal control system is strong in large-sized companies, management violates its system for reporting Benefits and skills to manage changes in income along with the size of the company.

Earnings management is defined as exploiting the flexibility of accounting rules to manage the measurement and presentation of accounts in the interests of report preparers. Earnings management is a managerial action that leads to the ability to reduce or increase income or profits aggressively through accounting activities (Lin, Pizzini, Vargus, & Bardhan, 2012) . Earnings management involves company managers to show an increase in company income so that it is in the most profitable position (Yaşar & Yalçın, 2024) . Managerial activities involve manipulating profits by changing transactions or smoothing profits from year to year (Bajra & Cadez, 2018) .

Hypothesis

Credit risk is the failure of the bank to receive interest and/or loans so that it is necessary for the bank to increase the reserve funds to anticipate default losses from debtors. Banks face business risks, namely the risk of bad credit. If the credit loan goes bad, the bank's interest income will also decrease. The N *on Performing Loan* (NPL) ratio is used to assess bad credit owned by a bank and will also influence the assessment of bank performance, in this case whether a bank is healthy or not (Ariani, Indriani, & Zahra, 2024) . It is necessary to control indicators of loan failure in a timely manner such as changes in non-performing loans, allowance for loan losses and loan write-offs (Leventis, Dimitropoulos, & Anandarajan, 2012) . Research conducted by (Ariani et al., 2024; Kusumaranny, 2013; Na separate, 2020) , which provides research results that NPL has a significant positive effect on earnings management. Meanwhile, based on research conducted by Shidiq (2011), it is stated that NPL has no significant effect on earnings management. Referring to the description above, the hypothesis in this research is:

H1: Credit risk has a significant effect on earnings management

Return on Assets (ROA) is a type of profitability ratio that is used to reduce a company's ability to handle cash used in its operational activities with the aim of generating income by utilizing available resources (Ardimas & Wardoyo, 2014) . Kasmir (2015) states that what influences *ROA* is return on investment which is influenced by net profit margin and total *asset turnover.* The results of

previous research state that profitability has a significant effect on earnings management (Purnama, 2017b) . Referring to the description above, the hypothesis in this research is:

H2: Profitability has a significant effect on earnings management

Company size is a measure, scale or variable that describes the size of the company based on several provisions, such as total assets, log size, market value, total sales, shares, income, capital and others. Company size in this research is measured through total company assets. Companies that have a large amount of assets will increase the value of the company so that management will pay more attention to the company's profits and will take profit management actions. Profit management actions can also be taken for companies that have a small amount of assets because management wants the company's assets to appear in large numbers. at the time of reporting. Size is related to the company's internal control system, thereby reducing suspicions of earnings management (Suripto, 2023) . revealed in his research that large companies have to manage their profits because of greater pressure from investors and to meet analyst expectations (Barton & Simko, 2002) . In research (Lukani, 2013), the results obtained were that companies, both small and large, managed their profits to hide their losses or to show positive trends in their income.

H3: Company size has a significant effect on earnings management

RESEARCH METHODOLOGY

This type of research is quantitative, that is, it is a type of data that can be measured or calculated directly, in the form of information or explanations expressed in numbers or in the form of numbers. The population in this study was 512 commercial banks in the Asian region in 2011-2022. The research sample used a purposive sampling method, purposive sampling is a technique for sampling data sources with certain considerations so that a sample of 156 banks in the Asian region was obtained. The data analysis technique uses panel data regression in conducting panel data regression by testing hypotheses using the t test and F test.

RESULTS AND DISCUSSION

In the initial stage of analysis, the analysis is first carried out to test the accuracy of the panel data model between the three approaches, namely the common effect model, fixed effect model and random effect model. To choose one of the three approaches, three tests were carried out including the Chow test, Hausman test and Lagrange multiplier test.

Based on data processing, test results were obtained as shown in table 1.

Table 1. Stationarity Test

Variable	Unit Root Test	
	Levels	**1st Difference**
DAC	0.0000	0.0000
NPLs	0.0008	0.0000
ROA	0.0003	0.0000
SIZE	0.9764	0.0000

From the results of the stationarity test using the *Augmented Dick-Fuller (ADF) test* in the table above, the company size variable level results are not stationary so it needs to be looked at at the *fi* rst *difference level.* The results show that only Siz non stationary at level but all variables can be stationary at the *first difference level* .

Based on data processing, the results of the cointegration test were obtained as shown in table 2.

Table 2. Cointegration Test

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalues	Trace Statistics	0.05 Critical Value	Prob.**
None *	0.352869	269.9584	47.85613	0.0000
At most 1*	0.218907	134.1738	29.79707	0.0000
At most 2*	0.115270	57.09072	15.49471	0.0000
At most 3*	0.058716	18.87915	3.841465	0.0000

Trace test indicates 4 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Based on the Cointegration Test results, it shows that if credit risk, profitability and company size have a probatbiliy value smaller than 0.05, it can be concluded that in this research model there is a cointegration relationship. This means that there is a long-term relationship between the variables credit risk, profitability and company size .

Table 3. Chow Test

Redundant Fixed Effects Tests
Equation: Untitled
Cross-section fixed effects test

Effects Test	Statistics	df	Prob.
Cross-section F	1.390702	(155,1713)	0.0016
Chi-square cross-section	221.882167	155	0.0003

Based on Table 3, the results of the *Chow test* show that the probability value *of Cross-section* F is 0.0016 and *Cross-section Chi-Square is* 0.0003, which means the *probability value of Cross-section* F and *Chi-Square* < 0.05 shows the results that the model chosen in this research is the Fixed Effect Model (FEM).
The results of the Hausman test can be seen in table 4.

Table 4. Hausman Test

Correlated Random Effects - Hausman Test
Equation: Untitled
Cross-section random effects test

Test Summary	Chi-Sq. Statistics	Chi-Sq. df	Prob.
Random cross-section	24.154021	3	0.0000

Based on Table 4, the results of the *Hausman* test show that *the probability cross section* value is 0.0000 with a significance level of 0.05 . then the results show that the model chosen in this research is *the Fixed Effect Model* (FEM).
Based on the results of the Chow test and the Hausman test carried out, it shows the same results , namely stating that the best model used in this research is *the fixed effect model* , based on the results of these two tests there is no need to carry out the *Lagrange Multiplier* (LM) test.
One of the prerequisites that must be met in using regression analysis is classical assumption testing, where in this research the classical assumption tests carried out are multicollinearity and heteroscedasticity tests.
The results of data processing for the multicollinearity test can be seen in table 5.

Table 5. Multicollinearity Test

	NPLs	ROA	SIZE
NPLs	1,000000	-0.058396	-0.369418
ROA	-0.058396	1,000000	0.022208
SIZE	-0.369418	0.022208	1,000000

Based on Table 3, it is known that each independent variable has a correlation value smaller than 0.90, so it can be said that each of the variables in this study does not have a large correlation between variables so it can be said that there is no multicollinearity problem.
The results of the heteroscedasticity test are as shown in table 6.

Table 6. Heteroscedasticity Test

Dependent variable: RESID^2

Variable	Coefficient	Std.Error	t-Statistics	Prob.
NPLs	0.000755	0.000801	0.942954	0.3458
ROA	0.002668	0.002711	0.983873	0.3253
SIZE	-0.011870	0.006081	-1.951849	0.0511

Based on Table 6 , it shows that each independent variable, NPL ROA and SIZE have a probability value greater than the 5% significance level. So it can be said that the residual value from one observation to another is constant or homoscedastic or heteroscedasticity does not occur.

After determining the best model to use in the research, it can be concluded that *the fixed effect model* is the right model to use. Table 7 is the result of panel data regression estimation using the fixed effect model.

Table 7. Fixed Effect Model

Dependent variable: DAC

Variable	Coefficient	Std.Error	t-Statistics	Prob.
C	0.494483	0.222380	2.223593	0.0263
NPLs	-0.006966	0.001207	-5.770157	0.0000
ROA	0.024540	0.004088	6.002448	0.0000
SIZE	-0.019966	0.009169	-2.177460	0.0296
MSE Root		0.098255	R-squared	0.161968
Mean dependent var		0.017260	Adjusted R-squared	0.084672
Hannan-Quinn Criter		-1.459432	F-statistic	2.095415
Durbin-Watson stat		1.949448	Prob(F-statistic)	0.000000

The credit risk variable produces a t-statistic value of 5.770157 > t table 1.97569 with a p-value of 0.0000 < α=0.01, which means reject Ho and H1 is accepted. The hypothesis H1 " Credit Risk has a significant and influential effect on earnings management" is accepted. The negative influence shown by the NPL indicates that the higher the problem loans in the Bank's credit management as shown in the NPL, the lower the Bank's income level which is reflected in profits. This means that credit risk has a negative influence on earnings management. This negative influence explains that the relationship between credit risk and earnings management is negative, namely that the higher *the Non-Performing Loans (NPL)* , the more bank earnings management will decrease. The negative influence shown by the NPL indicates that the higher the problem loans in the Bank's credit management as shown in the NPL, the lower the Bank's income level which is reflected in profits. This means that credit risk has a negative influence on earnings management. It can be said that the relationship between credit risk and earnings management is negative, namely that the higher *the Non-Performing Loans (NPL)* , the lower the banking earnings management will be .

The financial performance variable produces a t-statistic value of 6.002448 > t table 1.97569 with a p-value of 0.0000 < < α=0.01, reject Ho and H2 is accepted. The hypothesis H2 " Financial Performance has a significant and influential effect on earnings management" is accepted. The results of this research indicate that profitability as measured by ROA has an influence on earnings management. So it can be explained that when a company's profitability level shows an increasing figure, this is also in line with an increase in earnings management, and vice versa, if a company's profitability is low, the potential for earnings management by that company will be lower. This is in line with agency theory highlighting that managers in a company (*agent*) have incentives to improve financial performance in meeting or exceeding targets set by the company owner or shareholder *(principal)* . This research is in line with Aulia, 2021; Vo et al., (2022) and Yuliastuti & Nurhayati, (2023) state that profitability has a positive effect on earnings management.

The company size variable produces a t-statistic value of 2.177460 > t table 1.97569 with a p-value of 0.0296 < α=0.05 or reject Ho and H3 is accepted. H3 that is " Company size has a significant and influential effect on earnings management" is accepted. Company size has a negative influence on earnings management due to the influence of assets. Banks must have a prudential principle , so that the distribution of funds for asset management must be done carefully. Often there are unproductive assets that become costs which will affect bank profits. In the context of agency theory, company size (total assets) can play an important role in determining the extent to which earnings management practices are carried out in the banking industry. Managers in larger banks may have more incentives, autonomy, and resources to manipulate financial statements, which can affect the

trustworthiness and integrity of reported financial information. Therefore, strict supervision, good transparency and proper regulation are essential to ensure ethical earnings management practices and safeguard the long-term health of banking companies. Study Simanjuntak & Anugerah, (2018) , Prasetya & Gayatri, (2016) , Alam, Ramachandran, & Nahomy, (2020) and Purnama, (2017a) obtained results that company size has a significant effect on earnings management.

The calculated F value is 2.66 > F table 1.78 with a probability value of 0.000000 < α=0.05 which means H4 "credit risk, profitability, company size simultaneously have a significant effect on earnings management" is accepted. Earnings management occurs when managers use judgment in financial reporting and transaction preparation to distort financial reports to mislead shareholders on the basis of the organization's economic performance or to influence results in accordance with contracts that depend on reported accounting numbers. There are two important perspectives that can be used to explain why earnings management is carried out by managers, namely the information perspective and the opportunist perspective. The information perspective is a view that suggests that earnings management is a managerial policy to express the manager's personal expectations regarding the company's future cash flows. Efforts to influence information are carried out by taking advantage of the freedom to choose, use and change accounting methods and procedures. The opportunist perspective is a view that states that earnings management is the behavior of managers to deceive investors and maximize their welfare because they have more information than other parties (Muhammadinah, 2016) . Joe & Ginting, (2022) research results show that company size, leverage and profitability influence Profit Management in Manufacturing Companies listed on the Indonesia Stock Exchange for the 2017-2020 period.

CONCLUSION

Based on the data obtained and the results of the data analysis that has been carried out as well as the discussion that has been stated previously, it can be concluded that;

1). Credit risk has a significant effect on earnings management, NPL reflects the credit ratio, if the higher the NPL ratio, the greater the possibility of a bank being in trouble and allowing lower profits to be achieved, but if the smaller the NPL, the smaller the credit risk borne by the party. bank.

2). Profitability has a significant effect on earnings management, this means that when a company's level of profitability shows an increasing figure, it is also in line with an increase in earnings management, and vice versa, if a company's profitability is low then the potential for earnings management by that company will be lower.

3). Company size has a significant effect on earnings management. It can be said that the relationship between size and earnings management is negative, this is because large companies, including large banks with large total assets, tend to have more mature internal supervision and control systems.

LIMITATIONS AND SUGGESTIONS

This research is limited to years of observation and measurement of the determinants of earnings management which are only limited to credit risk, profitability and company size. It is hoped that future researchers can expand the years of observation and add several variables that are considered to influence earnings management.

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