



Earnings Management and Firm Value: The Moderating Role of Institutional Ownership

Ahmad Reza Azizi¹, Haniyah Berliana Putri¹, Amrie Firmansyah^{2*}

¹ Politeknik Keuangan Negara STAN, Indonesia

² Universitas Pembangunan Nasional Veteran Jakarta, Indonesia

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Abstract

In the banking sector, information asymmetry allows managers to opportunistically manipulate Loan Loss Provisions (LLP), eroding financial transparency, destroying investor trust, and ultimately threatening firm value. This study aims to investigate the impact of earnings management on firm value and to examine the moderating role of institutional ownership as a governance mechanism within the Indonesian banking subsector. Utilizing an explanatory quantitative approach, the study analyzes a panel dataset of 105 firm-year observations from 23 banking companies listed on the Indonesia Stock Exchange (IDX) over the 2019-2023 period. The Generalized Method of Moments (GMM) is employed to effectively tackle endogeneity and simultaneity bias. The empirical findings indicate that earnings management significantly reduces firm value. However, institutional ownership moderates this relationship by weakening the adverse impact of earnings manipulation on market valuation. These findings provide theoretical support for agency theory by demonstrating the effectiveness of institutional monitoring in mitigating opportunistic managerial behavior in emerging markets. In practice, the study offers policy implications for the Financial Services Authority (OJK) to strengthen supervision of LLPs, while assisting investors in using institutional ownership as a proxy for governance quality to mitigate potential value erosion.

Keywords: *Earnings Management, Firm Value, Institutional Ownership, Banking Sector, Corporate Governance.*

INTRODUCTION

The banking subsector plays a vital role in supporting a country's stability and economic growth (Korneev et al., 2023; Vrotslavskyy & Dropa, 2024). As a key pillar of the financial system, banking institutions act as intermediaries between surplus units (savers) and deficit units (investors), ensuring liquidity to support economic activity (Dalimunthe & Lubis, 2023; Hassoon & Kadhim, 2022). In this context, firm value serves as a critical indicator of market perceptions of a firm's future prospects and its ability to generate profits (Meidawati et al., 2026). However, achieving firm value is often constrained by agency problems arising from conflicts of interest between principals and agents (Alexander, 2025), particularly in environments characterized by high information asymmetry.

Information asymmetry allows managers to pursue personal incentives through opportunistic financial reporting practices, most notably earnings management (Liu et al., 2025; Pietoyo et al., 2022). By manipulating financial statements, managers distort the firm's true economic performance, increasing information risk and reducing the reliability of financial information used by investors (Permana et al., 2025). As a consequence, investors may misinterpret firm fundamentals, leading to inaccurate valuation decisions. The Bank Bukopin case in 2018 provides a clear illustration, where manipulation of credit card data inflated commission-based revenue and resulted in a significant increase in impairment losses, ultimately causing a 25.76% decline in share price (Alifia & Amelia, 2025; Almawadi, 2022). This case demonstrates

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Corresponding author's email: amriefirmansyah@upnvj.ac.id

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how earnings management, when perceived as opportunistic behavior, can directly erode firm value and investor trust.

Despite this theoretical expectation, empirical findings on the relationship between earnings management and firm value remain inconclusive. Several studies document a negative association, arguing that earnings management reduces transparency and increases information risk, which leads investors to discount firm value (Eliwa et al., 2025; Jayanti & Wirama, 2025; Tulcanaza-Prieto & Lee, 2022). In contrast, other studies find no significant relationship and suggest that market responses to earnings management may depend on contextual factors such as governance effectiveness and institutional environment (Bangun & Natsir, 2025; Heling & Lastanti, 2024; Karianga et al., 2022). These contrasting findings indicate that the impact of earnings management on firm value is not uniform, but rather contingent upon mechanisms that influence how investors interpret financial information.

From an agency theory perspective, institutional ownership serves as a critical external monitoring mechanism that can reduce information asymmetry and constrain managerial opportunism. Institutional investors possess superior resources, expertise, and incentives to monitor management actions, enabling them to detect and discipline earnings management practices (Shiwa & Karina, 2023). Consequently, their presence may alter investor perception by reducing the information risk associated with earnings management. When institutional monitoring is strong, the market may interpret reported earnings as more credible, thereby weakening the negative impact of earnings management on firm value. Conversely, in the absence of effective monitoring, earnings management is more likely to be perceived as opportunistic behavior, leading to stronger negative market reactions.

However, the effectiveness of institutional ownership as a moderating mechanism remains an empirical question, particularly in emerging markets such as Indonesia, where governance structures and investor protection may not be fully developed. This condition creates an important research gap, as the interaction between earnings management and institutional ownership may differ across institutional environments. Therefore, it is necessary to reexamine how institutional ownership influences the relationship between earnings management and firm value within this context.

Based on this reasoning, this study aims to examine the effect of earnings management on firm value and to analyze the moderating role of institutional ownership in the Indonesian banking sector. The Indonesian banking sector provides a relevant empirical setting due to its ongoing regulatory reforms, increasing asset growth, and critical role in maintaining financial stability and transparency (Permana et al., 2025; Putri et al., 2025). This study contributes to the literature in several ways. First, it strengthens the theoretical linkage between agency theory and firm value by explicitly explaining how information asymmetry and monitoring mechanisms shape investor perception. Second, it provides empirical evidence from an emerging market context, where governance effectiveness may influence market responses to earnings management. Third, this study employs the Generalized Method of Moments (GMM) to address endogeneity issues commonly found in panel data analysis. Practically, the findings are expected to inform regulators such as the Financial Services Authority (OJK) in enhancing supervision of Loan Loss Provisions (LLP), as well as to assist investors in using institutional ownership as a proxy for governance quality to mitigate potential value erosion.

LITERATURE REVIEW

The effect of earnings management on firm value

Agency theory explains that conflicts of interest between managers and shareholders arise from information asymmetry, which is particularly pronounced in the banking sector due to the

complexity and opacity of bank assets (Alexander, 2025; Suriawinata, 2023). In such conditions, managers possess greater discretion over financial reporting and may engage in opportunistic behavior to pursue personal incentives. One of the primary instruments used in this context is Loan Loss Provisions (LLP), which inherently involves subjective judgment in estimating future credit risk (Handriani & Anggara, 2025; Kanagaretnam et al., 2004). This subjectivity creates opportunities for managers to manipulate earnings through discretionary LLP.

From a theoretical perspective, earnings management increases information asymmetry and reduces the reliability of financial reporting, thereby increasing the perceived information risk for investors. When financial statements no longer reflect the firm's true economic performance, investors face uncertainty in evaluating firm fundamentals, leading to distorted market perceptions (Wibowo et al., 2025). In capital markets, such uncertainty is typically penalized through valuation discounts, as investors demand compensation for higher information risk and reduced transparency.

Empirical studies generally support this argument by showing that earnings management negatively affects firm value, as it signals lower earnings quality and weakens investor confidence (Eliwa et al., 2025; Jayanti & Wirama, 2025; Tulcanaza-Prieto & Lee, 2022). These findings suggest that investors are increasingly sensitive to the credibility of financial reporting and tend to interpret earnings management as an indicator of opportunistic behavior rather than efficient contracting. In the banking sector, where financial statements are already highly opaque, the presence of discretionary LLP further intensifies market skepticism. Consequently, earnings management not only reduces the informational value of reported earnings but also triggers negative market reactions, as reflected in declining stock prices and lower firm valuation. This indicates that market valuation is not only driven by reported earnings, but also by the perceived credibility of those earnings.

H₁: Earnings management has a negative effect on firm value.

The Moderating Role of Institutional Ownership

Institutional ownership serves as a key external monitoring mechanism, as institutional investors possess superior financial resources, analytical capabilities, and information access compared to individual investors (Eliwa et al., 2025). This advantage enables them to more effectively detect and monitor discretionary accruals, including earnings management practices conducted through LLP, thereby reducing the likelihood that such practices are driven purely by managerial opportunism.

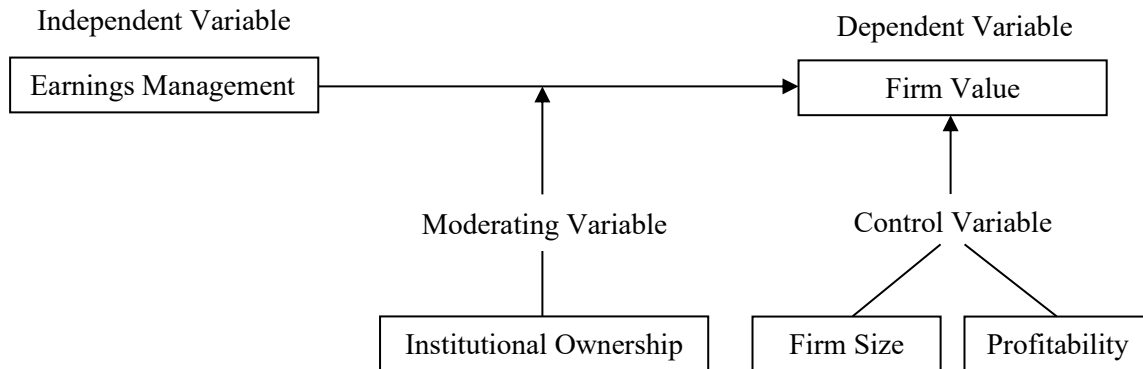
From an agency theory perspective, institutional ownership reduces information asymmetry by constraining managerial discretion and enhancing the credibility of financial reporting. Active monitoring by institutional investors creates pressure on managers to align their actions with shareholders' interests, thereby limiting opportunistic behavior

(Shiwa & Karina, 2023; Wilson et al., 2022). Consequently, institutional ownership not only serves as a monitoring mechanism but also shapes how the market interprets financial information, particularly in the presence of earnings management.

Empirical findings suggest that institutional ownership can mitigate the adverse effects of earnings management by strengthening governance quality and improving investor confidence (Eliwa et al., 2025; Jayanti & Wirama, 2025; Tulcanaza-Prieto & Lee, 2022). These findings indicate that market reactions to earnings management depend on the perceived effectiveness of monitoring mechanisms. In firms with high institutional ownership, earnings management is more likely to be interpreted as controlled managerial discretion under effective oversight, thereby reducing negative market responses. In contrast, in firms with low institutional ownership, similar practices are more likely to be perceived as opportunistic, leading to stronger valuation discounts.

However, this moderating role may be less effective in institutional environments characterized by weak legal enforcement and governance structures, which can limit the effectiveness of institutional monitoring. Thus, institutional ownership functions not only as a monitoring mechanism but also as a signal that reshapes investor interpretation of earnings quality.

H₂: Institutional ownership weakens the negative effect of earnings management on firm value.



RESEARCH METHOD

Research Design

This research is an explanatory (causal) quantitative study because it is designed to investigate the causal relationship between variables. Specifically, it aims to explain the negative impact of earnings management on firm value and test whether institutional ownership moderates this relationship within the Indonesian banking subsector.

Population and Sample

The population of this study comprises all companies in the banking subsector listed on the Indonesia Stock Exchange (IDX). The sampling strategy utilized is purposive sampling. The 2019-2023 observation period (5 years) was chosen because it encompasses significant economic dynamics, including the pre-pandemic, pandemic, and post-pandemic phases of economic recovery. This dynamic timeframe provides substantial variation in banking financial performance and earnings management practices, making it highly suitable for panel data estimation, particularly for analyzing how these factors have evolved across different economic phases, such as the pre-pandemic, pandemic, and post-pandemic periods. Based on the purposive criteria (e.g., consistently listed on the main board, no mergers/acquisitions, and transparent ownership structures), the final sample consists of 23 companies, yielding a total of 105 firm-year observations. This study includes 23 company issuers, selected based on the following sampling criteria:

Table 1. Research Sample Criteria

Criteria	Amount
Banking subsector companies listed on the Indonesia Stock Exchange (IDX) during the period 2019–2023	67
Banking subsector companies that are not listed on the main board of the Indonesia Stock Exchange (IDX) during the period 2019–2023	(37)
Banking subsector companies that underwent mergers or acquisitions during the period 2019–2023	(1)
Banking subsector companies that were newly listed on the IDX after January 1, 2019	(1)

Criteria	Amount
Banking subsector companies that openly disclose shareholder composition and ownership status during the period 2019–2023	(4)
Banking subsector companies consistently reported financial statement data during the period 2019–2023.	(1)
Number of company samples	23
Number of research years	5
Total amount	105

Data Collection, Processing, and Appropriateness

The data used are secondary, obtained from audited financial statements and annual reports available on the IDX website and the companies' official websites. These documents are reliable because the audited financial statements comply with the International Financial Reporting Standards (IFRS), ensuring high objectivity and minimizing reporting bias. Data collection is done manually in Excel. To ensure data quality during cleaning, companies with missing values were excluded from the sample. Furthermore, to address extreme outliers that could distort regression results, the continuous variables (such as LLP and Firm Value) were winsorized at the 1st and 99th percentiles.

Validity and Reliability

In quantitative secondary research, the reliability of the data is inherently supported by the independent auditor's certified financial reports. The validity of the measurement is ensured by employing well-established proxy variables widely recognized in prominent accounting literature. Furthermore, the validity and reliability of the statistical estimation are strictly evaluated using standard diagnostic tests specific to dynamic panel data. It is important to explicitly note that the classical normality test is deliberately excluded from this methodological framework. The Generalized Method of Moments (GMM) is inherently a distribution-free estimator that relies on moment conditions rather than density functions (Hall, 2005). Consequently, GMM estimators remain consistent and asymptotically normal regardless of whether the underlying error terms follow a normal distribution (Hall, 2005). Therefore, the diagnostic evaluations strictly focus on the Variance Inflation Factor (VIF) for multicollinearity, the Arellano-Bond test to assess the model's robustness to autocorrelation, and the Hansen J-test to validate the instrumental variables used in the estimation.

Variable Measurement

1. Dependent Variable (Firm Value): Measured using Tobin's Q, formulated as $(\text{Market Equity Value} + \text{Book Value of Total Debt}) / \text{Book Value of Total Equity}$ (Wijaya & Firmansyah, 2021).
2. Independent Variable (Earnings Management): Proxied by Discretionary Loan Loss Provisions (LLP). It is obtained by estimating the residuals from the specific banking LLP model developed by Abdelsalam et al. (2016); Kanagaretnam et al. (2004); Wijaya & Firmansyah (2021), which incorporates changes in non-performing loans and credit balances.
3. Moderating Variable (Institutional Ownership): Measured as the percentage of shares owned by institutions relative to total outstanding shares (Kusumayani & Suardana, 2017).
4. Control Variables: Firm Size, measured by the natural logarithm (Ln) of total assets (Efendi et al., 2022), and profitability, measured by Return on Assets (ROA) (Arwani et al., 2024).

Data Analysis Technique

The data analysis technique employed is the Generalized Method of Moments (GMM) panel data regression. Unlike Ordinary Least Squares (OLS), which assumes all independent variables are strictly exogenous, OLS yields biased and inconsistent estimates when applied to dynamic panel data. In corporate finance research, variables such as earnings management and firm value are often endogenous, particularly due to simultaneity (reverse causality). For instance, while earnings management affects firm value, a decline in firm value may, conversely, pressure managers to manipulate earnings to meet market expectations. GMM is specifically chosen over OLS because it effectively addresses endogeneity by using lagged values of the endogenous variables as internal instruments (Boonyanet et al., 2024). By using internal instrumental variables, GMM provides consistent and unbiased parameter estimates that standard regression techniques cannot achieve in dynamic corporate finance settings.

To test the hypotheses within this dynamic framework, the empirical model formulated for the GMM panel data regression is specified as follows:

$$FV_{it} = \alpha + \beta_1 FV_{it-1} + \beta_2 EM_{it} + \beta_3 IO_{it} + \beta_4 (EM_{it} \times IO_{it}) + \beta_5 FS_{it} + \beta_6 ROA_{it} + \epsilon_{it}$$

Where:

- FV_{it} = Firm Value for firm i in year t
- FV_{it-1} = Lagged Firm Value (firm value in the previous year, capturing the dynamic nature of the model)
- α = Constant
- β₁... β₆ = Regression coefficients
- EM_{it} = Earnings Management, proxied by discretionary Loan Loss Provisions
- IO_{it} = Institutional Ownership (Moderating variable)
- FS_{it} = Firm size (Control variable)
- ROA_{it} = Profitability (Control variable)
- ε_{it} = Error term

FINDINGS AND DISCUSSION

The descriptive statistics for each variable in this study are shown in Table 2 below.

Table 2. Descriptive Statistical Analysis

	EM	IO	ROA	FS	FV
Mean	0.27	87.10	17.39	18.10	1.57
Maximum	4.94	100	52.79	21.41	18.50
Minimum	-0.18	0.25	0.83	11.62	0.35
Std. Dev.	0.76	19.15	7.01	2.18	2.61

Table 2 presents the descriptive statistics of the variables used in this study. Firm value (FV) has an average of 1.57 with a relatively large standard deviation of 2.61, indicating substantial variation in market valuation among the sampled banking firms. Earnings management (EM), measured using loan loss provisions, has a mean of 0.27 with a wide range (-0.18 to 4.94), suggesting heterogeneity in earnings management practices across banks. Institutional ownership (IO) shows a high average of 87.10%, indicating that institutional investors dominate ownership structures in most sampled firms. Meanwhile, the control variables also exhibit variability within the sample. Firm size (FS) reflects differences in the scale of banking operations, while return on

assets (ROA) indicates varying levels of profitability among the observed firms.

Next, based on the results of the GMM method panel data regression, a summary of the results is obtained as shown in Table 3 below:

Table 3. Regression Results using the GMM method

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	5.417	2.774	1.95	0.03**
EM	-10.82	3.45	-3.14	0.00***
IO	0.003	0.013	0.29	0.38
ROA	-0.124	0.080	-1.54	0.06*
FS	-0.128	0.169	-0.76	0.23
EM*IO	0.136	0.044	3.10	0.01**
Wald Chi2		7018.12		
Prob > Chi2		0.0000		
AR(1) test (p-value)		0.362		
AR(2) test (p-value)		0.205		
Hansen test (p-value)		0.586		

Notes: Statistical significance is denoted as follows: *** at the 1% level, ** at the 5% level, and * at the 10% level.

To further evaluate the robustness and validity of the estimated model, several diagnostic tests were conducted and are summarized in Table 4.

Table 4. Diagnostic Tests Summary

Test	Result	Interpretation
Multicollinearity	VIF = 1.17	No multicollinearity detected
Normality	Not required in GMM	GMM estimators are consistent without a normality assumption
Heteroscedasticity	Robust GMM estimator used	Potential heteroscedasticity is handled by the estimator
Autocorrelation	AR(1) p = 0.362; AR(2) p = 0.586	No serial correlation detected
Instrument Validity	Hansen p = 0.586	Instruments are valid

The multicollinearity test indicates that the independent variables in the model do not exhibit serious multicollinearity. This is evidenced by the Variance Inflation Factor (VIF) value of 1.17, which is far below the commonly accepted threshold of 10. A low VIF value suggests that the explanatory variables are not highly correlated with each other, thereby allowing reliable estimation of the regression coefficients (Gujarati & Porter, 2009).

Unlike conventional regression models such as Ordinary Least Squares (OLS), the Generalized Method of Moments (GMM) does not require normally distributed error terms. GMM estimators rely on moment conditions derived from the theoretical model rather than strict distributional assumptions, allowing consistent parameter estimation even when the residuals are not normally distributed (Gujarati & Porter, 2009). In addition, the use of the robust GMM estimator

helps address potential heteroscedasticity in panel data, which is common in financial and accounting datasets (Boonyanet et al., 2024).

The overall regression model is statistically significant, as indicated by a Wald Chi-square value of 7018.12 and a p-value of 0.000. This result suggests that the independent variables jointly influence the dependent variable, namely, firm value. Furthermore, the Arellano-Bond test for autocorrelation shows that there is no evidence of first-order autocorrelation (AR(1), $p = 0.362$) or second-order autocorrelation (AR(2), $p = 0.586$). The absence of second-order autocorrelation is particularly important in dynamic panel models estimated using GMM, as it indicates that the lagged instruments are appropriate and that the model specification is valid.

In addition, the Hansen test for overidentifying restrictions yields a p-value of 0.586, which is greater than the 0.05 significance level. This finding shows that the GMM estimation instruments are valid and that the model is not overidentified. Therefore, the instrument set used in the estimation procedure can be considered reliable for explaining the relationship between earnings management, institutional ownership, and firm value.

It is also important to note that the coefficient of determination (R^2) is not reported in this study. In the context of GMM estimation, the R^2 statistic is generally not considered an appropriate indicator of model fit because the GMM estimation technique focuses on satisfying moment conditions rather than minimizing the residual sum of squares as in OLS regression (Gujarati & Porter, 2009). Consequently, studies employing GMM typically rely on diagnostic tests such as the Wald test, Arellano-Bond autocorrelation tests, and the Hansen test to assess the adequacy and validity of the estimated model.

The effect of earnings management on firm value

The regression result in Table 3 indicates that earnings management hurts firm value. This finding suggests that, in the market's view, discretionary provisioning is not a neutral accounting adjustment but rather a signal that materially alters investor expectations. From an economic perspective, the magnitude of this effect suggests that even incremental increases in discretionary LLP can trigger a substantial decline in market valuation, reflecting investors' high sensitivity to earnings quality in the banking sector.

From an agency theory perspective, this result reflects the fundamental conflict between managers and shareholders under conditions of information asymmetry. Managers may exploit their discretion over LLP to smooth earnings, meet regulatory thresholds, or achieve compensation-related targets (Haq, 2023). However, such actions introduce ambiguity regarding the true quality of bank assets, particularly in a sector where financial statements are inherently opaque. As a result, investors rationally interpret discretionary LLP as a potential indicator of hidden credit risk, such as unreported non-performing loans or deteriorating loan portfolios (Le & Dinh, 2025). This interpretation increases perceived information risk, leading investors to demand higher risk premiums, reduce their valuation expectations, and ultimately discount firm value (Bachtiar et al., 2025; Vatis et al., 2025). Thus, the negative relationship between earnings management and firm value is not merely a statistical association, but a reflection of how agency conflicts are priced in capital markets.

This finding aligns with prior studies demonstrating that earnings management reduces the credibility of financial reporting and lowers firm valuation (Eliwa et al., 2025; Jayanti & Wirama, 2025; Tulcanaza-Prieto & Lee, 2022). However, the literature also reveals important contradictions regarding the interpretation of LLP in banking contexts. While some studies emphasize the opportunistic use of discretionary LLP for earnings manipulation and regulatory arbitrage (Haq, 2023; Ozili, 2023; Putri et al., 2025), others argue that LLP may reflect prudent credit risk management, particularly in environments with strict regulatory oversight (Apergis, 2024; Guo et

al., 2024; Luu et al., 2023). This divergence suggests that market reactions to LLP are contingent upon the perceived intent behind managerial discretion. In emerging markets, where governance mechanisms and transparency are often less robust, discretionary LLP is more likely to be interpreted as opportunistic behavior rather than prudent risk management, thereby amplifying its negative impact on firm value.

The moderating role of institutional ownership for the effect of earnings management on firm value

The regression result indicates that institutional ownership weakens the negative effect of earnings management on firm value. This finding suggests that although earnings management is generally associated with valuation discounts, higher levels of institutional ownership reduce the extent to which investors penalize such practices. In this context, the presence of institutional investors enhances market confidence in managerial discretion, as institutional monitoring signals stronger governance and reduces concerns about opportunistic financial reporting, as also highlighted by Sing et al. (2025).

From an agency theory perspective, institutional investors function as effective monitoring mechanisms that mitigate managerial opportunism, as emphasized by Wilson et al. (2022). Compared to individual investors, institutional shareholders possess greater financial resources, analytical capabilities, and incentives to actively oversee managerial decisions, thereby strengthening corporate governance practices and improving oversight of financial reporting, as discussed by (Bagh et al., 2025; Nguyen et al., 2024). Beyond monitoring, high institutional ownership also serves as a certification mechanism in capital markets, enabling sophisticated investors to interpret complex accruals, such as discretionary loan loss provisions, and reducing the severe information asymmetry between insiders and external stakeholders.

This monitoring and certification role shapes how the market interprets earnings management. When investors observe substantial institutional backing, they perceive a lower risk of wealth expropriation by managers, as noted by Jha and Tiwari (2025). As a result, reported earnings, although subject to managerial discretion, are viewed as being under effective scrutiny and within acceptable bounds, rather than purely opportunistic. This reduces the perceived information risk associated with earnings management and limits the magnitude of valuation discounts. Conversely, in firms with weaker institutional ownership, similar practices are more likely to be interpreted as opportunistic behavior, leading to stronger negative market reactions.

This interpretation is supported by prior studies that emphasize the role of institutional investors in improving financial reporting quality and reducing agency problems. Eliwa et al. (2025) show that institutional monitoring enhances earnings quality and reduces information asymmetry, while Jayanti & Wirama (2025) provide evidence that institutional ownership can mitigate investor concerns regarding earnings manipulation. Similarly, Tulcanaza-Prieto & Lee (2022) highlight that strong governance mechanisms shape how the market responds to earnings management practices. However, the effectiveness of institutional monitoring is not universal. Bangun and Natsir (2025) argue that weak investor protection can limit institutional investors' ability to discipline managerial behavior, and Heling and Lastanti (2024) find that governance mechanisms may not always function effectively in certain institutional settings. In line with this, Karianga et al. (2022) emphasize that in environments with weak regulatory enforcement, institutional ownership may not fully mitigate opportunistic financial reporting practices.

The effect of firm size and profitability on firm value

The regression results indicate that firm size and profitability do not have a significant effect on firm value. This finding suggests that, within the banking sector, traditional financial

indicators such as scale and short-term profitability are not the primary determinants of market valuation. From an economic perspective, this implies that investors do not automatically assign a valuation premium to larger or more profitable banks, but instead condition their valuation decisions on other factors, particularly those related to risk and information quality.

The insignificant effect of firm size may be explained by the trade-off between scale advantages and complexity-related risks. While larger firms are generally expected to benefit from economies of scale, greater market power, and better access to capital, they also face higher operational complexity, stricter regulatory scrutiny, and increased monitoring costs. These factors can offset the expected positive impact of size on firm value, as they introduce additional uncertainty and reduce managerial flexibility (Chernobai et al., 2021). Consistent with this argument, Handini & Susilo (2025) and Maza et al. (2025) find that firm size does not necessarily translate into higher valuation, while Handayani et al. (2022) emphasize that investors tend to focus more on performance quality than on firm scale when making investment decisions.

Similarly, the insignificant effect of profitability reflects the limitations of accounting-based performance measures in capturing firm value, particularly in the banking sector. Profitability is highly sensitive to macroeconomic conditions, credit cycles, and regulatory requirements such as capital adequacy and provisioning policies, which may distort its ability to signal long-term value creation (Ozili, 2023). More importantly, in the presence of earnings management, profitability figures may lose their informational content. When investors suspect that reported earnings are influenced by discretionary accounting practices, such as loan loss provisions, they are less likely to rely on profitability as a credible indicator of firm performance. This behavior is consistent with the notion of market skepticism, where investors discount reported earnings when their credibility is questionable (Pandey et al., 2025). As a result, even high profitability does not necessarily lead to higher firm value if it is perceived as being driven by low-quality earnings.

Overall, these findings indicate that market participants place greater emphasis on the credibility of financial reporting and the effectiveness of governance mechanisms than on conventional financial metrics such as firm size and profitability. In this context, variables related to information quality and monitoring, such as earnings management and institutional ownership, become more relevant in explaining firm value. This also reinforces the main findings of this study, which highlight the central role of governance in shaping investor perception and market valuation in the banking sector.

CONCLUSIONS

This study aimed to examine the effect of earnings management on firm value and to investigate the moderating role of institutional ownership in the Indonesian banking sector. The empirical results indicate that earnings management, proxied by loan loss provisions, has a negative and significant effect on firm value. This finding indicates that investors tend to respond negatively to indications of earnings manipulation, as such practices reduce the credibility and transparency of financial reporting.

The findings substantiate agency theory, which posits that managerial discretion in financial reporting may increase agency costs and diminish market valuation. The results also indicate that institutional ownership moderates the relationship between earnings management and firm value by weakening the negative impact of earnings management. This highlights the role of institutional investors as an effective monitoring mechanism that can reduce managerial opportunism and improve oversight within the corporate governance structure.

This study contributes to the literature by providing empirical evidence from an emerging market context, particularly Indonesia, where institutional investors may play an important role in strengthening corporate governance practices. The findings imply that stronger institutional

monitoring can help mitigate the adverse effects of earnings management and support greater confidence in financial reporting and firm value in the banking sector.

LIMITATION & FURTHER RESEARCH

This study has several limitations that should be acknowledged. First, the sample is limited to banking sector companies listed on the main board of the Indonesia Stock Exchange, which may limit the generalizability of the findings to other sectors or market segments. Second, the observation period covers only five years, which may not fully capture longer-term variations in earnings management practices and firm value dynamics. Third, earnings management in this study is proxied solely by loan loss provisions (LLP), which may not fully represent all forms of managerial discretion in financial reporting within the banking industry. Future studies may incorporate alternative proxies of earnings management or additional governance variables to obtain a more comprehensive understanding of managerial behavior and its impact on firm value.

Further research could extend this analysis by examining additional sectors, lengthening the observation period, or conducting cross-country comparisons to explore whether the moderating role of institutional ownership varies across different regulatory and governance environments. Such approaches may provide deeper insights into the relationships among earnings management, corporate governance, and firm value across diverse institutional contexts.

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