CASH FLOW ACTIVITIES AND STOCK RETURNS IN MANUFACTURING OF INDONESIA: A MODERATING ROLE OF EARNING MANAGEMENT

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ABSTRACT

The research objective was to analysis the effect of earning management as a moderator in relation between cash flow activities towards stock returns. The purposive sampling technique is used to obtain 204 samples of manufacturing company in 2012-2016. The statistical methods in this research using multiple regression analysis. The results of this study show that operational and financial cash flow take positive effect on stock returns, investment cash flow take negative effect on stock returns. Furthermore, earning management is able to strengthen the relationship between operational and financial cash flow towards stock returns. However, earning management is unable to strengthen the relationship between investment cash flow and stock returns.

Keywords: Cash Flow Activity, Earning Management, Stock Returns.

INTRODUCTION

Cash flow statement is one of the sources of information that become the concern of investors when they want to invest their capital. Cash flow statement is made to report the cash receipt and cash disbursement during one period. It sourced from operational activities, investment activities and financial activities. Financial Accounting Standard Boards (FASB) obliges every company to report their cash flow statement through Pernyataan Standar Akuntansi Keuangan (PSAK) No. 95 to alternate the report on changes in financial position. International Accounting Standard Committee (IASC) regulates every company to provide cash flow report in inclusion of financial statements. This regulation obliges companies to report cash flow statements in a certain period and classified by operational activities, investment activities and financial activities.

The Fawzi (2015) and Collins (2014) research results, showed a significant relationship between cash flows from operational activities on stock returns. The research about the relation of cash flow from investment activity to stock returns conducted by Kroes and Manikas (2014) proves that there is a significant relationship between cash flow from investment activity to stock returns. While Collins's (2014) research shows a significant relationship between cash flow from financial activities to stock returns. This is contrary to the results of research conducted by Shi (2014) that cash flow from financial activity is not related to stock returns.

Kormedi and Lipe (1987) examined the relationship between earnings innovation and stock returns. The results showed that the magnitude of the reaction of stock returns on earnings should be associated with the effect of earnings innovation on expectations of future benefits earned by shareholders. So it can be concluded that the magnitude of the relationship between stock returns and earnings depends on the persistence of a company's earnings. Solechan (2007) in his research, that there is no effect between accrual discretionary to stock returns. But Bazrafshan (2016) explains that companies that performing earning management with opportunistic goals for the short term will increase the value of the company and get a positive return.

By seeing the inconsistent results of our research, encourage us to conduct further research about the activities found in the cash flow statement to evaluate company performance and show the revenue earned under the presence of incoming and outgoing cash transactions, and also by adding earning management as a moderating variables which strengthen or weaken the relationship between cash flow activity and stock returns. Based on the background explained above, then the problem that will be discussed in this research is about: (1) what is the effect of operational cash flow, investment cash flows and financial cash flow to stock returns, and (2) what is the effect of earning management as a moderating variable on the relation of cash flow activity to stock returns?.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Signaling Theory

The signaling theory shows how companies signal financial statements' user. This signal is information about what has been done by the management to realize what the user want, such signals may be a promotions or other information that states that the company is better than other companies. According to Wolk et al. (2001) the signal theory shows the existence of information asymmetry between the company management and the parties which concerned with the information. Managers provide information through financial statements, that they apply a conservative accounting policy that results in higher returns. If the profit information presented is real (positive) information, it will provide a positive signal also for users of financial statements.

Cash Flow

Cash flow statements is the basic financial statements which reporting the cash received and its changes of cash generated from operating, investments and financing assets of a business during a specified period. According to PSAK No.2, the definition of a cash flow statement is a statement that provides historical information about changes in cash and cash equivalents of a company through a cash flow statement that classifies cash flows on the basis of operating activities, investment activities, and financing activities during an accounting period. Cash flow statements are considered providing a lot of information about the company's ability to gain profit and liquidity in the future. The cash flow statement provides relevant information about cash receipts and disbursements of a company for a certain period, classifying transactions based on operating, financing and investment activities (Fawzi et al., 2015).

Earning Management

Earnings management is opportunist behaviour of the managers in the process of preparing external financial reporting so as to increase or decrease accounting earnings in accordance with their interests to gain some advantage for the interests of individuals. Wang et al. (2014) explains that earning management occurs when the managers use several considerations in arranging financial statements and establish certain transactions to alter financial statements in order to manipulate the amount of earnings to some stakeholders about the underlying economic performance of the company, or to influence the outcome of a dependent agreement on accounting figures reported. Earning management can be done by utilizing the leniency in using accounting methods and procedures, creating accounting policies, and accelerating or delaying costs and revenues to make the company's profit smaller or larger than it should be.

Stock Returns

According to Tan et al. (2012) stock returns is the return earned from the investment that has happened (actual return) and has expected (expected return). Return investment is the main objective for investors in investing their capital. Stock investment provides benefits in two ways. First, sell stocks until prices rise, it commonly called capital gains. Second, awaiting dividends that are part of the company's earnings distributed to shareholders. According to Joegiyanto (1998) return enjoyed by investors of an investment they did. Without the profit that can be enjoyed from an investment, of course investors will not make an investment. Thus, any short-term and long-term investments have the primary goal of obtaining benefits called direct or indirect returns.

HYPOTHESIS

Operational Cash Flow on Stock Returns

Operational activities come from transactions and other events affecting the determination of net profit or loss. If the operational activities are good, then the company will have the remaining cash used to support the next operation, especially operations sourced from transactions and other events affecting the determination of net profit or loss and determining whether the operations of the company can generate sufficient cash to repay the loan, maintaining the operational ability of the company, pay dividends and make new investments without relying on external sources of funding. This will provide a positive signal for investors; this is proven from the increase in stock prices which are directly related to the received return. The Fawzi (2015) and Collins (2014) research result shows that there is significant influence between operational cash flow and stock returns.

H_1: The higher the operational cash flow of the company, the greater the value of stock returns.

Investment Cash Flow on Stock Returns

Cash flows from investment activities occur when cash is received from returns or returns on investments which made previously. This is a positive signal for investors to invest in the company. So that stock prices will increase in line with the increase in trading volume that will result directly to stock returns. Investment activity reflects cash expenditures in connection with the resources aimed to generate revenues and future cash flows, as well as lending activities and collecting these receivables as well as obtaining and selling long-term productive investments and assets. This investment cash flow provides a positive signal for investors that enable the company to invest and ultimately can increase the value of the company. Companies with good

Performance will be able to maximize the company's profit to improve the welfare of shareholders, so it can attract investors to make investments that will lead to rising stock prices and rising stock returns. Kroes and Manikas (2014) states that there is an influence between investment cash flows on stock returns.

H_2: The higher the investment cash flow of the company, the greater the value of stock returns.

Financial Cash Flow Activities on Stock Returns

Funding activities can lead to changes in the amount and composition of equity and corporate loans, one of which is the issuance of debt of bonds or cash. The cash earned then used as a source of funding to run its business and to benefit the shareholders (Francis, 2013). In addition, signaling theory explains that the market will react negatively to funding activities that are closely related to the expected return of stocks. The results of a research conducted by Collins (2014) indicate the relationship between provided information of financial cash flow to stock performance.

H_3: The higher the financial cash flow of the company, the greater the value of stock returns.

Operational Cash Flow with Earning Management on Stock Returns

The liquidity ability is highly concerned by the owners of related companies in the financing of short-term debt which considered very profitable for the company. The companies that want to get a positive value from the market will determine the amount of funds earned that can be an incentive for managers to create attractive prospectuses. The lack of information available to investors raises the encouragement and motivation of management to report beneficial information on financial statements to manage reported profit. Opportunistic behaviour becomes a powerful driver in doing earning management. Investor as the owner of the company wants a return on investment in the form of stock returns. On the other hand, managers always want a bonus from the owners for their performance. Various attempts are made by managers to make financial statements look good to attract investors so that managers will get the bonus is through earning management.

Test results by Ball and Brown (1968) concluded that the increase or decrease in the annual earnings of a company followed by an increase or decrease in stock prices. This is similar by the results of Bazrafshan (2016) which states that the company's efforts to provide a positive signal to the market about the company they manage, so that the increase in profit indicates the opportunistic attitude of management to raise the price of the shares they offer.

H_4: Earning management is able to moderate the relationship between operating cash flows and stock returns.

Investment Cash Flow with Earning Management on Stock Returns

Cash flows from investment activities reflect cash receipts and disbursements in relation to resources aimed to general revenues and future cash flows. The research results of Kroes and Manikas (2014) explain that investment cash flow has a significant relationship to stock returns.

The higher the investment cash flow will increase the stock returns of the company. Enomoto (2015) also states about the effect of earnings management on stock returns. However Solechan (2007) shows that cash flow has no significant effect on stock returns.

$H_{5:}$ Earning management is able to moderate the relationship between Investment cash flows and stock returns

Financial Cash Flow with Earning Management on Stock Returns

The research conducted by Collins (2014) states that the financial cash flow has a significant effect on stock returns and be able to mediate the relationship between financial cash flow with stock returns. Thus, the higher the financial cash flow indicates that the company has an increase in its funding, thus making a higher profit correction as well, and this will affect the increasing company's stock returns as well. Opportunistic behaviour becomes a powerful driver in doing earning management. Investor as the owner of the company wants a return on investment in the form of stock returns. On the other hand, managers always want a bonus from the owners for their performance. Various attempts are made by managers to make financial statements look good to attract investors so that managers will get the bonus is through earning management. Solechan (2007) research states that earning management will positively affect the initial value of the company. The high corporate value at the beginning will possibly for the investors to get a positive return. Companies with high financial cash flows allegedly carrying out earning management because they will reflect the company's condition which is getting closer to the violation of debt contract and will also provide bad news or negative signal for investors, So that the management makes policies that can increase revenue and be able to influence investor's decisions to invest.

$H_{6:}$ Earning management is able to moderate the relationship between financial cash flows and stock returns.

METHODS

Populations and Samples

The population used in this study is a company listed on the Indonesian Stock Exchange. The sampling technique is done through purposive sampling method; with criteria:

1. The companies issued audited financial statements during the period 2012-2016.
2. Having financial statements with rupiah currency.
3. The company has complete data on the variables needed in the research.

The data used is in the form of financial statements of manufacturing companies that have been audited during the study period 2012-2016 (Table 1).

Table 1
RESEARCH SAMPLE

Criteria	2012	2013	2014	2015	2016	Total Sample
All manufacturing companies are listed in BEI						692
Financial report could not be found	(38)	(10)	(19)	(21)	(21)	(109)
Does not have rupiah currency	(5)	(10)	(11)	(21)	(24)	(71)

Table 1
RESEARCH SAMPLE

Do not have data on earning management variables	(4)	(5)	(3)	(2)	(0)	(14)
Do not have data on variable of financial	(4)	(3)	(4)	(4)	(7)	(22)
Do not have data on variable of investment cash flow activity	(1)	(1)	(2)	(2)	(0)	(6)
Do not have complete stock price data	(4)	(3)	(0)	(0)	(0)	(7)
Total sample	83	103	100	88	89	463
Earning Management Outlier						(10)
Total Sample After Earning Management Outlier						453
Outlier analysis of research data						(249)
Total Sample						**204**

Source: IDX, 2018

Definition and Measurement of Research Variables

1. Stock Return is the rate of return or return of an investment received by the investor. Stock returns is a variable that arises from changes in stock prices as a result of market reaction due to the delivery of financial information of an entity in the capital market. The return used in this research is stock returns at end of period.
2. Cash Flow from Operational Activity arising from each activity in the total cash flows in the cash flow statement.
3. Cash Flow from Investment Activity arising from each activity in the total cash flows in the cash flow statement.
4. Cash Flow from Financial Activity arising from each activity in the total cash flows in the cash flow statement.
5. Earning management (DACC) can be measured through discretionary accruals calculated by disposing total accruals (TACC) and nondiscretionary accruals (NDACC). This study uses absolute discretionary accruals (because it is not referring the income increasing and income decreasing) with the following steps:
    1. Calculates total actual accruals:

$$TAC_{it}=Nl_{it}–CFO_{it}$$

    2. Calculates nondiscretionary accruals:

$$NDTAC_{it}=\beta 1\ (1/Ta_{it}\text{-}1)+\beta 2(\Delta Sales/Ta_{it}\text{-}1)+\beta 3(PPE/Ta_{it}\text{-}1)+e$$

    3. Calculates discretionary accruals:

$$DTAC_{it}=TAC_{it}/Ta_{it}\text{-}1–NDTAC_{it}$$

RESULT AND DISCUSSION

Table 2
DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation
AKO	204	-7.93	9.07	0.4276	2.29072
AKI	204	-9.85	8.22	-0.6807	2.07472
AKP	204	-8.28	9.22	0.1578	2.15133
RS	204	-23	0.72	0.1270	0.17657
DA	204	0.003	2.79	0.2742	0.30287
Valid N (list wise)	204	-	-	-	-

Source: Processed secondary data, 2018.

The minimum value change in operational cash flows to -7.93 indicates that the lowest change in operational cash flow decreased by 793% from the previous period. The average manufacturing company experienced an increase in operational cash flow by 42.76% from the previous period. The results of descriptive analysis can be seen the minimum value of investment cash flows of -9.85. The average manufacturing company experienced a decrease in investment cash flow of 68.07% from the previous period. The minimum financial cash flows of research indicates that the change in financial cash flows decreased by 828% from the previous period. The average manufacturing company experienced an increase in financial cash flow of 15.78% from the previous period. Stock returns also decreased by 23% from previous stock price. The average value of 0.1270 means that the average manufacturer gives a stock returns of 12.70% of the stock price in previous period. While the average manufacturing company that performs earning management of 0.2742 (Tables 2 & 3).

DISCUSSION

Table 3
HYPOTHESIS TESTING RESULT

		Unstandardized Coefficients		Standardized Coefficients		
Model 1		**β**	**Std. Error**	**β**	**T**	**Sig.**
	(Constant)	0.081	0.015	-	5.340	0.000
	AKO	0.027	0.005	0.354	5.534	0.000
	AKI	-0.010	0.006	-0.119	-1.762	0.080
	AKP	0.020	0.006	0.250	3.661	0.000
	DA	0.088	0.041	-0.241	-2.169	0.033
	AKO*DA	0.080	0.031	0.310	2.573	0.012
	AKI*DA	-0.009	0.016	-0.067	-0.593	0.555
	AKP*DA	0.063	0.028	0.287	2.338	0.022

Source: Processed secondary data, 2018.

Table 4
REGRESSION RESULT

Variable	**Dependent**	**RS**	**Conclusion**
	Coefficient	**P-Value**	
Constant	0.081	0.000	
AKO	0.027	0.000	Accepted
AKI	-0.010	0.080***	Rejected
AKP	0.020	0.000	Accepted
DA	0.088	0.033	
AKO*DA	0.080	0.012	Accepted
AKI*DA	-0.009	0.555***	Rejected
AKP*DA	0.063	0.022	Accepted
F	11.998		
R^2 Adjusted	0.208		

***Significance >10%.
Source: Processed secondary data, 2018.

The Table 4 states that the F value count of 11.998 with a significance value of 0.000 (smaller than 0.05) indicates that the regression model can be used to predict stock returns because the value of significance is smaller than the specified significance value of 0.05. For adjusted r-square value of 0.208, it means that 20.8% of stock returns variables can be explained by operational cash flow, investment cash flow, and financial cash flows as independent variables. The rest is explained by other factors outside the research model.

Based on *H1* test results, the value of the regression coefficient of variable cash flows from operational activities of 0.027. This means that operational cash flow has a positive effect on stock returns, so if the operational cash flow increased by 1 unit then the stock returns will increase by 0.027 units with the assumption of other independent variables are constant. The t value count of 5.534 with a significance value of 0.000, whose value is significant at level 1%, means that the cash flow variable from operational activities has a positive and significant effect on stock returns. Therefore, *H1* is accepted.

H2 is rejected because the t value count equal to -0.010 with a significance value of 0.080 (>0.10), it means that the cash flow variable from investment activity has a negative effect on stock returns. So, if the operational cash flow increased by 1 unit then the stock returns will increase by 0.010 units with the assumption of other independent variables are constant. This study uses a sample of large companies in manufacturing companies based on the size of the company with total assets. Investors are advised to make a decision to invest in medium-sized companies or startups that are now in Indonesia successfully gain huge profits. Thus, the results of this study further encourage the realization of investments from small and medium-sized companies. In Indonesia supports innovative local companies. The principle of an investment is that when it produces high profits, the risk is also high. Conversely, when investing with not too large profits, the risks faced are also very low. Indonesia is the fourth country in the world with the largest population, and is the largest economic power in Southeast Asia. The good news for investors seeking opportunities is that Indonesia has not been flooded with capital for small and medium-sized companies.

While *H3* accepted because the value of the regression coefficient of variable cash flow from financial activities of 0.020 indicating that the financial cash flow has positive effect on stock returns. So, if the operational cash flow increased by 1 unit then the stock returns will increase by 0.020 units with the assumption of other independent variables are constant. For *H4* test, it is found that operational cash flow with earning management has regression coefficient equal to 0.080 with t value count equal to 2.573 and its significance value equal to 0.012 so it said the result is significant because less than level 0.05. The regression coefficient has positive result, it means that earning management be able to strengthen the relation between cash flow component from operational activity to stock returns. Thus, operational cash flow has a positive effect on stock returns with earning management as moderation variable, empirically supported or *H4* accepted. The presence or absence of earning management in a company will be followed by an increase and decrease in changes in operational cash flows and stock prices which then affect the amount of stock returns. The result of this study shows that the company's earning management is able to mediate the relationship between operational cash flow to stock returns.

The variable of investment cash flow with earning management has a regression coefficient of -0.009 with t value count of -0.593 and its significance value of 0.555 so the result is not significant (>0.10). This causes *H5* rejected. High or low cash issued by the company for investment activity is not determined by the weakness of earning management, so in this study earning management cannot mediate the relationship between cash flow from investment activity to stock returns. In financial cash flow with earning management has a regression coefficient of 0.063 with t value count of 2.338, and its significance value of 0.022 so the result is significant because less than the 0.05 level. The regression coefficient has a positive result, thus indicating that earning management is able to strengthen the relationship between financial cash flow and stock returns. This makes *H6* acceptable.

An increase in the financial cash flow and earning management will make investors use financial cash flow and earning management as information in making investment decisions. The number of investors, who invest in the company, will affect the stock price of the company which gives effects on the return of shares to be obtained by the investors. These results indicate that earning management be able to mediate the relationship between cash flow from financial activities to stock returns.

CONCLUSION

Based on the results of the analysis, it can be concluded that operational cash flow has a positive effect on stock returns, while investment cash flows have a no effect on stock returns. Investors are advised to make a decision to invest in medium-sized companies or start up that are now in Indonesia successfully gain huge profits. In addition, earning management is able to strengthen the relationship of operational and financial cash flows to stock returns, but earnings management is unable to strengthen the relationship between investment cash flow to stock returns. It is expected to be used in stock returns with earning management as a moderating variable in other industries outside the manufacturing industry. In addition, in the next research can be added years of observation so that it can help decision-making for a long-term investment. For investors who want to invest in a company, investors should not only analysis the company but also pay attention to economic conditions. If economic conditions decline, investors should be careful to choose a company that can continue to operate even though economic conditions are declining. In next research, the researcher should expand the year of observation so that the research results can be used to improve the accuracy of accounting. Reports there are still many variations of disclosure by the sample companies are not covered in the list of items this study and add variables and conduct research on other sectors.

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