



# The Effect of Capital Structure, Information Asymmetry, and Free Cash Flow on Earnings Quality

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## ABSTRACT

This study analyzes the effect of capital structure, information asymmetry, and free cash flow on earnings quality. Capital structure is measured by the debt ratio, information asymmetry is proxy by the measure of liquidity, and free cash flow is measured by the FCF ratio. The hypothesis in this study is that capital structure affects earnings quality, information asymmetry affects earnings quality, and free cash flow affects earnings quality, and simultaneously influences the capital structure, information asymmetry, and free cash flow on earnings quality. The sample in this study is Consumer Non-Cyclicals listed on the Indonesia Stock Exchange which publishes financial reports consecutively for the 2017-2021 period. Determination of the sample in this study using the purposive sampling method. The analytical method used is multiple linear regression analysis using eviews software. The results of this study indicate that capital structure has no effect on earnings quality, information asymmetry has no effect on earnings quality, free cash flow has effect on earnings quality but capital structure, information asymmetry, and free cash flow simultaneously have an effect on earnings quality.

**Keywords:** Capital Structure, Information Asymmetry, Free Cash Flow, Earnings Quality, Consumer Non-Cyclicals

## 1. INTRODUCTION

Moment a company make decision as well predict conditions of the company in the future, requires the role of internal accounting process and serve data in a manner accurate as shape report accountability to *stakeholders*. This information is provided by company in the form of an *annual report* (Nugrahani & Retnani, 2019). Wrong one of several indicators urgent which can be utilized for evaluate an accurate company value, namely earnings quality (Machdar et al., 2017). Earnings with high quality are earnings that have the ability to predict future income (balls & Shivakumar, 2005). Information related to company performance which affects the uptake of decisions are given more than high quality earnings [7].

Companies that have high profits steal the attention of investors to invest, because it will have an effect on profit

growth in subsequent years. Yet this is often the cause that managers do earnings management practice (Nugrahani & Retnani, 2019). *Earnings management* is shape manipulation report finance company, that is report finance which intended to communicate between company management and external parties of the company and done by company managers (agents). Thing the causing report finance specifically on part profit company Becomes not enough quality and will affect investors when take decision investment. in fact, profit quality is profit published without any earnings management in the information distributed by company (Utami & Kartikasari, 2020).

Separation between managers as corporate agents and shareholders share which role as principal create clash. Manager usually trying to exploit their personal interests do not even hesitate to sacrificing the holder shares (Alhadab

& Own, 2017). There are interests different between investors (external parties) as well as company management (internal parties) creates agency conflict or also called agency conflict. Agency conflict originates from agency theory which based on motivation from each party, good agent or principal for fulfil interest each. Agent role as holder of all important company information and know the conditions company. By because that, interest party agent the could affect the principal so as to cause information asymmetry or also called information asymmetric for hide various information i urgent which there is in company whereas principal l no know it. (Nugrahani & Retnani, 2019).

Many factors can influence the quality of earnings. The capital structure is one of them, which is the source of funds for run the operational activities of the company [17]. Researchers have investigated the relationship between earnings quality and capital structure. Research by Nizar & Kiswanto (2022) found that structure capital no there is influence on quality profit whereas results study Ahmad & Alrabba (2017), capital structure has an influence on quality profit. Level small size company debt greatly affects quality profit (Hasna & Aris, 2022). Companies with private equity holdings those who are higher tend to do earnings management (Ahmad & Alrabba, 2017). Meanwhile, according to Chung (2005), a greater opportunity to carry out earnings management occurs in companies that have high free cash flow, this is because the agency problems faced by companies are indicated to be greater.

## 2. THEORETICAL BACKGROUND

Theory agency have assumption that every individual have imotivated by personal interests this creates a conflict of interest between principals as well as agents. Due to conflict which arise this, will bring forth information asymmetry financial reports that accepted by agents and principals. Morally, managers as agents have responsibilities answer in optimizing as well as maximizing profit from principal. However, a manager own interest also to maximize its own profit. Therefore, great the odds that a agent no always Act by the best interests of the principal so as to raise *agency problems* or problem agency (Andian, 2019).

Origin from theory agency ( *agency theory*) first time sparked in United States of America, to be exact in the year of 1976 by Jensen and Meckling. The theory is defined as a contract or agreement that where principal assign or

employ agent (manager) which given a number of authority taking decision for do profession on name they (principal) (Jensen & meckling, 1976).

Eisenhardt (1989) in his research explains agency theory based on the 3 basic characteristics possessed by humans, first, *self-interest* , which means basically human only cares about himself itself, secondly, the bounded *rationality* own meaning intellect man about future perceptions limited , and third, risk *averse* always avoid risk (Rahayu, 2022). Agent owns not quite enough answer for maximizing profit or profit from the owner of the company (shareholders), but in other side agent also own his own interests for maximize it welfare. With thus, any indication that agents do not always do his job only for principal (Jensen & meckling, 1976).

The last few decades, quality profit being the thing to be important concern for the company, because many companies compete with one each other from various industries using financial conditions as well income company with reason user report finance could interesting some conclusions about viability long term life company and the potential for produce profit in the future (Alqamet al., 2022). Quality profit is very dependent with relevance from information i decided. The definition of earnings quality itself has 3 aspects, namely, quality profit is decided in the context of a particular model. Next, a report of the numbers profit is an indication for assessing the quality of the profit generated, it depends on informative about performance finance resulting from by company [7]. In counting quality profit for produce numbers that can be an indication of quality profit could using the formula operating cash flow of a company divided by profit clean which generated in period certain (Sumertiasih & Yes sa, 2022).

Some research show that the current profit stream will be continues in the future with quality profit (Sofian et al., 2022). Investors use financial reports to evaluate investment them and predict future earnings (Chen et al., 2022). Investors and parties other which interested with financial statements very care with quality corporate profits. Income with a strong ability to forecasting future earnings qualifies as "qualified tall" (Abed et al., 2022).

Basically if quality income tall investors love it, because of the results the in period future tend will repeated and naturally provide more returns for investors such as for example dividends. That way, changes with high quality earnings are likely to befollowed with price share which also tall. Otherwise, entity which report income with

quality more low will not pull investors, so stock prices are lower (AccountingTools, 2022). Better earnings quality is also referred to as "earnings fidelity". information which inevitable for investment decision, which give profitable return on investment. On the other hand, poor earnings quality signify integrity problem and credibility reported earnings, and investors bear the risk of investment returns that do not match expectations (Alqam et al., 2022).

According to Subramanyam & Wild (2017) capital structure is a equity as well as liabilities used by the company to fund activity so that can walk. In the corporate world, the concept of structure Capital is an economic concept. Capital structure means the relative share of debt and equity financing which is determined based on several tangible things and intangible facts (Shoaib & Siddiqui, 2020). If an asset company more heavily funded by debt from the capital owned by her so role from investors will decrease, so that Thing the very affect level quality profit (Marliana et al., 2017).

When the capital structure is optimal, the marginal benefits of debt are the same with cost marginal debt, which lead on maximization performance company (Shoaib & Siddiqui, 2020). This capital structure aims to blend in a manner permanent source fund which could used n company so that it can maximize company *value* (Andian, 2019). According to the optimal capital structure argument, public companies tend to adapt ratio debt going to level equilibrium for maximizing firm value and also minimizing the cost of capital (Li et al., 2020).

If company own structure capital which big, Thing that indicates a bad condition that occurred in the company, because of their own capital which which owned company more a little used for yes i asset company rather than debt, so that resulted happening worst case scenario, that is, the company cannot afford or fails to pay for it pay off his debts. When this happens, then the trust that has built by investors will decrease so that own influence to *earnings quality* which generated (W. Sari & Wiyanto, 2022).

The main friction that can occur in the company can be caused by information asymmetry, which is the root of the agency problem (Jensen and Meckling 1976). Asymmetry information appear when information no evenly distributed between the parties which is involved in transactions market (Camison et al., 2022). According to Myers and Majluf (1984), asymmetry i information happen when a manager more know income current companies and investment opportunities in the future than investors outside. in

addition, he acts in the interests of the company's shareholders existing (Hidayat et al., 2020). Assumptions that can be interpreted as information asymmetry is if the manager finds a good investment opportunity (present value high net). they can't deliver information the to outside investors. However, outside investors don't believe it though manager very want to inform which project Good for raise n their share price. Based on the structural model reduced micro market n by Easley et al. (2002), difference cross information investors produce information asymmetry. Informed traders store personal information, buy if they accept good news, and sell if they accept news bad (Ye et al., 2022).

Information asymmetry has an influence on earnings quality performance company, where the lower the quality the lower the profit stock liquidity in the capital market, this is due to the risk of adverse *selection* embodied in charge trading can increase, if investors own different views in processing related information profit, then quality that profit bad can produce information which different for investors and with thus exacerbate asymmetry information in financial markets (Machdar et al., 2017). Based on previous research (Akker, 2017; Barth et al., 2016), company information asymmetry is assessed by level liquidity share in exchange use method bid-ask spreads. Bid-ask the spread is determined by calculating the difference the average between the bid price and ask price for every share of the company within a certain period (Weli & Betseda, 2021).

Cash is part of the current assets of a company that is easily manipulated (Christabel & Bangun, 2020). Free cash flow or in Bahasa England known *as free cash flow* in the company is source of conflict between managers and shareholders or others known with conflict agency (Yes sa, 2020). Jensen (1986) manifests *free cash flow* in a company as remainder from cash flow on funding projects that generate *positive Net Present Value* as well as at the relevant discounted cost of capital rate (Basyirun, 2018). While Brigham and Houston (2006) define it as a current that cash owned by company for operate and maintain n ongoing company operations and distribution of dividends to para investors (Nugrahani & Retnani, 2019).

If *free cash flow* company big so ability company endure in circumstances bad also will be more tall Thing that indicates the company is healthy (Christabel & Wake up, 2020). *Free cash the existing flow* in a company will affect action and also decisions taken by managers, this gives investors an overview magnitude dividend which will shared, no only

how to get around i market with the aim of increasing corporate *values* (Kodriyah & Fitri, 2017).

It will affect quality company profit, whereas if a company has good cash flow it will go hand in hand with results quality profit which also good (Ms et al., 2021).

### 3. METHODS AND DATA

Based on background behind the problem served \_ previously by writer complete with formula, purpose as well as framework thinking study., hence the author formulate hypothesis about "Influence Capital Structure, Asymmetry Information, and *Free Cash Flow* on Earnings Quality" as following.

#### **The Influence of Capital Structure on Earnings Quality**

For companies, capital structure is an important issue, this is due to the good and bad conditions of the company's capital structure influential directly on its financial position (Hakim & Naelufar, 2020). state of the structure the capital (*capital structure*) . big signifies company in that state not enough good or bad with thus capital structure has a big influence on the company, especially on the quality of earnings which generated (W. Sari & Wiyanto, 2022). Previously, para researcher has do study about influence structure capital to quality profit. As Nizar and Kiswanto (2022) and [17] who obtained capital structure results has no effect on earnings quality. However, Judge is different and Naelufar (2020), Hasna and Aris (2022), Ahmad and Alrabba (2017) who obtain results that structure capital impact to earnings quality.

From the research results which different , researcher want to research i also how the influence of the capital structure itself on earnings quality generated by the company to convince from the research results already available. Based on theory and research earlier which has been explained n on, so writer formulate hypothesis as following:

**H<sub>1</sub> : Structure Capital has an influence on earnings quality.**

#### **The Influence of Information Asymmetry to Earnings Quality**

Companies that have a high level of free cash flow too will face problem agency which could causing manager the more motivated for do management profit (Sustain et al., 2020).

Disclosure accounting information company, related with accounting professionals and is very important for the decision-making process for company managers (Almeida et al., 2020). But unfortunately sometimes quality questionable information , due to information asymmetry. Akerlof (1970) explain that asymmetry information related with incompatibility of information between one party and another party in a connection which related with agency theory, where when one party obtain more or better information than others, then they will be involved with the interest or activity selfish alone (Things et al., 2021).

Before this research was carried out, the researchers had conducting research with varying results related to earnings quality influenced by the asymmetry information. Sari (2020) and Widjayant i (2018), in his research obtain results asymmetry information no influence earnings quality , results the different with results researcher ian who has conducted by Machdar et al. (2017), Fera and Zalzillo (2021), as well

Hasna and Harris (2022) which prove that quality profit could influenced by exists asymmetry information.

From the research results which different , researcher want to research i also how the influence of the information asymmetry itself on quality profit which generated by company for convincing of results study which already there is. Based theory as well as study earlier which already explained on, so writer formulate hypothesis as following:

**H<sub>2</sub> : Asymmetry Information has an influence on earnings quality.**

#### **The Influence of *Free Cash flow* on Earnings Quality**

Free cash flow is cash flow created from activities operation less operating costs and capital expenditures for business development (Nona et al., 2021). If the free cash flow is higher available at the company then it indicates the company is in good health, because it has good cash available to continue to grow the company, pay off its debts, and also pay dividend on para investors company (Yes sa, 2020).

Previous researchers have used free cash flow as variable independent in study as well as earnings quality as el variable dependent. From the results of his research That is, there is

a difference between one and the other other. According to study which has conducted by Marilita (2019), variable free cash flow not own influence on quality profit which produced, while different from Nugrahani and Retnani (2019), Lestari et al. (2020), and Yasa (2020) which obtained the opposite result, namely free cash flow own influence on quality profit which generated company.

already there is. Based theory as well as study earlier which already explained non, so writer formulate hypothesis as following :

**H<sub>3</sub> : Free cash flow has an influence on earnings quality.**

#### **The Influence of Structure Capital, Asymmetry Information, and Free Cash Flow On Earnings Quality**

Based on results study earlier which discuss about variables the author Use in this study , among them earnings quality , capital structure, information asymmetry, and free cash flow results various kinds, both positive and negative . In this research, researchers have not found research that examines related to joint variables which discusses the influence of capital structure, information asymmetry, and free cash flow on earnings quality. From the minimum study regarding the topic the so researcher take hypothesis to four that is:

**H<sub>4</sub>: Structure capital, information asymmetry, and free cash flow has an influence on earnings quality.**

## **4. DATA ANALYSIS AND PROCESSING**

Researchers use the company population *Consumer Non-Cyclicals* which recorded in IDX in 2017-2021 in study this. Thing the because all countries in the world, one of which is Indonesia, is currently dealing with a pandemic called Covid-19. This pandemic is having an effect on various sector, specifically that is on sector economy. Lots companies that suffered setbacks caused by the pandemic. The *consumer non-cyclicals sector* is seen experiencing a decline starting in 2021 (Kenia, 2021). Company goods consumer primary or *non-consumer cyclicals* are which company carry out production or distribution goods and services in the form of primary or anti-cyclic goods, which is growth n The economy has no influence on the *demand for* these goods and services (Kayo, 2021). IDX shows that *year to date* (ytd) exists decline on sector this as big 11.29%. Slump sector this is the worst after the real estate

From the results of these different studies, researchers want to research i also how the influence of the *free cash flow* itself on quality that profit generated by company for convincing from results study which

and property sector. This decline occurred due to the acceleration of raw materials.

#### **The Influence of Structure Capital on Earnings Quality (H<sub>1</sub>)**

After testing the hypothesis, the result is that capital structure does not affect earnings quality. This is reflected from the results of the t test that has been carried out, where in table 4.12 shows score *probability* structure capital as big 0.1541 more big from alpha (0.05). Variable structure capital in study this be measured with total debt year divided by total assets in year t. Based on statistical test results descriptive in table 4.2 shows score variable average structure amount of capital 0.515, which means 51.5% of the company's assets from the research sample there is financed by debt.

The results of the research that has been carried out by this researcher are in line with research on capital structure, namely the research of Nizar and Kiswanto (2022), Wahyudianti et al. (2021), Priskanodi et al. (2022), as well Marliyana et al. (2017) stated that the capital structure does not have i influence on quality profit. If level high *leverage* of a company, the greater the debt is used to finance the company's activities compared to capital. That way the party that will benefit is *debt holder*. Thing the because belief from party debtor to company that is able to pay or pay off its debts with look asset which owned.

Viewed from results study which researcher do through *leverage* calculation, which has the smallest value in the sample derived from a consumer non-cyclicals company, namely Provident Agro Tbk (PALM), but quality highest profit not obtained by PALM, but by Enseval Putera Megatrading Tbk (EPMT). It signifies that the more big score assets that funded by debt no will hear uhi quality profit during management company can manage assets and capital company with good.

#### **The Influence of Information Asymmetry on Earnings Quality (H<sub>2</sub>)**

On variable asymmetry information, after testing hypothesis conducted, obtained results asymmetry information no effect to earnings quality. This is reflected in the results of the t test that has been carried out, in where in table 4.12 shows the probability value of information asymmetry of 0.8060 more big from alpha which used that is as big 0.05.

The results of this study are in line with research conducted by Sari (2020) and Widjayanti (2018) which states that asymmetry information i no effect on quality profit. From the results it indicates n asymmetry information no is which factor very considered n in earnings management actions carried out by company management. Information asymmetry owned by management not used by party management for do manipulation profit so that no influence quality profit which generated.

Next from the analysis results descriptive score the *mean* of the variable asymmetry information as big 0.293. It means, as much 29.3% company have a degree of information asymmetry. From the total *mean* can be interpreted that the level of information asymmetry is quite low every year less than 30%. This is in line with research conducted by Triadinanti (2019) where it reveals that level information asymmetric reduced every the year, also with results that calculation conducted by researcher i, as happened to the company KINO Indonesia Tbk (KINO), where calculation which has been done obtain results which decreased every the year, on year 2017 as big 35%, 2018 as big 33%, 2019 as big 32%, 2020 as big 30% and 2021 as big 17%. With level asymmetry which every the year decrease so Thing the also will Becomes signal participate decline motivation from management company for do earnings management . So it can not affect the quality profit company which generated.

### **The Influence of Free Cash Flow on Earnings Quality (H<sub>3</sub>)**

Based on hypothesis testing already done, obtained the result is that the *free cash flow (FCF)* variable affects earnings quality. Thing the reflected from results test t which has conducted, in where on table

4.12 shows the *probability value of the free cash flow* variable of 0.0188 not enough from alpha (0.05).

The results of this study are in line with research conducted by Yasa (2020), Nugrahani & Retnani (2019), and also

Lestari et al. (2020) which state that FCF has influence on quality profit. From the results it indicates that with the FCF that is getting available height in a company, then the company's ability to survive in the situation bad will also be higher. It can be said that, company which own FCF tall is company which healthy. FCF which there is on something company will influence action

and also decisions which taken by manager, Thing this will give investors an idea of the amount of dividends they will receive. With the FCF tall then the company has free cash that can finance payments debt, asset purchase and Thing other so that possibility management n to do earnings management will be smaller and earnings quality even will the more good.

Managers company often time to pay attention FCF in determine the value of the company, because of the large value of operating activities very dependent company at the expected FCF by company for continuity the future of the company for can defend n the business. The results of this study are also in accordance with the research conducted by Kodriya and Fitri (2017), which state that FCF is determinants (factors). Determining the value of the company so that manager more focused on effort for increase it .

### **The Influence of Capital Structure, Information Asymmetry, and Free Cash Flow on Earnings Quality (H<sub>4</sub>)**

Based on tests which has done, respectively variable independent has an impact on the dependent variable, there is an effect and there is also which no influential. Besides that researcher also test i linkages between all independent variable simultaneously (simultaneously) to variable dependent. This matter proven with test F which has conducted, score probability (F-Statistics) or the p-value of the capital structure, information asymmetry, and free cash flow that is equal to 0.02147. the value smaller than 0.05 or p-value  $< \alpha$  (0.02147 < 0.05). With this result then H<sub>0</sub> is rejected and H<sub>a</sub> is accepted. That is, capital structure, information asymmetry, and *free cash flow* in a manner simultaneous influential to quality profit.

Based on the above exposure variables structure capital, asymmetry information, and FCF together (simultaneous) influential to earnings quality is in accordance with the hypothesis that has been described by the author previously. Quality that profit well is wrong one master key

for company for can be successful in running business. With structure good capital, and minimal information asymmetry and free cash flow owned by company so quality profit will impact good for company as well as stakeholders such as *suppliers*, creditors, and also para investors in take decision invest.

real, by not filtering them

## 5. RESULT AND CONCLUSION

1. Capital structure (X 1) has no effect on earnings quality (Y). This matter shows that the greater the value of assets funded by debt will not affect the quality of earnings as long as the company's management is capable manage capital and asset company with good.
2. Information asymmetry (X 2) has no effect on earnings quality (Y). Thing This shows the level of asymmetry every year decrease then it will also be a signal also decreased motivation from company management to carry out earnings management. So p the no can have an effect on quality corporate profits which generated.
3. Free cash flow (X 3) effect on earnings quality (Y). This matter showing with a high FCF then the company has free cash who can finance debt payments, purchase assets and other things so that possibility management for do management profitwill Becomes more small and quality profit so will the more good.
4. Structure capital (X 1), asymmetry information (X 2 ), and *free cash flow* (X 3 ) effect on earnings quality (Y). This shows the quality of earnings Good quality is one of the main keys for the company in order to success in running a business. With a good capital structure, and minimal information asymmetry and owned FCF by company then quality profits will have a good impact on the company as well as the employees stakeholders interest.

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