JAS (Jurnal Akuntansi Syariah)
June 2025, Vol.9, No.1: 22-40

Are sharia firms able to mitigate the involvement of institutional ownership on earnings management?

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https://doi.org/10.46367/jas.v9i1.2250
Received: Dec 12, 2024 **Revised:** Mar 28, 2025 **Accepted:** Apr 09, 2025 **Published:** Jun 25, 2025

Abstract
Purpose - This study examines Shariah firms' role in mitigating institutional ownership's involvement in earnings management. **Method -** The sample uses a purposive sampling method for firms listed on the IDX from 2015 to 2021. This study analyzes 2,238 firm-year observations using multiple linear regression analysis, multigroup regression, and independent t-tests. The results of this study support research that argues that institutional ownership positively affects earnings management. This study also proves that Sharia firms have lower earnings management than non-Sharia firms, but Sharia firms cannot mitigate the involvement of institutional ownership in earnings management. **Findings -** These results have practical implications for regulators and investors. For regulators, the findings highlight the importance of developing policies that strengthen oversight of institutional investors to minimize earnings manipulation. For investors, understanding the role of institutional ownership in earnings management can aid in making informed investment decisions and assessing financial statement reliability. **Implications -** Theoretical implications of this study indicate that companies adhering to Sharia compliance norms can reduce agency problems. Furthermore, these findings reinforce social norms and institutional theory, suggesting that ethical and religious factors (Sharia compliance) serve as internal control mechanisms against opportunistic managerial behavior.
Keywords: institutional ownership, earnings management, sharia firms, multigroup.

Introduction

Researchers agree that earnings management causes low-quality financial reports because it will produce misinformation for investors and stakeholders. Previous studies have shown that earnings management causes low-quality earnings (Farichah 2017; Beyer, Guttman, and Marinovic 2019; Cug and Cugova 2021). If the quality of earnings is low, financial reporting is also low (Hamour et al. 2024). Management is responsible for reporting on the company's financial condition accurately and correctly. Capital market players rely on reporting accuracy to make the right investment decisions (Davis and García-Cestona 2023). However, in reality, management tends to act in personal interests (Jensen and Meckling 1976), or get pressure from large shareholders so that they take profit management actions (Jaggi and Tsui 2007; Zhong, Gribbin, and Zheng 2007).

Institutional ownership (IO) is generally a large and significant shareholder and continues to increase as capital management increases (Berk and DeMarzo 2017; Davis and García-Cestona 2023). IO can control earnings management or vice versa with their resources and incentives to protect their investments. On the Indonesia Stock Exchange, IO controls 46.6% of outstanding shares (Simon 2024), making it a major player that is very influential in corporate governance and decision-making. If corporate governance does not have an

pISSN 2549-3086
eISSN 2657-1676
https://ejournal.isnjbengkalis.ac.id/index.php/jas

effective governance mechanism that regulates controlling shareholders, minorities and creditors are challenging to secure (Wang 2020).

Several agency theory framework studies have produced two perspectives: alignment and entrenchment (Shahzad et al. 2017; Lassoued, Attia, and Sassi 2018). From the alignment perspective, large shareholders have strong incentives to monitor efficiently to protect shareholders. In the study, large shareholders are proxied by institutional ownership. In the context of earnings management, it has been empirically shown that institutional ownership has a negative effect on earnings management (Umar and Hassan 2017; Potharla, Bhattacharjee, and Iyer 2021; Cahyathi, Assih, and Sumtaky 2024). From an entrenchment perspective, large shareholders influence management to protect their interests, thus creating another agency conflict between the majority and the minority. Institutional ownership has a positive relationship with earnings management (Emamgholipour et al. 2013; Bansal 2023; Davis and García-Cestona 2023). Recently, research on Sharia governance and earnings management has gained attention. Firms operating under Sharia principles have been found to exhibit better reporting quality and lower earnings management, as Sharia-compliant firms emphasize honesty and transparency in business (Farooq and AbdelBari 2015; Can 2021; Khaw, Al-Jaifi, and Zainudin 2023). Earnings management is considered dishonesty in financial reporting, classified as unethical and even fraudulent behavior (Kassem 2012; Abdullah 2013).

Referring to the entrenchment perspective, large shareholders influence management to protect their interests, thus empirically showing that institutional ownership has a positive relationship with earnings management. With Sharia governance's existence, institutional ownership's positive influence on earnings management should be mitigated. There is a gap in previous research between alignment and entrenchment perspectives, creating a critical research gap that will be filled in this study. First, do companies managed according to Sharia have better (lower) earnings management than non-Sharia firms? Second, can Sharia governance mitigate the influence of institutional ownership on earnings management if it is involved (positive influence)? The answer to this research question is hoped to be the novelty of this study. Therefore, this study aims to fill this research gap by examining the role of Sharia firms in moderating the relationship between institutional ownership and earnings management. By doing so, this study provides new insights into how governance mechanisms rooted in religious and ethical principles affect financial reporting practices. This study will contribute to the corporate governance literature and offer practical implications for regulators, investors, and policymakers seeking to enhance transparency and accountability in financial markets.

Literature review

Agency theory

According to agency theory, managers are responsible for optimizing the owner's profits and obtaining compensation according to the contract. However, differences in interests caused managers not to always act in the owner's interests (Jensen and Meckling 1976). Earnings management arises due to the interests of managers in managing the company (Kazemian and Sanusi 2015). However, this behavior is undesirable from the principal's perspective, as managers are expected to operate in the owners' best interests (Jian et al. 2024). This misalignment of interests leads to agency conflict, a core concept in agency theory (Jensen and Meckling 1976). This conflict can be minimized by the presence of large shareholders (Gillan and Starks 2003; Korkmaz, Ma, and Zhou 2017), because they can control management actions with share ownership that gives them voting rights (Demiralp et al. 2011; Reyna 2018).

Social norm theory

Social norm theory was first introduced by Kohlberg (1984). This theory states that individual behavior and attitudes are shaped by the social norms of the environment in which they live or work (Elster 1989; Sunstein 1996). Religious social norms play an important role in shaping corporate managers' values, culture, behavior, and attitudes (Davern et al. 2018). In the context of this study, there is a relationship between the work environment built with religious social norms (Sharia compliance) and the behavior of managers in carrying out earnings management. Financial reporting fraud is smaller when a company has a strong religious social norm environment (Grullon, Kanatas, and Weston 2010; Dyreng, Mayew, and Williams 2012; McGuire, Omer, and Sharp 2012).

Institutional theory

Meyer and Rowan (1977) introduced the institutional theory, which states that organizational structures are formed not only based on efficiency and economic rationality but are also influenced by social, cultural, and regulatory environmental pressures that shape their structures and practices. This theory explains how institutions (rules, norms, and social practices) influence organizational and individual behavior. This theory is like the theory of social norms, which is that social norms and practices greatly influence institutional organization and individual behavior. Norms are the keywords that will limit individual behavior so as not to deviate outside the agreed norms, thus forming organizational and personal habits and behavior in making decisions (Hanlon, Yeung, and Zuo 2022).

Hypothesis Development

In agency theory, there is a conflict of interest between agents (managers) and principals (owners) (Jensen and Meckling 1976). This conflict is often called the type I agency problem in literature. The presence of large shareholders is considered capable of reducing the conflict (Gillan and Starks 2003; Korkmaz, Ma, and Zhou 2017). The presence of large shareholders, such as institutional ownership, can control and influence management so that earnings manipulation behavior can be minimized (alignment perspective). They are an effective control mechanism in financial reporting (Yeo et al. 2002). They can supervise management that overstates so that the presence of IO can increase the relevant value of accounting information (Omran and Tahat 2020). Empirically, several studies have shown a negative correlation between IO and earnings management (Umar and Hassan 2017; Potharla, Bhattacharjee, and Iyer 2021; M. J. Ali et al. 2024; Cahyathi, Assih, and Sumtaky 2024).

Conversely, when a company is under pressure, large shareholders pressure directors to enhance performance and maintain stable earnings (Ely and Song 2000; Zhong, Gribbin, and Zheng 2007). By having immense power, they intervene and encourage firm managers to engage in earnings management to enhance their profits (Jaggi and Tsui 2007). Large shareholders require higher returns on their investments and pose a threat of intervention to the company's management (Zhong, Gribbin, and Zheng 2007). This pressure will encourage management to manipulate earnings (entrenchment perspective) (Lassoued, Attia, and Sassi 2018). The involvement of large shareholders in earnings management is very detrimental to minority shareholders. In the literature, a conflict arises between majority and minority shareholders, which is called the type II agency problem.

Increasing ownership indicates increasingly concentrated ownership. Concentrated ownership occurs because legal protection for investors is weak (Porta et al. 1997; 2002). How about in the context of research in Indonesia? Indonesia is a country with weak law enforcement. One of the causes is the quality of law enforcers and low morality, so professionalism is reduced (Harruma and Nailufar 2022). In 2024, Indonesia had a rule of law index with a score of 0.53 and a score of 1 as the highest value. This score places Indonesia

68th out of 142 countries (Kumalasanti 2024). When legal protection for investors is weak, foreign investors are reluctant to enter, which causes ownership to be concentrated among certain groups, such as families. On the other hand, family-controlled companies have higher earnings management (Gadhoum 2021).

In East Asian countries, including Indonesia, more than two-thirds of companies are controlled by a single shareholder (Claessens, Djankov, and Lang 2000). As a result, the separation between management and controlling shareholders is rare, with 60% of top management having a relationship with controlling shareholders. This condition has implications for controlling shareholders' increasing ability and dominates management in earnings management. Previous studies show that large shareholders or strong controllers positively correlate with earnings management (Kim and Yoon 2008; Lail, Martin, and Thomas 2013; Bao and Lewellyn 2017). Based on this explanation, the hypothesis proposed is as follows:

H1: institutional ownership has a positive effect on earnings management.

According to the social norms theory, an individual's attitude and behavior are influenced by the social environment in which he or she lives or works (Elster 1989; Sunstein 1996; Boahen and Mamatzakis 2015). Institutional theory also strengthens the idea that organizational and individual behavior is greatly influenced by social rules, norms, and practices (Meyer and Rowan 1977). In Indonesia, social norms are influenced mainly by religious norms. When religious norms are applied in a company environment, it will form an environment with social religiosity norms. Sharia compliance is a manifestation of implementing religious norms in the company environment (Tawfik, Elmaasrawy, and Hussainey 2025). This religious environment will influence and shape the ethical behavior of individuals in the company (Moid 2016). The implication is that unethical behavior in manipulation is also decreasing. Companies that implement Sharia principles have higher earnings quality than conventional companies. This study's findings support the view that Sharia firms present more reliable earnings reports to attract foreign investment, have greater demand for high-quality financial reporting due to their Sharia status, and are under stricter supervision from regulators and institutional investors (Ismail, Kamarudin, and Sarman 2015).

Several researchers have examined the relationship between Sharia firms and earnings management behavior. Farooq and AbdelBari (2015) claim that Sharia-compliant firms have lower earnings management because they have financial reporting characteristics such as low cash, receivables, and leverage. Can (2020) revealed differences in the behavior of financial reporting quality of Sharia-compliant and non-compliant firms, where Sharia-compliant firms improve reporting quality by reducing discretionary accruals and audit aggressiveness. Khaw, Al-Jaifi, and Zainudin (2023) found that Sharia certification mitigates earnings management, especially for companies that maintain their Sharia status. According to them, the longer and continuous the Sharia certification status, the smaller the earnings management. Consistent with previous studies and referring to social norms and institutional theory, this study predicts that firms with a religious or Sharia-based environment have lower earnings management than non-Sharia firms. However, this study slightly differs from the previous one, where Sharia-based firms are expected to mitigate the influence of IO on earnings management. Therefore, the proposed hypothesis is as follows:

H2a: the positive influence of institutional ownership on earnings management is lower in Sharia firms than in non-Sharia firms.

H2b: earnings management is lower in Sharia firms compared to non-Sharia firms.

The research framework for this study can be seen in Figure 1

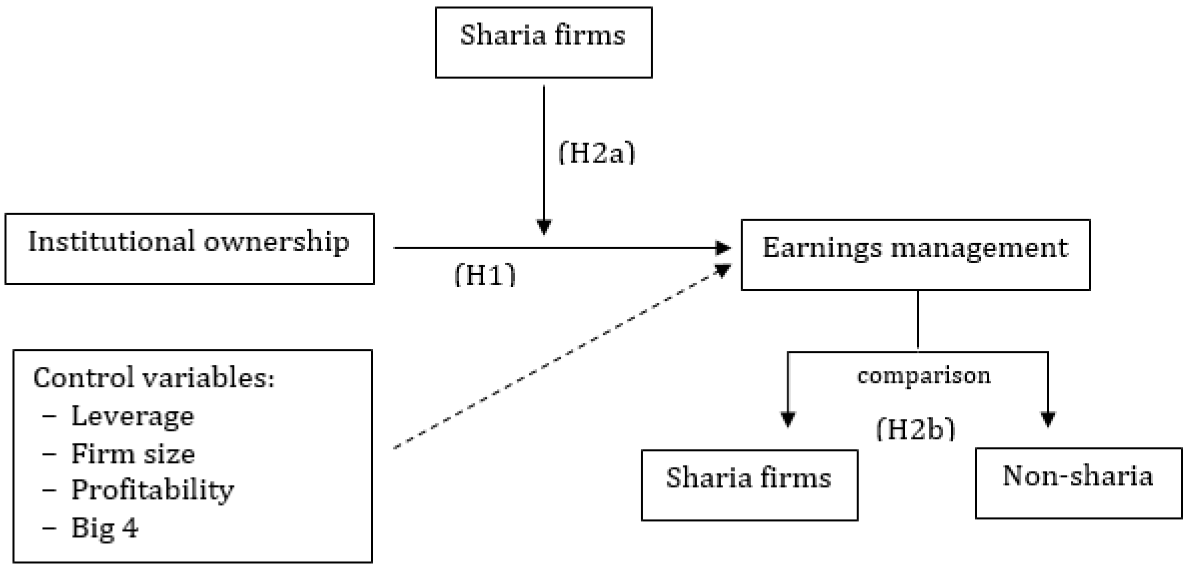

Figure 1 research framework

Method

This study uses a quantitative method approach, namely a type of research that explains phenomena by collecting numerical data that is analyzed using mathematical or statistical methods (Martha and Gunderson 2000; Creswell and Creswell 2018), and finally, hypothesis testing is carried out (Muijs 2011). The population of this study is companies listed on the Indonesian Stock Exchange (IDX) using a purposive sampling technique. The sampling criteria are as follows: (1) Companies are listed on the Indonesia Stock Exchange consecutively for the last seven years (2015-2021). The year 2015 was chosen as the starting point because, in that year, the OJK began to categorize companies that were following Sharia principles; (2). Companies are not from the financial or banking sector because these companies have differences in regulation and character compared to other companies (Zhong, Gribbin, and Zheng 2007; Korkmaz, Ma, and Zhou 2017). A total of 777 companies are listed on the IDX as of 2021. Furthermore, 124 samples from the financial sector, 338 suspended firms, and incomplete data were excluded. All criteria and data used are presented in Table 1.

Table 1 research sample

Sample		Amount
Firms listed on IDX		777
Agriculture	26	
Mining	50	
Basic and chemical industry	85	
Miscellaneous industry	51	
Goods and consumer industry	70	
Real estate and building construction	90	
Infrastructure, utilities and transportation	96	
Finance	124	
Trade, service & investment	185	
Financial sector firms excluded		(124)
Suspended firms and incomplete data		(338)
Sample used		315
Data observed (315 firms x 7 years)		2.205

Source: secondary data (processed 2024)

The earnings management measurement utilizes Jones's (1991) discretionary accrual proxy, which was later modified by Dechow, Sloan, and Sweeney (1995). Researchers widely adopt this measurement, as discretionary accrual is considered the most effective estimation model compared to other available models (Ashbaugh, LaFond, and Mayhew 2003; Jaggi and Tsui 2007). The modified Jones model is as follows:

$$TA_{i,t} = NI_{i,t} - CFO_{i,t} \quad (1)$$

$$\frac{TA_{i,t}}{A_{i,t-1}} = \beta_1 \frac{1}{A_{i,t-1}} + \beta_2 \frac{\Delta Rev_{i,t}}{A_{i,t-1}} + \beta_3 \frac{PPE_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \quad (2)$$

$$NDA_{i,t} = \beta_1 \frac{1}{A_{i,t-1}} + \beta_2 \frac{\Delta Rev_{i,t} - \Delta Rec_{i,t}}{A_{i,t-1}} + \beta_3 \frac{PPE_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \quad (3)$$

$$DA_{i,t} = \frac{TACC_{i,t}}{T_{i,t-1}} - NDACC_{i,t} \quad (4)$$

Where DA is discretionary accruals, TA is total accruals, NDA is non-discretionary accruals, NI has net income, CFO is cash flow operating, A is total assets, ΔRev is changing in revenue, ΔRec is changing in receivables, PPE is property, plant and equipment, Ɛ is the residual, and i, t is company and year.

The primary variable in this study is the level of institutional investor ownership. Institutional ownership refers to the shares owned by institutions such as banks, insurance firms, mutual funds, and others. Institutional ownership is measured by the number of shares owned by institutional investors divided by the number of shares outstanding. A Sharia company is a company whose business activities follow Sharia principles. Namely, activities that do not include usurious financial services; do not trade risks that contain elements of uncertainty (*gharar*) and gambling (*maysir*); do not produce, distribute, trade, do not provide goods or services that are haram in substance (*haram li-dzatihi*) and not because of their substance (*haram li-ghairihi*) as determined by the National Sharia Council - Indonesian Ulema Council. Sharia firms use a dummy variable with code 1 if the firm is indexed in ISSI, and if not, code 0. This measurement is also similar to Alsaadi, Ebrahim, and Jaafar (2017), which uses the Financial Time Stock Exchange (FTSE) global equity Sharia index, and Ashraf (2016), which uses Islamic Equity Indices (IEIs).

In this study, Sharia firm is a moderator variable with a dummy or categorical type. Moderator variables can be in the form of qualitative variables (e.g., gender, race, class) or quantitative variables (e.g., level of appreciation) that can affect the direction or strength of the relationship between the independent variable and the dependent variable (Baron and Kenny 1986). It is in line with Hair et al. (2011), who mentioned the relationship between continuous moderation (e.g., income) and categorical (e.g., gender). Because the moderating variable is categorical, the test compares each sample group's regression coefficients (Kock 2014; Sholihin and Ratmono 2021). Therefore, the proper test uses multigroup analysis, also known as subgroup testing.

This study includes four control variables for firm characteristics. The four control variables include leverage, firm size, profitability, and audit quality. Leverage is an indication of external pressure. Higher debt levels pressure the company, so managers try to make the report look better (Hanafi, Rohman, and Ratmono 2024). Several previous studies have found a positive correlation between leverage and earnings management (Liu et al. 2018; Jiang, Ma, and Wang 2020; Awuye and Aubert 2022). Firm size is used as a control variable because they have more resources than small firms, so it does not cause bias due to firm size. Large firms report better quality reports because investors analyze them a lot, and consequently, there are greater financial violations (Deli and Gillan 2000). Previous studies show a negative correlation between firm size and earnings management (Liu et al. 2018; Jiang, Ma, and Wang 2020; Awuye and Aubert 2022).

Likewise, profitability, the magnitude of profitability, is an indication that distinguishes large and small companies. Profitability influences earnings management choices (U. Ali et al. 2015; Nalarreason, T., and Mardiati 2019). Previous studies show that profitability is negatively correlated with earnings management (Liu et al. 2018; Jiang, Ma, and Wang 2020; Awuye and Aubert 2022). Audit quality is proxied by the Big 4 firms because they have a higher quality standard. Companies audited by the Big 4 usually have greater financial resources because the audit fee for the Big 4 is greater than that of the non-Big 4. So, the Big 4 is often used as a control variable in research. Companies audited by the Big Four show lower earnings management behavior (Francis and Yu 2009). Several studies show that the Big 4 negatively correlate with earnings management (Mokoteli and Iatridis 2017; Lopes 2018; Bawuah 2024).

Based on the explanation of the various variables above, operationally, it is presented in Table 2.

Table 2 operational variables

Variables	Measurement	References	Scale
Dependent variables: Earnings Management (|EM|)	|EM| = |DA|	(Jaggi and Tsui 2007)	Ratio
Independent variables: Institutional ownership (IO)	$IO = \frac{\text{institutional share}}{\text{outstanding share}}$		Ratio
Moderator variables: Sharia firms (Sf)	Sharia firms = 1, non-Sharia firms = 0	(Alsaadi, Ebrahim, and Jaafar 2017)	Dummy
Control variables: Leverage (LV)	$LV = \frac{\text{total debt}}{\text{total assets}}$	(Liu et al. 2018)	Ratio
Firm Size (Sz)	Ln of total asset	(Liu et al. 2018)	Ratio
Profitability (Pr)	$Pr = \frac{\text{revenue}}{\text{total assets}}$	(Jiang, Ma, and Wang 2020)	Ratio
Big four (B4)	B4 = 1, non-B4 = 0	(Lopes 2018)	Dummy

This research uses multiple linear regression (formula 5) to answer H1 and H2a. However, for H2a, two sample groups are used: the Sharia firms and the Sharia firms' sample. Furthermore, to answer H2b, an independent t-test is needed, where this test is intended to determine the difference in the means of earnings management in Sharia and non-Sharia firms.

$$|EM| = \partial + \beta_1 IO + \beta_2 Lv + \beta_3 Sz + \beta_4 Pr + \beta_{51} B4 + \varepsilon \quad (5)$$

Where |EM| is the absolute value of earnings management, and IO is institutional ownership. Furthermore, Lv (leverage), Sz (size), Pr (profitability), and B4 (big four) are control variables.

Results and discussion

Descriptive statistics

Table 3 shows the descriptive statistics of the full sample, non-Sharia, and Sharia firms. The average absolute discretionary accrual (|EM|) is 0.083, ranging from 0.000 to 0.870. For non-Sharia firms, |EM| is 0.092, and for Sharia firms, 0.079, indicating that earnings management behavior is greater in non-Sharia firms than Sharia firms. The average institutional ownership (IO) is 68 percent, with an ownership range of 0.8 percent to 100 percent. Furthermore, the average IO in non-Sharia firms is 67.6 percent, and in Sharia firms, 68.2 percent. This indicates that institutional ownership is greater in Sharia firms than non-Sharia firms.

Table 3 descriptive statistics

Variables	Min.	Max.	Full sample		Non-SF sample		SF sample	
			Mean	Std.	Mean	Std.	Mean	Std.
|EM|	0.000	0.870	0.083	0.084	0.092	0.098	0.079	0.078
IO	0.008	1.000	0.680	0.197	0.676	0.209	0.682	0.192
Lv	0.003	8.308	0.502	0.388	0.696	0.606	0.427	0.217
Sz	2.485	18.92	13.60	2.046	13.71	2.215	13.56	1.976
Pr	-1.538	0.716	0.025	0.114	-0.009	0.151	0.038	0.092
B4	0.000	1.000	0.390	0.488	0.350	0.478	0.400	0.491
Observation (N)				2,205		611		1,594

Source: secondary data (processed 2024)

The leverage control variable (Lv) has an average of 0.502. Where non-Sharia leverage is larger than Sharia firms (0.696 > 0.427), this indicates that Sharia firms are more conservative in external financing or debt than non-Sharia firms. Firm size (Sz) has an average of 13.60, and the size of non-Sharia firms is larger than that of Sharia firms (13.71 > 13.56). Performance (Pr) has an average of 0.025, where the performance of Sharia firms is better than that of non-Sharia firms (0.038 > -0.009). Audit quality (B4) has an average of 0.390, where Sharia firms have better audit quality than non-Sharia (0.400 > 0.350).

Correlation

Table 4 shows the correlation coefficients among the independent variables. The highest correlation is observed between Sz and B4 (r = 0.341). Since none of the correlation coefficients exceeds 0.90, collinearity is not a problem (Tabachnick and Fidell 2007; Hair et al. 2011).

Table 4 correlation coefficient model

Variables	|EM|	IO	Lv	Sz	Pr	B4
|EM|	1					
IO	0.087	1				
Lv	0.273	-0.031	1			
Sz	-0.204	-0.035	0.046	1		
Pr	-0.167	0.048	-0.261	0.106	1	
B4	-0.055	0.102	-0.055	0.341	0.226	1

Source: secondary data (processed 2024)

Multiple linear regression analysis

This study uses multiple linear regressions to answer H1, as in Table 5. To answer H2a, multiple linear regressions are grouped into two groups, namely samples of Sharia and non-Sharia firms, as in Table 6. Finally, to answer H2b, this study uses an independent t-test on Sharia and non-Sharia firms, as in Table 8.

Table 5 shows that institutional ownership (IO) positively and significantly impacts earnings management at α = 1% significance level (β = 0.037; p-value = 0.000). Consequently, H1, which proposes that Institutional ownership positively affects earnings management, is accepted. Additionally, the control variable of profitability (Pr) shows a significant negative

pISSN 2549-3086
eISSN 2657-1676
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relationship with earnings management (β = -0.066; p-value = 0.000), indicating that lower company performance is associated with higher earnings management. External pressure represented by leverage (Lv) also significantly influences earnings management (β = 0.058; p-value = 0.000). It suggests that higher debt levels increase creditor pressure on the company, driving institutional owners to push managers toward earnings management to protect their interests. Lastly, the control variable size (Zs) represents a company's size and significantly negatively affects earnings management (β = -0.009, p-value = 0.000). This result suggests that larger firms engage in fewer earnings management practices. One possible explanation is that larger companies receive greater public scrutiny as they attract increased attention from analysts and investors. As a result, these firms are more likely to produce high-quality financial reports (Chen, Lin, and Zhou 2005). Additionally, this study examines the impact of audits by Big Four accounting firms (B4). The results indicate that firms audited by the Big Four exhibit a significant positive association with earnings management (β = 0.008, p-value = 0.037). This suggests that the Big Four auditors cannot decrease earnings management practices. On the contrary, in some instances, these auditors may facilitate earnings management.

Table 5 multiple linear regression

Variables	*β*	p-value
Constant	0.150	0.000
IO	0.037	0.000
Lv	0.058	0.000
Sz	-0.009	0.000
Pr	-0.066	0.000
B4	0.008	0.037
Adj. R^2		0.135
F-test		69.693 (0.000)
Obs.		2,205

Source: secondary data (processed 2024)

Multigroup regression analysis

To answer H2a, we use an analysis of multigroup regression because the Sharia firm is a moderator variable, a dummy or categorical variable. This regression compares path coefficients within the same model across different samples (Kock 2014; Sholihin and Ratmono 2021). In this study, non-Sharia firms are Group 1, and Sharia firms are Group 2. The results of the multigroup regression analysis are presented in Table 6.

Table 6 multigroup regression

Variables	Non-Sharia sample (group 1)			Sharia sample (group 2)		
	β	S.E	p-value	*β*	S.E	p-value
Constant	0.141	0.025	0.000	0.146	0.016	0.000
IO	0.046	0.017	0.006	0.035	0.010	0.000
Lv	0.057	0.006	0.000	0.060	0.009	0.000
Sz	-0.009	0.002	0.000	-0.009	0.001	0.000
Pr	-0.151	0.024	0.000	0.014	0.022	0.503
B4	0.011	0.008	0.145	0.004	0.004	0.304
Adj. R^2			0.258			0.070
F-test			43.312 (0.000)			25.061 (0.000)
Obs.			611			1,594

Source: secondary data (processed 2024)

In Table 6, the non-Sharia sample group shows that institutional ownership (IO) significantly affects earnings management at α = 1% (β = 0.046; p-value = 0.006). Meanwhile, in the Sharia firms sample group, institutional ownership also affects earnings management at α = 1% (β = 0.035; p-value = 0.000). When compared, the coefficients of the non-Sharia and Sharia samples decreased (0.046: 0.035). However, whether this decrease is significant requires further testing with Pooled standard error (PSE) and Satterthwaite (Satt). Operationally, this test can be conducted using a spreadsheet of Kock (2014). The results of these tests are presented in Table 7.

Table 7 pooled standard error (PSE) and Satterthwaite (Satt)

Process	Institutional Ownerships
Inputs:	
Size of Sample 1 (Non-Sharia firms)	611
Size of Sample 1 (Sharia firms)	1,594
Coefficient 1 (β1)	0.046
Coefficient 2 (β2	0.035
Standard error of sample 1 (SE 1)	0.017
Standard error of sample 2 (SE 2)	0.010
<u>Outputs of PSE.</u>	
P-value of multi-group difference effect (1- tailed)	0.284
<u>Output of Satt.</u>	
P-value of multi-group difference effect (1- tailed)	0.289

Source: secondary data (processed 2024)

Based on Table 7, the pooled standard error (PSE) and Satterthwaite (Satt) tests indicate that institutional ownership is not significantly different (p-value of PSE = 0.284 and Satt =0.289), both over 0.05. Hence, H2a, which states that the positive influence of institutional ownership on earnings management is lower in Sharia firms than in non-Sharia firms, is rejected.

Independent t-test

Next, to answer H2b, the mean difference of absolute earnings management |EM| between non-Sharia and Sharia firms was tested. The test results can be seen in Table 8.

Table 8 independent samples test

|EM|	Non-sharia	Sharia	Levene's test		T-test for equality for means	
			F	p-value	p-value	Means Diff.
Mean	0.0916	0.0794				
Equal var. ass.			13.387	0.000	0.002	0.0122
Equal var. not ass.					0.006	0.0122

Source: secondary data (processed 2024)

Based on Table 8, Levene's test shows that the value of the F-count is 13.387 (p-value = 0.000 or < 0.05). It indicates homogeneity of variance between the |EM| groups. Because there is homogeneity, the t-test result used is Equal variances assumed, where sig. 0.002 < 0.05. It confirms a significant difference between the mean |EM| non-Sharia (0.0916) and Sharia firms (0.0794). Therefore, the earnings management in Sharia firms is lower than in non-Sharia firms and is very significantly different. Thus, H2b is accepted.

The influence of institutional ownership on earnings management

This result shows that institutional ownership (IO) positively affects earnings management. Higher institutional share ownership will provide stronger control over managers and other executives. IO has more incentives and capabilities to monitor manager behavior (Desai and Dharmapala 2009). They can influence management decisions because the power of shares they own is significant (S. M. Ali, Norhashim, and Jaffar 2023), which gives them voting rights (Klein 2002; Gillan and Starks 2003; Demiralp et al. 2011; Reyna 2018). IO can easily replace management through its voting rights. Managers who want the security of their positions tend to follow IO's wishes to secure their investments. IOs have significant investments, so they want good returns and want to avoid many losses. Large shareholders generally do not want significant investment losses, so they encourage managers to act in earnings management for their interests (Korkmaz, Ma, and Zhou 2017). They try to protect and increase their investments. If the company tends to be bad, they will pressure managers to do earnings management so that performance looks better in the eyes of investors and does not drop their stock prices.

The results of this study also show that Institutional ownership is highly concentrated, with an average of 68% (see Table 3). In companies with concentrated ownership, controlling shareholders can hide transactions that benefit themselves, such as taking over assets or profits in entities they control, also known as tunnelling. The implication is that minority shareholders are disadvantaged. Minority shareholders do not have access as the majority, so the company's profits or assets are unknowingly transferred to the majority owner. The practice of abuse of power by controllers that harms the minority is a form of agency problem type II. Different from agency problem type I, namely the conflict of interest between management and controlling shareholders.

The results of this study indicate a positive relationship between large shareholders, in this case, IO and earnings management. This means that there is cooperation carried out by management to carry out earnings management because of the encouragement of the IO, which is detrimental to minorities. It indicates that the conflict that occurs in Indonesia is type II. These results align with those of Claessens, Djankov, and Lang (2000), who found that many East Asian companies, including Indonesia, are controlled mainly by families. As a result, Asian companies usually have a concentrated ownership structure, in contrast to the wider ownership structure found in the US and Europe (Diyanti et al. 2013).

Indonesia as a country is characterized as a company with concentrated ownership. Such characteristics, usually large shareholders, tend to positively influence earnings management (Hanafi, Rohman, and Ratmono 2024). This study is in line with Emamgholipour et al. (2013); Bansal (2023); Davis and García-Cestona (2023) that institutional investor ownership is positively related to accrual-based earnings management. The findings of this study support the entrenchment perspective, which suggests that large shareholders positively influence earnings management.

The effect of Sharia firms on the relationship between IO and earnings management

Furthermore, this study has also explored whether companies managed by Sharia can decrease the positive effect of IO on earnings management. The group regression test on Sharia and non-Sharia firms' samples showed a decrease in earnings management, but it was insignificant. It shows that institutional ownership has firm control, so Sharia compliance cannot prevent or reduce the involvement of IO in earnings management. IO has considerable power through its voting rights over its significant investments. Suppose they feel threatened by their investments. They will continue to pressure management to improve profits because Sharia firms have been unable to limit IO's behavior. If management is not in line with it, IO can propose significant changes in management and policy through a general meeting of shareholders.

This study differs from the findings of Hanafi, Rohman, and Ratmono (2024), who focus on block holders as large shareholders both institutionally and personally. They found that religious companies can mitigate the positive influence of block holders on earnings management. In the context of this research, the primary focus is institutional ownership (IO). The study results show that Sharia firms have not been able to mitigate the influence of IO on earnings management. This indicates that institutional ownership has firm control in the corporate structure, where they can use their influence as controlling shareholders with better information to gain profits, often at the expense of minority shareholders.

This research's findings align with agency theory (Jensen and Meckling 1976), which explains how differences in interests between majority and minority shareholders can create agency conflicts. In some cases, institutional ownership, which should function as a monitoring mechanism, can be involved in earnings management practices to optimize its interests. In addition, corporate governance also emphasizes that the effectiveness of governance is highly dependent on the monitoring mechanisms implemented (Shleifer and Vishny 1997). In this case, Sharia governance does not seem to be an effective barrier to institutional ownership in influencing earnings management practices.

In the theory of social norms and institutional theory, organizational and individual behaviour is greatly influenced by rules and social norms in the company's environment. When the company implements Sharia-based social norms, the involvement of IO in profit management should decrease. Table 6 shows that when the company is managed according to Sharia, the influence of IO decreases, but it is not yet significant. This indicates that IO is powerful and concentrated, so the role of Sharia management is less significant.

Sharia firms have lower earnings management than non-Sharia firms

The results of this study align with the theory of social norms, where a work environment with religious social norms will affect the behaviour and attitudes of personnel or managers at work. Morals and ethics derived from religion (Conroy and Emerson 2004; Longenecker, McKinney, and Moore 2004; Hilary and Hui 2009) are religious values that will be carried into their work. Sharia firms are religious companies that, in their implementation, comply with Sharia values. This research aligns with prior research showing that religious companies can reduce earnings management (Dyreng, Mayew, and Williams 2012; McGuire, Omer, and Sharp 2012; Du et al. 2015; Montenegro 2017). This indicates that the more religious the company's environment is, the smaller the earnings management behavior.

From a broader perspective, this study's results align with the institutional theory that an environment's structure, norms, rules, and culture will influence the behavior of individuals and organizations. This theory was first introduced by Meyer and Rowan (1977), who stated that organizational structures are formed not solely based on economic efficiency and rationality but also because an organization operates by practices considered legitimate or by prevailing social norms. In this context, organizations often adopt certain practices not only because of internal factors but also in response to external pressures from their institutional environment. In other words, organizations follow patterns or standards widely accepted in society to gain legitimacy and sustainability in their operations. This principle of institutional theory can explain how

Sharia firms form and carry out their business practices. Sharia firms that operate with governance that adheres to Islamic principles are oriented towards economic efficiency and adapt to the social and religious values that apply in Muslim society. In this case, Islamic norms and rules create an institutional framework that demands transparency, accountability, and integrity in financial management. As a result, Islamic companies are more likely to strengthen ethical financial practices and avoid practices that can damage their reputation, such as earnings management. In addition, normative pressures from Islamic scholars, Islamic financial regulators, and the expectations of the Muslim community for transparency and business ethics play a role in shaping corporate behaviour. Thus, institutional theory can explain how compliance with Islamic principles provides legitimacy for Islamic companies and contributes to creating a more responsible financial system that is free from financial reporting manipulation practices. The findings of this study have implications for how good corporate governance can reduce earnings management. Strengthening religious values is important to instill and implement in the corporate environment so that they become a social norm. Following the existing theories, it is expected to influence the behaviour of individuals, managers, and organizations.

Conclusions

This research shows that institutional ownership significantly positively affects earnings management. These results strengthen the entrenchment perspective, where a conflict exists between controlling or majority shareholders and minority shareholders. It generally occurs in countries with concentrated ownership. Furthermore, companies that have governance following Sharia principles have lower earnings management than non-Sharia firms, which indicates that with Sharia governance, they have better financial reporting quality than non-Sharia firms. However, in this context, the strength of controlling ownership is institutional ownership; companies managed according to Sharia have not been able to reduce the involvement of institutional ownership in earnings management.

This study has implications for capital market investors to look at companies indexed in Indonesian Sharia Stocks because our study proves that Sharia firms have low earnings management; in other words, they have better reporting quality. For regulators, to reduce earnings management, regulators can consider strengthening the ethical integration framework in financial reporting standards. So, all companies are expected to foster a corporate culture based on ethical or religious values that can function as an internal control mechanism against opportunistic behaviour by management or other stakeholders. Theoretically, the implications of this study show that companies with Sharia compliance norms can reduce agency problems. In addition, this finding can strengthen social norms and institutional theory that ethical and religious factors (Sharia compliance) can function as internal control mechanisms against opportunistic management behaviour.

This research has limitations, primarily related to the measurement of Sharia-compliant firms. This study uses dummy variables derived from the results of the Financial Services Authority's (FSA) decision regarding whether the company follows Sharia principles. It may be the best choice because the FSA is very selective when making decisions for Sharia or non-Sharia firms. For future research, researchers are expected to explore other dummy variables to enrich the measurement of companies that comply with Sharia. For example, several researchers have found that Sharia-compliant firms have lower cash, receivables, and debt than non-Sharia firms. Future research can use these measurements to determine Sharia firms so that they can develop a research model different from this study. For example, Sharia firms with a moderation or intervention model (other than group tests like this study).

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