



# THE FINANCIAL SIGNALING AND INTERNAL FACTOR COMPANY AGAINST TO EARNING PER SHARE

**Yudhi Prasetyo**

Universitas Terbuka Indonesia  
yudhiprasetyo@ecampus.ut.ac.id

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## ABSTRACT

This research aims to determine the results of financial signal testing as indicated by return on equity (ROE) and liquidity and then the internal company as indicated by company size and audit quality on earnings per share (EPS). The research method used is quantitative. The population of this study is consumer goods companies, totaling 180 companies listed on the Indonesia Stock Exchange (IDX) during 2018-2021. The sample selection technique uses purposive sampling. The data analysis technique uses multiple linear regressions with the IBM SPSS 25 tool. The results show that return on equity, firm size and audit quality affect earnings per share. However, liquidity does not affect earnings per share. This research can be a source of reference for further research. Then it can also be a source of reference for companies in improving financial performance in maintaining the company's existence in the capital market and the maximum consistency of business development to satisfy the principles.

**Keywords:** ROE, liquidity, firm size, audit quality, EPS.

## INTRODUCTIONS

In the development of the business world and the competition in the business world, management is required to respond to future challenges. It must be planned from an early age so that the company can maintain its existence in public. In principle, the company has main goal in the operationalization of the business being carried out is to maximize profits to provide satisfaction for the stakeholders who own capital. If a company gets a significant income, it will impact the returns that investors will get by increasing the return on the value of their investment (Nurlatifah and Siburian 2021). In the fourth quarter of 2019, the world faced a new problem, namely the covid-19 pandemic, which was designated a global health crisis. The concept related to global trade existed before this pandemic event; this view is that investors should have been wiser in choosing companies to invest in. investment in any economic conditions (Muhaisan and Alobidyeen 2022).

Financial statements are the final product companies produce to communicate information on the results of their operations in the accounting period to information users (Kieso, Weygandt, and Warfield 2017). As we know, shareholders or investors are most interested in using financial statements in the



company. In this way, users of financial statements, in this case, shareholders can analyze and identify the company's development from time to time. Good and standardized company performance will reflect the company's ability to generate profits from one period to the next.

The measurement indicator used by shareholders or investors in evaluating the effectiveness and efficiency of business continuity and the company's business is by looking at the number of EPS generated by the company. EPS is a communication medium that can signal shareholders or potential investors to make a policy or decision related to their investment. EPS lets stakeholders get an overview of net income ready to be distributed to shareholders. The agency theory put forward by Jensen and Meckling (1976) states that agents, as part of company management, must be able to provide satisfaction to principals, namely shareholders, one of which is by increasing EPS. This happens because part of the company's income must also increase revenue so that the profit earned will be even greater (Sukamulja 2019). In the last four years, the average EPS in consumer goods companies has decreased continuously. There was a significant decline in the 2019-2020 range, from an average of 240 to 162. Many factors influenced it, one of which was the covid-19 pandemic, which made stock trading in the capital market unfavorable and uncontrollable. EPS should continue to increase because, with this, it becomes an assessment for investors and potential investors to see the success and ability of the company in running a business (The Indonesia Capital Market Institute 2022).

Previous research on stocks and capital markets has been carried out a lot. Research on the effect of ROE on earnings per share has been studied by Fadli and Suraya (2020); Nurlatifah and Siburian (2021), but it needs to examine liquidity, company size, and audit quality. Then research on the effect of company size on earnings per share was carried out by Taani and Banykhaled (2011); Uno, Tawas, and Rate (2014); Nugrahani and Suwitho (2016) but did not examine ROE, liquidity, and audit quality. Furthermore, research on the effect of liquidity on earnings per share has been carried out by Susilawati (2016); Siddiq, Setiawan, and Nurdin (2020), but it needs to discuss ROE, company size, and audit quality. Yunia (2018) researched the effect of audit quality on earnings per share but did not discuss ROE, liquidity, or company size. The literature shows that this research differs from previous studies and has a novelty value..

Based on the existing phenomenon, it is illustrated that EPS provides a signal of certainty for shareholders and potential investors. The resulting information can be appropriately analyzed, and the resulting performance reports can reflect the actual situation. Therefore, this research must be conducted to strengthen companies listed on the Indonesia Stock Exchange (IDX). Strengthening signals from the investment world can restore the development of the capital market after the covid-19 period begins to decline, and the economy will soon return to normal. This research focuses on companies engaged in the consumer goods sector. This sector is a company that is quite interesting in terms of the world of investment because it is engaged in the production of dairy products. It can be seen how far investors are interested in investing in consumer goods companies based on EPS and the factors that influence it, such as ROE, liquidity, company size, and audit quality of each company.



## **LITERATURE REVIEW**

### **Signal Theory**

The signaling theory proposes that the party making the information gives a sign or signal for the information that provides an overview of the overall condition of the company that can be useful for the recipients of information (shareholders/investors). Based on this theory, it can give an effect able to reduce errors in the delivery of information (asymmetry information) between stakeholders and company management as the driving force of the company, according to the company's need to be communicated information to stakeholders and the market by transmitting signals about their commitment to society (Bae, Masud, and Kim 2018). One of the information signals provided is EPS because it is a form of positive signal for the company to users of financial information, especially shareholders and potential investors (Yunia 2018). See these signals; the management can provide them through the results of the resulting financial performance. These businesses, such as liquidity, profitability, solvency, and other ratios, can affect earnings per share, ultimately increasing the company's value (Yunia 2018). The information provided from within is in the form of policies, plans, and developments carried out by management in developing business strategies that will affect the profits generated and published in financial statements (Suwardjono 2018). Only in the last decade has this signaling theory gained relevance in the analysis of practice; however, there is plenty of room for this approach to transition and to give a better description of the signal the company transmits (López-Santamaría et al. 2021).

### **Agency Theory**

Agency theory by Jensen and Meckling (1976) states that the organization, in this case, management is the party entrusted by the owners to run and manage the company. Agency theory describes the contractual relationship between the agent and the principal. In a business transaction, the shareholder or owner is the principal, and management acts as an agent. Management is responsible for day-to-day operations and preparing financial reports, but the final decision-making authority rests with the owners and shareholders. However, a dilemma exists where managers acting as agents of equity holders are motivated to act in their own best interests instead of their owners (Kirimi, Kariuki, and Ocharo 2022). Company owners can expect profits from the entity to provide returns to owners (Yunia 2018). Therefore, the price per share indicator is essential for measuring agents' performance to show the final results of the company's business operations (Kučera, Kalinová, and Divoká 2022).

### **Earnings per Share (EPS)**

EPS is one method that shareholders and investors can use to make decisions in terms of investment determination. Using analytics through EPS can determine the profits obtained based on the shares owned by shareholders or investors. If the company has a high net income, it will indicate that the price per share will be high, too; the fluctuations in the value of earnings per share can also affect the net profits obtained by the company (Riawan 2020). Therefore, for investors and shareholders, this EPS information can provide an essential and



valuable picture because it can describe future forecasting earnings in the company (Siddiq, Setiawan, and Nurdin 2020). If a company has a high level of financial ratios, it can represent that the earnings obtained by investors and shareholders are also more significant for the investments made. In other words, EPS can positively impact the entity's share price and can be published on the capital market. An information asymmetry and greater comparability increase financial transparency, which improves the information environment and increases stock liquidity; this will increase investors' interest in investing in companies in the capital market because the velocity of money that occurs with stock liquidation is smoother (Majeed and Yan 2022).

### **Profitability**

One of the factors that can affect the success of an investment made by shareholders and investors is to look at the profitability ratios generated and shown by the entity through the financial statements made. Profitability ratios can be explained by ratios that show the entity's ability to earn a return on the use of its equity (profit), while also providing direction on the level of effectiveness carried out by the company's management in carrying out operational activities of the company (Nugrahani and Suwitho 2016).

### **Hypothesis Development**

In this study, return on equity is used as a projection in measuring a company's profitability ratios. If the return on equity owned by the company has a good value, it can provide an overview and indication that the company has good profitability. Nevertheless, return on equity also shows how the company can make the level of efficiency and effectiveness in spending the money invested by investors and shareholders to achieve stable and reasonable profit growth (Nurlatifah and Siburian 2021). Previous research has been conducted by Nurlatifah and Siburian (2021); Uno, Tawas, and Rate (2014); Susilawati (2016) has found a relationship between ROE and earnings per share. Based on theoretical studies and previous research, return on equity a vital role in good profit growth so that it can satisfy the wishes of investors and shareholders, so that the hypothesis can be formed H1: ROE has a significant effect on earnings per share.

The liquidity ratio can provide an overview of the company's ability to carry out its financial obligations in the short term by a predetermined period. The liquidity owned by the company is shown by the size of the current assets that are easily converted into cash in a short period (Mudjijah 2015). Therefore, an entity that wants to maintain its existence in its business activities can have the ability to pay off its obligations on time (Nugrahani and Suwitho 2016). The relationship between liquidity and earnings is significant for investors because it can affect the wealth owned by the company (Snigaroff and Wroblewski 2021). The liquidity ratio is used as an indicator in seeing the sustainability of the company in fulfilling its responsibilities in financial obligations. Companies that are orderly in carrying out their obligations will provide confidence for investors that their investments can be appropriately processed. Then provide confidence that a good current ratio can illustrate that the company can return investments in the form of shares made by shareholders that will run well and smoothly. Previous research



conducted by Nugrahani and Suwitho (2016) found a significant effect between ROE and earnings per share. By reviewing the literature and strengthening the results of previous research, a can be formed a hypothesis H2: liquidity has a significant effect on earnings per share.

Firm size is an indicator that can describe the results of representing the company's total wealth in the form of assets it owns. Suppose the company has substantial total assets. In that case, it is categorized as having a very high level of wealth because, with significant investments, the company can generate high profits from its business operations. Companies having important total assets will provide a higher level of effectiveness in carrying out operations when compared to entities that have small total assets (Riawan 2020). Firm size is a contextual factor derived from various drivers, such as economies of scale, global power, and capitalism (Luo et al. 2022). Based on the description described Uno, Tawas, and Rate (2014) , the company's size is an estimator variable often used to explain the diversity in the disclosure of an entity's financial statements. Due to the company's large size, the information presented by management will be more complex and detailed to investors and shareholders, so the policies and decisions taken by investors and shareholders will be more accurate and precise. Previously, the relationship between company size variables and earnings per share has been studied by Nugrahani and Suwitho (2016); Riawan (2020) found results that had a significant effect on the two variables. Based on the theoretical studies and previous research described, can be formed hypotheses H3: firm size has a significant effect on earnings per share.

Audit quality is a way and an opportunity where an auditor can find and provide a statement in the form of a report if there is a violation of the accounting policy system adopted by the company. Audit quality is one of the results given by particular auditors, thus leading to audit quality as a form of possibility auditors find report misstatements and report violations that occur in company reports (Taqi et al. 2021). Small and large companies commit fraud; in general, the company will hide these errors neatly so that the examining auditor finds no indications. The probability of a violation being caught can be determined by the technical ability and independence of the auditor conducting the examination (Yunia 2018). In addition to these two things, there are several supporting elements such as auditor competence, auditor experience in similar auditing companies, professionalism, and audit structure carried out. In this case, the audit quality can be seen from the size of the public accounting firm (PAF), with a large PAF size certainly has good resources and is capable of increasing the level of audit quality. Four PAF in the world has credibility in their audit business. With these four major PAF, the results of the audits carried out provide good quality compared to audit firms that are not included in the Big Four category. This can be proven by the fact that companies listed on the Indonesian stock exchange mostly use the Big Four PAFs in carrying out audits of their financial statements. Previous research conducted by Yunia (2018) found a significant relationship between audit quality and earnings per share. Based on the literature review and previous research described above, it can be formed hypotheses H4: audit quality has a significant effect on earnings per share.





## METHODS

This quantitative research aims to analyze the causal relationship that can be used as an explanation of the relationship between the dependent variable and the independent variable (Sugiyono 2017). In this study, the dependent variable was estimated using earnings per share. In addition, the independent variables in this study are given indicators with return on equity, liquidity, firm size, and audit quality. The research population is consumer goods companies listed on the Indonesia Stock Exchange (IDX) for the 2018-2021 periods, totaling 180 companies. This study uses secondary data in the form of documentation from performance reports, financial reports, and independent auditors. Sampling used a purposive sampling method using the criteria shown in Table 1. The components of documentation related to the research variable instrument. Data come from audited financial statements published on the Indonesia Stock Exchange (IDX) or the company's website. The types of financial information used in collecting and calculating data are balance sheets, income statements, changes in equity reports, audit reports, and cash flow reports. The data analysis technique used in this study is to examine the relationship between the dependent variable and the independent variable by multiple regression analysis using IBM SPSS 25.

**Table 1 Sampling Criteria**

Nu.	Criteria	Amount
1	The consumer goods sector company consistently Initial Public Offerings (IPO) on the Indonesia Stock Exchange (IDX) from 2018 until 2021	180
2	Company financial statements that are not audited by external auditors during the study period 2018-2021	(0)
3	Companies that do not publish financial statements publications on the website <a href="http://www.idx.co.id">www.idx.co.id</a> or the company website during the observation period 2018-2021	(0)
4	Incomplete data are required for each sample year of the study period.	(0)
<b>Total Sample</b>		<b>180</b>

*Source: secondary data (processed)*

## RESULTS AND DISCUSSION

### Descriptive Statistics

In descriptive statistics, it can be seen how many samples are used in this study, see the distribution of data based on the minimum, maximum, average, and standard deviation values from the results of the research sample data processing (Ghozali 2018). Table 2 it is shown the details of the results of descriptive statistical tests during the 2018-2021 observation period. It is shown that EPS has a total of 180 data samples of companies with an average value of 1.3778, a standard deviation value of 1.12937, a maximum value of 4.00, and a minimum value of -2.00. ROE, with a sample size of 180 companies, has an average value of 754.4167, a standard deviation of 2782.03890, and maximum value of 22446.00, and a minimum value of -17831.00. Liquidity with a sample of 180



companies has an average value of 368.5278, a standard deviation of 852.63885, a maximum value of 9863.00, and a minimum value of 37.00. Firm size with a sample of 180 companies has an average value of 2851.7556, a standard deviation of 163.671168, a maximum value of 3282.00, and a minimum value of 2531.00.

**Table 2 Descriptive Statistics**

Variable	N	Minimum	Maximum	Mean	Std. Deviation
ROE	180	-17831.00	22446.00	754.4167	2782.03890
Liquidity	180	37.00	9863.00	368.5278	852.63885
Firm Size	180	2531.00	3282.00	2851.7556	163.67168
EPS	180	-2.00	4.00	1.3778	1.12937

*Source: secondary data (processed)*

### Normality Results

The normality test is intended to test the regression model that is formed for known symptoms of normality. Statistical tests cannot be performed if this assumption is violated or invalid. To test the assumption of normality in this study using the Kolmogorov-Smirnov test, if the significance value is  $> 0.05$ , then the statistical model assumption is normally distributed (Ghozali 2018). The normality test results show that the Kolmogorov-Smirnov significant value is  $0.200 > 0.05$ , meaning is research in this regression model is free from normality.

### Multicollinearity Results

The multicollinearity test can be used to determine whether the regression model finds a correlation between the independent variables used in this study. Multicollinearity Test with Tolerance and Variance Inflation Factor (VIF) (Ghozali 2018). If the tolerance value is more than 0.1 and the VIF is less than 10. Then there is no multicollinearity, but if the tolerance value is less than 0.1 and the VIF is more than 10, there is multicollinearity. Table 3 shows that the tolerance value is  $> 0.01$ , and the VIF value is  $< 10$ . The correlation of variables used in the study is free from the indication of multicollinearity.

**Table 3 Multicollinearity Result**

Variable	Tolerance	VIF
ROE	0.897	1.115
Liquidity	0.977	1.023
Firm Size	0.761	1.314
Audit Quality	0.726	1.378

*Source: secondary data (processed)*

### Autocorrelation Results

The autocorrelation test is a classic assumption test carried out on the regression model to test whether there is a relationship between the confounding error in the current period and the error in the previous period. The regression model that meets the requirements is a model that does not contain autocorrelation symptoms (Ghozali 2018). If the results show that the significance value for the trial is  $> 0.05$ , then there is no indication of autocorrelation (Ghozali 2018). Based on the results of the autocorrelation test, the significant value is shown at 0.654.



This provides evidence that this regression model is free from autocorrelation symptoms because the significance value of the test results is  $> 0.05$ .

### Heteroscedasticity Results

The heteroscedasticity test is one of the classical assumption tests designed to show whether a regression model has inequality of variance from one residual observation to another. The presence or absence of heteroscedasticity symptoms can be determined by using the Glejser test. The Glejser test uses the absolute value of the residual as the Y variable and regression on the independent variable. A significance value greater than 0.05 indicates the absence of heteroscedasticity symptoms, and a significance value smaller than 0.05 indicates heteroscedasticity symptoms (Ghozali 2018). Table 4 shows that the significant value in each variable has a value above  $> 0.05$  so that it is free from heteroscedasticity symptoms.

**Table 4 Glejser Test**

Variable	Sig.
(Constant)	0.725
ROE	0.526
Liquidity	0.354
Firm Size	0.605
Audit Quality	0.506

*Source: secondary data (processed)*

### Hypothesis Results

The value set by this test is intended to confirm whether the hypothesis used in this study is accepted or rejected. If the significance value is  $> 0.05$  then the hypothesis is rejected, but if the significance value is  $< 0.05$  then the hypothesis is accepted.

**Table 5 Hypothesis Results**

Variable	Coefficient	Sig.
(Constant)	-6.568	0.000
ROE	0.000	0.000
Liquidity	-1.282E-5	0.862
Firm Size	0.003	0.000
Audit Quality	0.455	0.004
<b>F</b>	39.241	0.000
<b>R Square</b>	0.473	

*Source: secondary data (processed)*

Table 5 shows that the independent variables are proxied in ROE, liquidity, firm size, and audit quality if one independent variable changes by one and the other is consistent so that changes in the dependent variable are proxied in EPS is equal to the beta coefficient (b) derived from the value of the independent variable. The ROE value is 0.000 which shows a significant value with a positive coefficient that has met the requirements because it is below the predetermined





standard of  $< 0.05$ , first hypothesis is accepted (H1 accepted). The liquidity value is 0.862 with the direction of the coefficient towards the negative where the value does not meet the requirements according to the established standard, which is  $> 0.05$ , second hypothesis is not accepted (H2 rejected). The firm size shows a significant value is 0.000 with a positive coefficient direction where the value is smaller than  $< 0.05$ , third hypothesis is accepted (H3 accepted). The audit quality shows a significant value is 0.04 which is smaller than the standard that has been set, which is  $< 0.05$ , fourth hypothesis is accepted (H4 accepted).

Table 5 shows that the significance value of F is  $0.000 < 0.05$ , meaning that simultaneously ROE, liquidity, firm size, and audit quality significantly affect EPS. Then the R Square value shows a value of 0.473 or 47.3%; this indicates that simultaneously the independent variables have a contribution value of 47.3% to the dependent variable, while other variables and factors explain the remaining 52.7%.

### **Effect of ROE on EPS**

The results of the first hypothesis in the multiple regression test above are accepted. Thus, ROE affects earnings per share if it is known that return on equity is a ratio that reflects that the entity has carried out its operational activities effectively in managing its capital. This will provide confidence and increase the interest of shareholders and investors to invest because, with a high ROE, there will also be an increase in profits on a sustainable basis. If it is associated with agency theory, agents have optimal because they can provide satisfaction to principals, namely investors, in maximizing the value of their financial performance in profitability indicators. Besides that, the company has also given signals to potential investors with successful financial performance that can provide a clear picture of the resulting financial performance. According to Mudzakar and Wardanny (2021), the better performance shown by the company will increase the attractiveness of investors to the company, and stock returns will also increase. These findings are in line with research conducted by Uno, Tawas, and Rate (2014); Nurlatifah and Siburian (2021) as well as research conducted by Susilawati (2016) which found a relationship between return on equity and earnings per share. However, this research is not in line with and is refuted by Umar and Savitri (2020); Suwandani, Suhendro, and Wijayanti (2017), which did not find a relationship between the two variables, namely ROE and EPS.

### **Effect of Liquidity on EPS**

The results of the second hypothesis in the results of multiple regression testing are rejected so that the liquidity in the current ratio does not affect earnings per share. If seen, small and large liquidity values will not affect earnings per share or earnings per share. So, in this case, companies engaged in consumer goods during the 2018-2021 periods in fulfilling short-term obligations by using their current assets do not influence earnings per share. Liquidity results are not significant and influential when viewed with existing theories; the current ratio is a rough assessment in calculating the smoothness of each part of the current assets owned by the company. Based on the theory presented by (Horne and Wachowicz 2009), companies with very liquid current assets generally are in the form of cash and receivables that are still outstanding compared to entities with extensive



inventories as current assets. So this is what causes the current ratio to be weak because it needs to distinguish which assets are more liquid than others. So, liquidation here cannot be a factor in EPS. Then this study is in line with Nugrahani and Suwitho (2016) research, not finding a relationship between the influence of the current ratio on earnings per share. Then this research is not in line and is refuted by research conducted by Uno, Tawas, and Rate (2014); Siddiq, Setiawan, and Nurdin (2020), which found a relationship between the current ratio and earnings per share.

### **Effect of Firm Size on EPS**

The results of the third hypothesis in the multiple regression analysis are accepted so that the firm size significantly affects earnings per share. Suppose, seen in observations and associated with theory and literature, that companies with significant total assets will also provide good company financial capabilities. In other words, the company is more effective and efficient in generating high profits based on the operationalization of its assets so that productivity can be carried out optimally and maximally. This is to the novelty found by Pradipta and Susanto (2019) that company size can minimize opportunistic income smoothing actions. In addition, companies with significant assets can control the company well so that the resulting financial performance will have a favorable implication to attract the attention of shareholders and potential investors to invest. This is in line with research conducted by Nugrahani and Suwitho (2016); Riawan (2020) found that firm size had a significant relationship effect on earnings per share. However, this is different from Uno, Tawas, and Rate (2014) research, which did not find a significant relationship between firm size and earnings per share.

### **Effect of Audit Quality on EPS**

Then the results of the fourth hypothesis in the test results of multiple regression analysis are accepted. Good audit quality results can increase investors' confidence to carry out investments. Because in general, investors give and put their trust in the auditor to be able to provide confidence that the financial reports and information submitted by the company's management can be trusted and held accountable. If the company continues to be regularly audited by independent auditors, it gives a positive stigma to the company because it conveys the actual condition of the company. Audit Quality guarantees transparency of useful financial statement information for decision-making purposes. It ensures that the performance of the auditor's duties is fair in checking the financial statements and that the results can be accounted (Taqi et al. 2021). This is in line with research conducted by Yunia (2018), which found that audit quality has a significant relationship with earnings per share.

## **CONCLUSIONS**

Based on the analysis carried out above, ROE, firm size, and audit quality partially show a significant effect on EPS. However, liquidity does not affect EPS. Simultaneously ROE, liquidity, firm size, and audit quality significantly affect EPS and have a contribution value is 47.3%. This research can be a source of reference for further research. Finding these results, the theoretical implications of



financial performance are significant in maintaining the company's existence in global competition. Because of sound financial performance, it gives good results in stock trading in the capital market. This study also provides an overview to the agents as company management to be able to carry out their duties and functions more optimally for the progress of the business and the company. This research still needs improvement, or its scope has been added for further research. Several suggestions can be recommendations for further research. For the sample used, the range of the year of research can be expanded, and it can use by other sector companies, especially the health sector. Because it can be linked to business before and after the covid-19 pandemic, using calculation methods and other data processing tools, and conducting a study of literature in various international journals as an additional reference for the following research.

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