

The Effect of Earnings Persistence and Leverage on the Earnings Response Coefficient



Althafani Dyah Istiningtyas
Universitas Trisakti Jakarta, Indonesia
123012404010@std.trisakti.ac.id

Abstract

This study examines the influence of earnings persistence and leverage on the earnings response coefficient (ERC) in basic materials sector companies of the Indonesian Stock Exchange (IDX) during the period 2021-2023. The population in this study is basic materials companies on the Indonesian Stock Exchange. This study uses a purposive sampling method, and the sample selected is 75 companies. Earnings persistence refers to the degree to which current earnings can predict future earnings, while leverage represents the level of a company's debt relative to its equity. The research was a quantitative method, and secondary data were collected from financial statements and analyzed through multiple linear regression. The results indicate that earnings persistence has a significant positive effect on the ERC, suggesting that more consistent and reliable earnings lead to stronger investor reactions. In contrast, leverage has a significant negative impact on the ERC, implying that higher debt levels may reduce investor trust in the credibility of reported earnings. These findings highlight the importance of earnings quality and capital structure in influencing investor reactions to financial performance.

Keywords: Earnings Persistence, Leverage, Earnings Response Coefficient

INTRODUCTION

Globalization presents both opportunities and challenges that drive companies to take strategic steps to enhance access to capital and expand market reach. Stakeholders within business organizations strive to transform their companies into public entities, allowing them to easily sell shares to the general public through the stock market. This is expected to be a strategic move that can influence the company's future growth and sustainability. Going public makes a company more attractive to investors and facilitates greater access to funding, enabling business expansion and strengthening its market position. However, becoming a public company requires greater attention to business management. A strong corporate reputation and profile are essential to establish a positive corporate image. Transparency and accountability also become focal points for the public in assessing a company's performance.

The capital market plays a vital role in supporting a country's economic growth by providing access to capital for companies and investment opportunities for the public. In this context, the quality of accounting information particularly earnings information is crucial, as earnings are a key indicator used by investors to evaluate a company's performance and prospects. One way to assess the relevance of earnings information to investors is through the Earnings Response Coefficient (ERC), which measures the sensitivity of stock prices to reported earnings changes. A higher ERC indicates a stronger market response to earnings, reflecting greater investor confidence in the quality of those earnings. A high ERC means that the company's reported earnings are considered highly relevant by investors in determining firm value. Historically and instinctively, investors have shown stronger reactions to earnings from companies perceived as credible, stable, and promising. While investors may not directly calculate ERC, their behavior often mirrors the reactions measured by the ERC concept. Research into the factors affecting ERC is important, as ERC serves as an indicator of how much the market trusts and reacts to earnings information.

This study is a replication of a research journal conducted by Sandy and Mulya (2024), titled *"The Effect of Earnings Persistence and Capital Structure on Earnings Response Coefficient."* The original study used Earnings Response Coefficient (ERC) as the dependent variable and Earnings Persistence and Capital Structure as the independent variables, with a research sample consisting of 265 companies listed on the Indonesia Stock Exchange (IDX) from 2011 to 2021. The development of this current research lies in the differences in the research period and the object of study. This study uses two independent variables and one dependent variable. The object of this research is companies in the Basic Materials sector listed on the Indonesia Stock Exchange (IDX) for the years 2021 to 2023.

REVIEW OF LITERATURE

Signalling Theory

Signalling theory is the idea that the company provides information to investors about how it will perform in the future. Based on signalling theory, it can be concluded that the signals and information delivered by the company influence investors' decisions on where to allocate their investments (Agus and Sutanto, 2024). The main goal of delivering signals is to reduce investor uncertainty and to differentiate well-performing companies from poorly performing ones. In relation to the Earnings Response Coefficient (ERC), signalling theory offers a framework for understanding that reported earnings are not merely accounting figures they also serve as signals about the company's future performance prospects. If

earnings information is perceived by investors as credible and informative, the market will respond positively to the announcement, which is reflected in a high ERC. Therefore, from the perspective of signalling theory, reported earnings are not only historical data but also a strategic communication tool. Earnings signals that are effectively communicated and supported by good disclosure practices will enhance market confidence in the company's outlook, ultimately increasing the ERC. Signalling theory thus provides a theoretical explanation of why and how earnings information can influence stock prices, as well as which factors may strengthen or weaken that influence.

Information Asymmetry Theory

Information Asymmetry Theory explains that in a market, not all economic agents have equal access to information. In the context of a company, information asymmetry occurs when management, as an internal party, possesses more complete, relevant, and timely information about the company's financial condition and business prospects compared to external investors. This imbalance in access to information can lead to poor investment decisions and misvaluation of a company's worth. When earnings information is announced to the public, the capital market responds to the announcement as a signal of the company's economic performance. However, the degree of market response to earnings information empirically measured through the Earnings Response Coefficient (ERC) is highly influenced by the level of existing information asymmetry. ERC reflects the sensitivity of stock price changes to earnings information; the higher the ERC, the stronger the market reaction to earnings changes.

Earnings Response Coefficient

The Earnings Response Coefficient (ERC) is a measure of the relationship between earnings and stock prices. ERC reflects the market's reaction to published earnings information, as indicated by stock price movements on the announcement date (Aiffa and Nadhifah, 2024). According to Ardiyani et al. (2024), the Earnings Response Coefficient is a measure of how the market will respond to a company's reported earnings, and it also reflects investors' perceptions of the company's profitability in the market. A strong market reaction to earnings information, indicated by a high ERC, shows that the reported earnings are of high quality. Conversely, a weak market reaction indicates a low ERC, suggesting that the earnings information is perceived as less useful or reliable (Fersela et al., 2021).

Earnings Persistence

Earnings persistence is a measure used to assess earnings quality by considering earnings forecasts and evaluating them through accruals and cash flows. Current earnings reflect future periods, and earnings consistency demonstrates a company's ability to sustain long-term profitability, indicating high-quality earnings. Increased earnings persistence tends to lead to a higher earnings response coefficient (Setiadi and Ningsih, 2024). Earnings are considered to have predictive power, which can reduce uncertainty risks. Most users, such as investors and creditors, rely on earnings as a basis for decision-making. Expected earnings should not only be high but also stable and sustainable over time. This condition is referred to as persistent earnings. (Tannia and Widyasari, 2023).

Leverage

Leverage (debt ratio) refers to the proportion of debt financing in an organization compared to its equity. This ratio is used to measure how much of the company's own capital is being used as collateral (Auliya and Africa, 2023). Leverage can increase both managerial

earnings (profits) and the risk of failure (losses). A company will have a higher degree of financial leverage if it carries a significant amount of debt. Investors tend to assume that the company will prioritize debt repayments to stakeholders before distributing dividends, which may reduce their trust in the company's reported earnings.

Conceptual Framework

Based on the theoretical framework and previous studies mentioned above, the researcher illustrates the research model as follows:

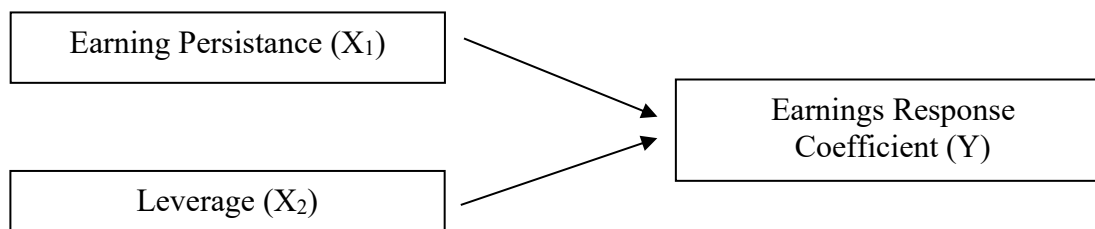


Figure 1.
Conceptual Framework

Hypothesis Development

The Effect of Earnings Persistence on the Earnings Response Coefficient

Consistent earnings performance enhances investor confidence and market reaction. Higher investor sentiment strengthens the positive effect of earnings persistence on the Earnings Response Coefficient (ERC), indicating that market reactions to earnings announcements are influenced by prevailing investor sentiment. Sandy and Mulya (2024) concluded that earnings persistence has a positive impact on ERC. The hypothesis testing results by Irawan and Talpia (2021) show that the coefficient for the earnings persistence variable and ERC is positive and significant. This means that the increasing level of profits from a company's normal activities over time is positively received by investors. Good earnings persistence is indicated by a result above 100%, which suggests that sustainable earnings are derived from the company's operations and are expected to continue into the following periods. The data examined shows varying levels of persistence and significant changes, including both increases and decreases in earnings. Therefore, persistence becomes a determining factor in corporate investment policy. The market responds more strongly to information that is expected to be consistent in the long term compared to temporary information. Earnings announcements are more likely to be responded to by investors when a company has succeeded in improving efficiency, rather than earnings resulting from asset sales (Sherlita and Ramadhian Fadlillah Ghassan, 2021). This research aligns with the findings of Handi et al. (2022), Winidiantari et al. (2024), and Chandra et al. (2021).

H₁: Earnings Persistence has a positive effect on the Earnings Response Coefficient

The Effect of Leverage on the Earnings Response Coefficient

Leverage increases both managerial gains (profits) and the risk of failure (losses). A company will have higher financial leverage if its level of debt is relatively high. Investors may perceive that the company will prioritize repaying debt to stakeholders before distributing dividends, which leads to reduced trust in the company's earnings disclosures. Excessive leverage poses several risks that concern investors who are invested in such companies. In companies with high leverage, investors tend to evaluate earnings information more skeptically. This skepticism arises from concerns that reported earnings may not

accurately reflect operational performance due to managerial pressure to meet debt covenants or to present a more favorable financial condition than reality.

Such conditions make earnings information less informative for investors, resulting in a weak market response to earnings announcements. In other words, the stock price reaction to reported earnings becomes less pronounced. This is reflected in the lower value of the Earnings Response Coefficient (ERC) for highly leveraged companies. This research is consistent with the findings of Ardiyani et al. (2024), Awawdeh et al. (2020), Suryani (2021), Lucyanda and Nahomy (2017), Tannia and Widyasari (2023), Sipahutar et al. (2023), and Raldy and Lubis (2024), who concluded that leverage has a negative effect on the earnings response coefficient.

H₂: Leverage has a negative effect on the Earnings Response Coefficient.

RESEARCH METHOD

Research Method and Data Sample

This study uses a quantitative research methodology. The main objective of quantitative research is to test hypotheses by collecting numerical data on research variables and analyzing the results statistically. The data used are secondary data in the form of annual reports. The population in this study consists of companies in the basic materials sector listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023, totaling 25 companies over a 3-year period, resulting in 75 data samples. In this study, the researcher determined the sample criteria as follows:

1. Companies in the basic materials sector listed on the Indonesia Stock Exchange during the observation period of 2021–2023.
2. Companies that publish complete financial statements for the research years and have data or information relevant to the study's requirements.
3. Companies that present financial statements in the currency IDR (Rupiah).
4. Companies that earned a profit or did not experience a loss during the 2020–2023 period.

Dependent Variable (Y)

The dependent variable is a variable that is influenced by other variables. It is often referred to as the response or outcome variable. In this study, the dependent variable used is the Earnings Response Coefficient (ERC). The Earnings Response Coefficient is a measure that indicates the relationship between earnings and stock returns. ERC is used to assess the extent of the market's reaction to earnings information disclosed in a company's financial report. The measurement of ERC involves Unexpected Earnings (UE) as a proxy for accounting earnings and Cumulative Abnormal Return (CAR) as a proxy for stock price. The steps to calculate the Earnings Response Coefficient (ERC) according to Yuliandhari and Fadila (2024) are as follows:

- a. Calculate the daily stock return using the following formula:

$$R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}}$$

Description:

R_{it} : Stock return of company i on day t

P_t : Closing price of the stock on day t

P_{t-1} : Closing price of stock i on day t-1

- b. Calculate the daily market return using the following formula:

$$R_{Mt} = \frac{IHSG_t - IHSG_{t-1}}{IHSG_{t-1}}$$

Description:

R_{Mt} : Market index *return* on day t

JCI : Composite stock price index on the day

JCI_{t-1} : Composite stock price index on day t-1

- c. Calculate the abnormal return (AR) using the following formula:

$$AR_{it} = R_{it} - R_{Mt}$$

Description:

AR_{it} : Abnormal return on company i period t

R_{it} : Daily stock return of company i on day t

R_{Mt} : Company i's daily market return on day t

- d. Calculate the cumulative abnormal return (CAR) using the following formula:

$$CAR_{it} = \sum_{-t}^{+t} AR_{it}$$

Description:

CAR_{it} : Cumulative abnormal return of company i period t

AR_{it} : Abnormal return of company i period t

- e. Calculate the unexpected earnings (UE), which is the difference between actual earnings and earnings expectations, using the following formula:

$$UE_{it} = \frac{E_{it} - E_{it-1}}{E_{it-1}}$$

Description:

UE_{it} : Unexpected earnings of company i in period t

E_{it} : Accounting profit of company i period t

E_{it-1} : Accounting profit of company i period t-1

f. Calculate the Earnings Response Coefficient (ERC) using the following formula:

$$CAR_{it} = \alpha + \beta UE_{it} + \varepsilon$$

Description:

CAR_{it} : Cumulative abnormal return (CAR) of company i during the observation period

UE_{it} : Unexpected earnings of company i in period t

α : Constant

β : Earnings response coefficient

ε : Error

Independent Variable (X)

The variable used in statistical analysis or research to predict or influence another variable, referred to as the dependent variable—is called the independent variable. Independent variables are typically considered the causal factors or drivers of the outcomes measured by the dependent variable.

Earnings Persistence (X₁)

According to Beredugo (2023), earnings persistence refers to the consistency of earnings figures, indicating how long accounting earnings are expected to persist into the future. A high level of consistency reflects a sustainable earnings generation process, which is highly valued by investors. Persistent earnings are those expected to recur, making persistence a desirable characteristic of reported earnings.

Earnings Persistence is calculated using the following formula:

$$EP = \frac{EBT_t - EBT_{t-1}}{Total Asset}$$

Description:

EBT_t : Profit before tax in year t

EBT_{t-1} : Profit before tax year t-1

$Total Asset$: Total assets

Leverage (X₂)

Leverage is a ratio that describes the proportion of debt used in a company's capital structure. Leverage indicates the extent to which a company relies on external financing (debt) to carry out its operational activities. In this study, leverage is measured using the formula of Total Liabilities divided by Total Assets (Total Liabilities / Total Assets), following the approach used by Collins and Kothari (1989).

$$Leverage = \frac{Total Liabilities}{Total Assets}$$

Data Analysis Method

This study uses panel data and applies quantitative data analysis methods. The sample was determined through sources such as the IDX website, sustainability reports, and company financial statements. As cited from DQLab.id, panel data is a type of data that combines cross-sectional data at a specific point in time with time series data. This type of data merges two dimensions: individual (or entity) and time. Information about several units, such as individuals, companies, or countries, is collected over a specified period. This study applies the panel regression method using SPSS as the statistical analysis tool.

Descriptive Statistics

Descriptive statistics is a statistical technique used to describe or summarize collected data. This technique includes data collection, data processing, and data presentation in formats such as tables, charts, measurements, or graphs (Lubis, 2021). The results of descriptive statistical tests provide the mean, standard deviation, minimum, and maximum values of each research variable.

Interpretation of Panel Data Regression

Hypothesis Testing

This hypothesis testing is used to determine whether there is an influence between Earnings Persistence and Leverage on the Earnings Response Coefficient. This study uses multiple linear regression analysis as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$$

Explanation:

Y : Earnings Response Coefficient

α : Constant Value

$\beta_1 - \beta_2$: Linear Regression Coefficients

X_1 : Earnings Persistence

X_2 : Leverage

e : Error Term

RESULTS AND DISCUSSION

Data Analysis

Descriptive Statistics

Descriptive statistical analysis is a statistical method used to analyze data by describing or illustrating the data that has been collected.

Tabel 1
Result of Statistics Descriptive

	N	Minimum	Maximum	Mean	Std. Deviation
Earnings Persistence	75	1.01	848.36	1.6946E2	223.68616
Leverage	75	.03	.74	.3518	.17195
Earning Response Coefficient	75	-982.96	1.56E6	3.0555E4	1.97906E5
Valid N (listwise)	75				

Classical Assumption Test

Normality Test

Table 2.
Normality Test
One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		75
Normal Parameters ^a	Mean	.0000000
	Std. Deviation	1.90007340E5
Most Extreme Differences	Absolute	.393
	Positive	.393
	Negative	-.227
Kolmogorov-Smirnov Z		3.401
Asymp. Sig. (2-tailed)		.100

a. Test distribution is Normal.

In Table 2, it can be concluded that the Asymp. Sig. (2-tailed) value is $0.100 > \alpha = 0.05$, which means that, based on the decision criteria using the Kolmogorov-Smirnov test, the data follow a normal distribution and thus meet the normality assumption required in the regression model.

Autocorrelation Test

Table 3
Autocorrelation Test
Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.280 ^a	.078	.053	1.92628E5	1.159

a. Predictors: (Constant), Leverage, Earnings Persistence

b. Dependent Variable: Earning Response Coefficient

Based on the Durbin-Watson value shown in the table above, which is 1.159, and considering the acceptable range between 0.987 and 2.46, it can be concluded that there is no autocorrelation in this study.

Multicollinearity Test

Table 4.
Multicollinearity Test

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Earnings Persistence	1.000	1.000
	Leverage	1.000	1.000

In Table 4, the tolerance value for the Earnings Persistence variable is $1.000 > 0.10$, and for the Leverage variable is also $1.000 > 0.10$. Therefore, it can be concluded that there is no indication of multicollinearity in the regression model.

Heteroscedasticity Test

Table 5.
Heteroscedasticity Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	46398.867	43700.181		1.062	.292
	Earnings Persistence	389.131	81.410	.486	.780	.109
	Leverage	-139465.176	105904.516	-.134	1.317	.192

a. Dependent Variable:
ABS_RES

In Table 5, the test results show that the significance value for the Earnings Persistence variable is $0.109 > 0.05$, and for the Leverage variable is $0.192 > 0.05$. Based on these values, it can be concluded, according to the decision criteria of the Glejser test, that there is no heteroscedasticity in the regression model.

Hypothesis Testing Multiple Linear Regression Analysis

Table 6.
Multiple Linear Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	24044.664	53736.794		.447	.656
Earnings Persistence	236.087	100.108	.267	2.358	.021
Leverage	-95219.386	130227.588	-.083	10.731	.047

a. Dependent Variable: Earning Response Coefficient

Based on the results of the multiple linear regression analysis in the table above, the following equation is obtained:

$$Y = 24044.664 + 236.087X_1 - 95219.386X_2$$

This equation can be interpreted as follows:

1. Based on the multiple linear regression equation above, the constant value is 24044.664, meaning that if the independent variables Earnings Persistence and Leverage are assumed to be constant, the Earnings Response Coefficient can be predicted to be 24044.664 units.
2. The Earnings Persistence (X_1) variable in the regression model has a coefficient value of 236.087, meaning that if the value of this variable increases by 1 unit while the other variables remain constant, the Earnings Response Coefficient is predicted to increase by 236.087.
3. The Leverage (X_2) variable in the regression model has a coefficient value of -95219.386, meaning that if the value of this variable increases by 1 unit while the other variables remain constant, the Earnings Response Coefficient is predicted to decrease by -95219.386.

Table 7.
t-Test, F-Test, R² Results

Model		Standardized Coefficients	t	Sig.
		Beta		
1	(Constant)		.447	.656
	Earnings Persistence	.267	2.358	.021
	Leverage	-.083	10.731	.047
Adjusted R2 : 0,053				
F Test : 3,055			Sig : 0,050	

a. Dependent Variable: Earning Response Coefficient

Based on the table above, the influence of each independent variable on the dependent variable is as follows:

a. Earnings Persistence (X_1) on Earnings Response Coefficient (Y)

The hypothesis of this study is that Earnings Persistence (X_1) has a positive effect on the Earnings Response Coefficient (Y). Based on the SPSS output table "Coefficients" above, the significance value (Sig.) for the Earnings Persistence variable (X_1) is 0.021. Since the Sig. value of $0.021 < 0.05$, it can be concluded that H_1 is accepted and H_0 is rejected. This means there is a significant effect of Earnings Persistence (X_1) on the Earnings Response Coefficient (Y).

b. Leverage (X_2) on Earnings Response Coefficient (Y)

The hypothesis of this study is that Leverage (X_2) has a positive effect on the Earnings Response Coefficient (Y). Based on the SPSS output table "Coefficients" above, the significance value (Sig.) for the Leverage variable (X_2) is 0.047. Since the Sig. value of $0.047 < 0.05$, it can be concluded that H_2 is accepted and H_0 is rejected. This means there is a significant effect of Leverage (X_2) on the Earnings Response Coefficient (Y).

Based on the SPSS "Anova" output table above, the significance value (Sig.) is $0.05 < 0.05$, thus it can be concluded that the hypothesis is accepted. In other words, Earnings Persistence (X_1) and Leverage (X_2) simultaneously have a significant effect on the Earnings Response Coefficient (Y). Based on the SPSS "Model Summary" output table above, the value of the coefficient of determination (R Square) is 0.078, or 7.8%. This means that the variables Earnings Persistence (X_1) and Leverage (X_2) simultaneously influence the Earnings Response Coefficient (Y) by 7.8%. The remaining 92.2% ($100\% - 7.8\%$) is influenced by other variables outside this regression equation or by variables that were not included in the study.

The Effect of Earnings Persistence on Earnings Response Coefficient

Based on the results of the t-test, the significance value (Sig) for the Earnings Persistence (X_1) variable is 0.021. Since the Sig. value of $0.021 < 0.05$, it can be concluded that H_1 is accepted and H_0 is rejected. This means that there is a significant positive effect of Earnings Persistence (X_1) on the Earnings Response Coefficient (Y). Earnings persistence describes the extent to which current earnings can reflect future earnings. Persistent earnings are typically considered higher in quality because they better represent the company's

sustainable performance. Therefore, persistent earnings information tends to be more valued by investors as it provides a more reliable signal regarding the company's future prospects. The higher the level of earnings persistence, the stronger the market response to earnings information, as reflected by a higher ERC value. Investors will react more strongly to earnings reports perceived as representing long-term performance. Conversely, if earnings are not persistent or are temporary, investors may view the information as less relevant, resulting in a weaker market response (lower ERC). This study shows that Earnings Persistence has a positive effect on the Earnings Response Coefficient, which is supported by the findings of Sandy and Mulya (2024), Irawan and Talpia (2021), Handi et al. (2022), Winidiantari et al. (2024), and Chandra et al. (2021).

The Effect of Leverage on Earnings Response Coefficient

Based on the results of the t-test, the significance value (Sig) for the Leverage (X_2) variable is 0.047. Since the Sig. value of $0.047 < 0.05$, it can be concluded that H_2 is accepted and H_0 is rejected. This means that there is a significant negative effect of Leverage (X_2) on the Earnings Response Coefficient (Y). Leverage indicates how much of the company's assets are financed through debt (Kasmir, 2014:112). Leverage can increase both managerial gains (profits) and the risk of failure (losses). A company will have higher financial leverage if its debt level is relatively high. Investors tend to believe that the company will prioritize repaying its debts to stakeholders before paying dividends, which reduces their trust in the company's earnings disclosures. Excessive leverage creates numerous risks, raising concerns among investors in the company. As a result, the market reaction when earnings are announced will be minimal, indicating lower earnings quality. This finding is supported by previous research conducted by Ardiyani et al. (2024), Awawdeh et al. (2020), Suryani (2021), Lucyanda and Nahomy (2017), Tannia and Widyasari (2023), Sipahutar et al. (2023), and Raldy and Lubis (2024), who concluded that Leverage has a negative effect on the Earnings Response Coefficient.

CONCLUSION

This study concludes that earnings persistence has a significant positive effect on the earnings response coefficient (ERC), as demonstrated by a significance value of 0.021, which is below the 0.05 threshold. This finding indicates that consistently high earnings are favorably viewed by the market and contribute to increased investor confidence in a company's financial performance. On the other hand, leverage has a significant negative effect on the ERC, as shown by a significance value of 0.047. This implies that higher levels of leverage can elevate perceived risk among investors, leading to a diminished market response to reported earnings. These results highlight the importance of both earnings quality and capital structure in influencing investor reactions to financial disclosures.

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