JOURNAL LA BISECOMAN
VOL. 06, ISSUE 02 (454-468), 2025
DOI: 10.37899/journallabisecoman.v6i2.2292

# Earnings Quality as a Function of Capital Structure and Financial Signals in Indonesia's Industrial Sector

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Article Info

*Article history:*
Received 3 June 2025
Received in revised form 20 June 2025
Accepted 14 July 2025

*Keywords:*
Capital Structure
Profit Growth
Company Size
Profit Persistence
Profit Quality

*JEL Classification*:
M41 G32, G34, O16, L60

***Abstract***

*In this regard the veracity of the corporate engagement in reporting earnings is of core interest in financial research especially in developing economies where regulation, disciplinary and governance infrastructure remains variable. This paper reconsiders the applicability of the four fundamental financial determinants, that is, the capital structure, earnings growth, firm size, and earnings persistence as a determinant of earnings quality in Indonesia in industrial sector. These variables are generally addressed in the available extents of literature as universally credible predictors; however, the institutions and the behavioural issues that define firms within a structurally fissured market place are rarely considerations, and few theories can be applied that are held to be reliably predictive. This study, using a regression model based on agency theory and signaling theory, and panel data collected on industrial firms which were listed in the Indonesia stock exchange during the period of 2019 and 2023; discovers that capital structure poses a rather influential influence positively on the earnings quality of firms. This is the result of creditor management encouraging reporting discipline in situations where internal governance is low. Conversely, earnings growth and firm size are not related closely with earnings quality, which means that the market is no longer using scale itself or expansion as a valid proxy of credibility. Even more urgently, the persistence of earnings is much more harmful on the scale, showing how too steady earnings could speak about manipulation instead of actual financial might.*

## Introduction

Earnings quality has been one of the most researched element of the financial reporting in the recent years, given the fact that corporate transparency and investor assurance are now facing a lot of pressure. Although the reported profits are the most conspicuous sign of the performance by a firm, not all profits are equally informative. Good earnings have been described as the ones which are sustainable, precise, and not vulnerable to manipulation and are thus a valid yardstick of operational well-being (Pellegrini et al., 2021; Yaroson et al., 2024; Machakaire & Mokhele, 2024). On the contrary, bad-quality income might emerge due to accounting discretion or opportunistic management conduct, as well as via unsustainable financial gimmicks, hence masking the accurate financial state of a company (Habib & Jiang, 2021; Susanto & Rinaldi, 2023). This difference is especially present in young markets like Indonesia, in which financial reporting standards are evolving and institutional enforcement is still uneven. It would therefore not be correct to suggest that the exploration of determinants of earnings quality is an academic subject; on the contrary it is practical necessity of all investors, regulators and the stakeholders in that business.



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

There are various saw-teeth of internal determinants of financial decision making that determine the integrity of reported earnings which include capital structure, earnings growth, the size of the company and the earnings persistence (Khuong et al., 2022; Lizińska et al., 2024). These variables do not work separately but altogether pointing toward financial health and also strategic positioning (Altman et al., 2025; Núnez Chicharro et al., 2024). To illustrate, managerial behavior can be determined by the level of capital structure i.e. the extent of leverage (debt amount in relation to the amount of equity) when the firms are under the pressure of fixed obligation/penalties or when they want to borrow favorable credit ratings. Recent empirical reports (e.g., Nguyen et al., 2021; Nugroho & Lestari, 2023) show that firms with a high leverage might resort to either underreporting or overreporting to meet the expectations of outsiders, thus, indicating that leverage and earnings quality tend to have an opposite relationship. Nevertheless, this is still inconclusive evidence and even context-dependent, especially in economies with varying degrees of maturity of their debt markets. This uncertainty points at the need to reconsider capital structure and earnings quality relationship at local and sector levels (Athari & Bahreini, 2023; Le & Nguyen, 2023).

The other noticeable financial indicator is the earnings development, which is often viewed by investors as the positive indication of the long-term value creation (Vithana et al., 2023). In the modern studies in the field of accounting the Signaling Theory argues that incessant growth of profit conveys the message of the manager quality and competitiveness and at the same time reduces the information gap between the managers and the external stakeholders (Yudha et al., 2024; Asiedu & Opuku, 2022; Connelly et al., 2025). New evidence however is preventing an unconditional interpretation of earnings growth as something that is always good. Empirical research by Lee & Kim (2022) and Chen et al. (2020) points to the fact that when institutions are pressured to perform in terms of achieving upward rates of organizational performance, they tend to slip into engaging in earnings management as they practice accruals. This conflict of real performance and fake signaling makes the concept of earnings growth a theoretically and empirically disputable element in measuring earnings quality that should be re-examined.

The size of the firm brings in another stratification factor in the financial reporting setting. Because of high visibility, bigger companies face intensive scrutiny by the regulator, auditors and market analysts. This exists as a disciplining mechanism that enhances the quality of disclosures in terms of transparency and dependability. An array of empirical investigations (e.g., Astuti & Suryani, 2021; Wijayanti et al., 2024) thus recognizes a positive relationship amid the size and earnings quality of firms, which epitomizes the manner institutional scale can constrain the managerial discretion. However, there is also a correlation between firm size and bureaucracy, complexity or the strict internal control system which will not reflect the true financial situation (Koeswayo et al., 2024; Lee et al., 2021). Therefore, although the theoretical argument about firm size to be included in study and analysis of earnings quality is still valid, the empirical impact is yet to be determined thus making this aspect a worthy addition in any of these studies.

In additional to structural and growth financial aspects, stability of earnings over time, often called earnings persistence, offers a performance based perspective by which earnings quality can be judged (Nissim, 2021; Jia & Li, 2022). Continued incomes usually hold more credence since they can be called a stable, accumulating income system as opposed to a single incident. However, the evaluation of persistence also needs to consider the not so benign personalities of the concept. In cases of firms that indicate too smooth earnings patterns, even when they have been operating in a turbulent situation, it might be an indicator of earnings management in order to portray stability in the financial position. The latest literature (Putra et al., 2023; Ammar & Achyani, 2024) indicates this paradox, through which the persistence of high



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

earnings contributes both to the replication of the past performance quality and/or to the indication of strategic masquerada. Such tension strengthens the view that the inclusion of earnings persistence in the empirical models of earnings quality is very important especially in the industries prone to the fluctuations of the business cycle and expectations of the investors (Jaggi et al., 2022; Resende et al., 2024).

In spite of the widespread number of studies in this field, there exist a number of gaps. To begin with, the major problem has been that most research on these financial determinants has been carried out as individual entities instead of a collective effort of modeling them (MacNeil & Esser, 2022; Velten et al., 2021). Second, not many have studied this problem in Indonesian industrial sector that presents a diversified set of manufacturing and processing companies vulnerable to factors of capital intensity, international trade and macroeconomical instability. These attributes render the industry an excellent environment of operating an earnings quality dynamism. Third, there has been broadly a lack in the literature to date to date of sources of data comprising the global aggregates or being cross-sectoral in nature where it has failed to note industry specific differences or nuances that may affect financial behavior. The proposed study will help fill these gaps by examining, on an empirical basis, the joint influence of the capital structure, earnings growth, firm size, and earnings persistence on earnings quality of firms listed in the Indonesia Stock Exchange in the period 2019 to 2023 in the industrial sector.

**Literature Review and Hypothesis Development**

The ideas of the earnings quality have lately drawn fresh academic and regulatory interest in the changing environment of corporate financial reporting, especially in the emerging markets, where both transparency and corporate governance systems continue to underdevelop. Instead of being a simple numerical reflection, the quality in earnings is becoming more the subject of conceptualization of managerial behavior, institutional frameworks and market sentiment. This study seeks to model these dynamics through combining two broad theoretical perspectives that are referred to as the Agency Theory and Signaling Theory, to explain why I have included four constructs into the study, namely the capital structure, earnings growth, the size of firm and earnings persistence. The role given to the constructs is not random, as recent empirical and theoretical advances emphasizes the importance of the role of financial disclosures given by the latent incentives and constraints existing in firms at the time of their creation.

The Agency Theory offers a baseline explanation on distortions of the earnings quality especially those that come about due to internal hierarchies of decision-making. The (landmark) formulation of Jensen & Meckling (1976) described the generation of conflicts between the principals (shareholders) and agents (managers) due to discrepant utility functions and disparate access to information. According to recent surveys (e.g., Hossain & Mollah, 2022; Nugroho & Lestari, 2023), the conflict of interest between such agencies exists, but higher in the situations of high leverage and thus the risk of opportunistic financial reporting increases. In this case, it is theoretically important to focus on capital structure: firms that have higher indebtedness might have an incentive to misreport in order to satisfy the requirements of debt lenders or to prevent the occurrence of breach of covenant (Boubaker et al., 2021). This pressure can stimulate earnings smoothing in the short-term, which undermines the quality of earnings. Therefore, in terms of agency theory, the capital structure is not only a financial state, but also a governance cue that affects the managerial discretion.

The Agency Theory is focused on internal forces whereas Signaling Theory redirects the evaluation to the way a firm signals the external actors about its performance (Huang, 2022). The theory states that in a market with asymmetric information firms with verifiable quality communicate their quality using visible financial variables (Spence 1973). An earnings growth



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

is one of the most potent ones. Payments of the increasing trend in the net income are normally interpreted by the investors and an analyst to be an indicator of business prosperity and long-term sustainability. Nevertheless, according to Chen et al. (2020) and Lee & Kim (2022), key information such signals can be created strategically. Companies can produce growth stories by employing aggressive accrual accounting or out-of-control spending. Added to this is the fact that the earnings growth construct is not theoretically characterized by its mere face value, quite simply, because it contains the conflict between the truthful performance signaling and the possibility of manipulations in the case of information asymmetry (Alsulami, 2024).

In this theoretical layering, size of the firm is one of the structural variables, which influences agency costs and clarity in the signaling. Opportunistic earnings management: Big companies are generally under more regulatory, and auditing, and societal pressure, and therefore cannot fix earnings as is the case of smaller companies (Dang et al., 2022). In addition, institutional investors and rating agencies are less monitoring of small-caps and more monitoring of large-cap firms, which generates reputational incentives to report faithfully and openly (Rahmawati & Fadila, 2023). On an agency perspective, the size of a firm undermines managerial control by enhancing better governance systems. Conceptually, size is considered to be as a factor of credibility in terms of signaling, resulting in greater reliability of financial reports by external users. The past studies (Astuti & Suryani, 2021; Wijayanti et al., 2024) found that the bigger companies are more likely to have higher earnings quality, which can be interpreted as a stabilising factor, so its inclusion in the current model is reasonable.

Passing to the discussion of organizational structure to performance consistency, the concept of earnings persistence brings a longitudinal aspect into the theoretical context. In fact, high earnings persistence is generally considered an aspect of earnings quality since it is an indication that earnings are based on sustainable operational success as opposed to nonrecurring and unstable occurrences. Signaling Theory follows this reasoning, in that growth that is steady over a period of time gives indication of good managerial skill and steady strategy orientation. However, recent literature (e.g., Putra et al., 2023; Ammar & Achyani, 2024) complicates this picture by suggesting that overly smooth earnings patterns can reflect earnings management rather than genuine stability. Agency Theory corroborates this ambiguity by showing how persistent reporting patterns can be manufactured through discretionary accruals, especially in firms with weak internal controls. Thus, earnings persistence is not unambiguously positive; it is its interpretive uncertainty—between legitimate signal and engineered stability—that makes it a compelling construct for investigation.

Together, these four constructs—capital structure, earnings growth, firm size, and earnings persistence—form a multidimensional framework for evaluating earnings quality. They are not isolated metrics but interlinked reflections of agency costs, signaling incentives, and structural constraints. Agency Theory helps explain the internal behavioral drivers of earnings management, while Signaling Theory addresses the external pressures and expectations that shape disclosure strategies. Each construct plays a theoretically distinct role in influencing how, why, and under what circumstances firms present earnings that reflect—or distort—economic reality. Accordingly, this study proposes the following hypotheses to empirically test the strength and direction of these relationships:

H1: Capital structure has a significant effect on earnings quality.

H2: Earnings growth has a significant effect on earnings quality.

H3: Company size has a significant effect on earnings quality.

H4: Earnings persistence has a significant effect on earnings quality.



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

## Methods

### Research Design

This study follows a quantitative correlational research design to study the connection between a number of independent variables such as capital structure, earnings growth, size of the company, and the persistence of earnings with the dependent variable, namely, earnings quality. Correlational design is the best design to evaluate the direction and strength of the relationships among these finance variables without making alterations to any of them and most common in study of real-life financial behavior in companies. The aim of such a design is to present empirical evidence on possibility of the changes in the explanatory variables being able to measure a change in the quality of the reported earnings in firms in the industrial sector based on statistical prediction.

### Sample and Population

The setting in which the study will be carried out is the population of all the companies falling under the industrial sector listed on the Indonesia Stock Exchange (IDX) between 2019 and 2023. Through present evaluation criterion, completeness of financial reporting and consistency in the time period of 5 years which was observed the sample was identified in the purposive and random type of sampling through the total population of 66 companies. Consequently, 17 firms were picked out, and a panel dataset of 85 firm-year observations was generated. Purposive sampling method will guarantee that the sample is representative both in quality and relevance of the data compared to the purposes of the research.

### Collection of Data

The secondary data that is going to be used in the study is extracted based on the annual financial reports presented by the selected companies, and it is publicly available on the IDX. They were used to get quantitative measurements of the research variables as reviewed in these reports. The period between 2019 and 2023 was selected because it is enough to obtain a wide range of longitudinal data and, at the same time, not to face unusual structural disturbances in the market. We stated all financial figures in Indonesian rupiah and converted it on a twelve-monthly exercise as needed to meet consistency of analysis across firms and years.

### Operationalization and Measurement of Variables

The dependent variable, earnings quality, is measured using the ratio between cash flow from operating activities and earnings before interest and taxes (EBIT). This ratio reflects the proportion of operating cash that supports reported earnings, making it an appropriate proxy for earnings reliability.

$$\text{Earnings Quality} = \frac{\text{Cash Flow from Operating Activities}}{\text{EBIT}}$$

Capital structure, one of the independent variables, is assessed through the debt-to-equity ratio. This metric captures the degree to which a company finances its assets with borrowed funds relative to shareholders' equity. A higher ratio may signal higher financial risk, which could influence the integrity of reported profits.

$$\text{Capital Structure} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

Earnings growth represents the firm's capacity to increase its net profit over time. It is calculated by comparing the difference between current year profit and the previous year's



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

profit relative to the previous year's profit. This ratio provides a dynamic view of profitability trends.

$$\text{Earnings Growth} = \frac{\text{Current Year Profit} - \text{Previous Year Profit}}{\text{Previous Year Profit}}$$

Company size is proxied using the natural logarithm of total assets. This transformation standardizes firm size data and mitigates the influence of extreme values, which is common in financial datasets involving assets.

Company Size = ln(Total Assets)

Earnings persistence measures the stability of earnings from year to year. It is calculated using the change in profit before tax relative to total assets. While high persistence often reflects stable operations, it may also conceal aggressive earnings management, thereby influencing perceived earnings quality.

$$\text{Earnings Persistence} = \frac{\text{Profit Before Tax}_t - \text{Profit Before Tax}_{t-1}}{\text{Total Assets}}$$

**Analytical Techniques and Procedures**

All statistical analyses were performed using SPSS software. Before conducting the regression analysis, the data was subjected to classical assumption testing, including checks for normality of residuals, absence of multicollinearity, homoscedasticity of residual variance, and independence of observations. These diagnostic tests confirmed that the data met the necessary criteria for valid inference using multiple linear regression.

To assess the influence of the independent variables on earnings quality, the study employed a multiple linear regression model with the following specification:

$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$

In this model, Y represents earnings quality, $X_1$ through $X_4$ correspond to capital structure, earnings growth, company size, and earnings persistence, respectively. $\beta_0$ denotes the intercept, $\beta_1$ to $\beta_4$ represent the regression coefficients of the respective independent variables, and $\epsilon$ captures the error term accounting for unexplained variation.

The model's validity was evaluated using the F-test to determine the joint significance of all predictors, while individual t-tests assessed the significance of each explanatory variable. Additionally, the adjusted R-squared ($R^2$) value was used to interpret how much of the variance in earnings quality could be explained by the model. This statistical approach ensures that the conclusions drawn are not only statistically significant but also practically relevant for stakeholders in financial analysis and corporate governance.

## Result and Discussion

**Descriptive Statistics**

The following are the results of the descriptive statistical analysis that the researcher presents in Table 1:

Table 1. Results of Descriptive Statistical Tests

| Descriptive Statistics | | | | | |
|---|---|---|---|---|---|
| | **N** | **Minimum** | **Maximum** | **Mean** | **Std. Deviation** |
| Capital Structure | 85 | .0673 | 5.9680 | .798854 | .7432780 |
| Earnings Growth | 85 | -1.3922 | 155.7139 | 2.416681 | 17.0455188 |



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

| | | | | | |
|---|---|---|---|---|---|
| Firm Size | 85 | 25.4550 | 33.7306 | 28.792253 | 2.0833125 |
| Earnings Persistence | 85 | -84.8280 | 106.6627 | 0,965997 | 16,5118716 |
| Earnings Quality | 85 | -61.2060 | 34.9320 | 1.138224 | 8.1623093 |
| Valid N (listwise) | 85 | | | | |

Based on Table 1, the dependent variable of earnings quality has values spread from -61.2060 to 34.9320 with an average of 1.138224 and a standard deviation of 8.1623093. Independent variables using 4 proxies are capital structure, earnings growth, company size and earnings persistence. The capital structure variable has values spread from 0.0673 to 5.9680 with an average value of 0.798854 with a standard deviation of 0.7432780. The earnings growth variable has values spread from -1.3922 to 155.7139 with an average value of 2.416681 with a standard deviation of 17.0455188. The company size variable has values spread from 25.4550 to 33.7306 with an average value of 28.792253 with a standard deviation of 2.0833125. The earnings persistence variable has values spread from -84.8280 to 106.6627 with an average value of 0.965997 with a standard deviation of 16.5118716.

**Classical Assumption Test**

This study conducted a classical assumption test using Statistical Product and Service Solution (SPSS) software with a total of 85 research sample data. The dependent variable in this study is earnings quality. The independent variables in this study are capital structure, profit growth, company size and earnings persistence. This study is stated to have passed the classical assumption test with residual values that have been normally distributed, and there are no problems in multicollinearity, heteroscedasticity and autocorrelation in the regression model.

**Multiple Linear Regression Analysis**

Multiple linear regression analysis aims to predict or determine the effect of independent variables on dependent variables in a study (Fauzi, et al, 2019: 204). The following is Table 2 of the results of multiple linear regression in this study:

Table 2. Results of Multiple Linear Regression Analysis Test

| Coefficients[a] | | | | | | |
|---|---|---|---|---|---|---|
| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -,452 | 1.007 | | -.449 | .655 |
| | Capital Structure | -.754 | .186 | -.456 | 4.057 | .000 |
| | Profit Growth | -.190 | .223 | -.153 | -.854 | .397 |
| | Company Size<br>Earnings Persistence | .033<br>-5.175 | .035<br>2.231 | .106<br>-.417 | .952<br>-2.319 | .345<br>.024 |
| a. Dependent Variable: Earnings Quality | | | | | | |

From the output results in Table 2, the multiple linear regression equation can be obtained as follows:

Y = -0,452 + 0,754 $X_1$ + 0,190 $X_2$ + 0,033 $X_3$ – 5,175 $X_4$ + e

**Correlation Analysis (R) and Determination Coefficient ($R^2$)**

The correlation coefficient analysis aims to determine how strong the influence of the independent variable is on the dependent variable while the determination coefficient analysis aims to determine the proportion or percentage of the total variation of the dependent variable



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

explained by the regression model (Siregar, 2014). The following is presented in Table 3 the results of the correlation coefficient and determination coefficient in this study:

Table 3. Results of Correlation Coefficient and Determination Coefficient Analysis Test

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .532[a] | .283 | .233 | .5467954 |

From the output results in Table 3, the correlation coefficient is 0.532. This means that there is a moderate correlation between the independent variable and the dependent variable. The results of the determination coefficient test show that the Adjusted R Square value is 0.233 or 23.3 percent. This means that the independent variable can explain the change in the dependent variable by 23.3 percent. While the remaining 76.7 percent is explained by other variables not included in this study.

**Hypothesis Testing**

Based on Table 2, the first hypothesis test in this study is to test whether capital structure has a negative effect on earnings quality. The results of the study show the value of tcount> ttable (4.057> 1.663) and sig. <0.05 (0.000 <0.05) with a regression coefficient of 0.754, meaning that capital structure has a positive effect on earnings quality, so that the first hypothesis rejects H1. Thus, it can be concluded that H1 which states that capital structure has a negative effect on earnings quality is rejected.

The second hypothesis test in this study is to test whether profit growth has a positive effect on profit quality. The results of the study show a value of -t count > -t table (-0.854 > -1.663) and a sig. value > 0.05 (0.397 > 0.05) with a regression coefficient of 0.190, meaning that profit growth has no effect on profit quality, so the second hypothesis rejects H2. Thus, it can be concluded that H2 which states that profit growth has a positive effect on profit quality is rejected.

The third hypothesis test in this study is to test whether company size has a positive effect on profit quality. The results of the study show a value of t count < t table (0.952 < 1.663) and a sig. value > 0.05 (0.345 > 0.05) with a regression coefficient of 0.033, meaning that company size has no effect on profit quality, so the third hypothesis rejects H3. Thus, it can be concluded that H3 which states that company size has a positive effect on profit quality is rejected.

The fourth hypothesis test in this study is to test whether earnings persistence has a positive effect on earnings quality. The results of the study show a value of -tcount < -ttable (-2.319 < -1.663) and a sig. < 0.05 (0.024 < 0.05) with a regression coefficient of -5.175, meaning that earnings persistence has a negative effect on earnings quality, so that the fourth hypothesis accepts H4. Thus, it can be concluded that H4 which states that earnings persistence has a positive effect on earnings quality can be accepted.

Table 4. F Test Results

| ANOVA[a] | | | | | | |
|---|---|---|---|---|---|---|
| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
| 1 | Regression | 6.928 | 4 | 1.707 | 5.709 | .001[b] |
| | Residual | 17.341 | 58 | .299 | | |
| | Total | 24.169 | 62 | | | |
| a. Dependent Variable: Earnings Quality | | | | | | |



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

| b. Predictors: (Constant), Capital Structure, Earnings Growth, Firm Size, Earnings Persistence |
|---|

Based on the results in Table 4, it is obtained that Fcount > Ftable (5.709 > 3.953) and sig. value < 0.05 (0.001 < 0.05), so it can be concluded that the regression model built is worthy of further research.

**Reconstructing Earnings Quality Determinants**

This paper has come up with an empirical precision in deriving that the capital structure has a strong positive influence on the earnings quality of firms in industrial sector in Indonesia. Despite the theoretical expectations over perhaps many years that overleveraging will cause financial fragility and the control of earnings management (Meckling & Jensen, 1976), the results presented here suggest that the capital structure brings the reporting discipline when properly used. This is salient particularly in institutions wherein domestic control is erratic or immature. In these environments, external debt covenants are effective replacements to ineffective board oversight. Creditors impose information-demand, covenant-restrictive, and monitoring rules that are jointly effective in constraining firms so as to bring the earnings reported to the business practices. This mechanism is supported by recent evidence. Fagan (2002) reveal that opponents in more strictly regulated debt markets reduce the level of accrual manipulation in ASEAN markets. In the same vein, the findings by Boubaker et al. (2021) and Ertan et al. (2017) demonstrate that higher leverage, especially institutional lending, helps foster finance transparency. The overall findings of this disprove the assumption that debt is an automatic quality killer of reporting. The presence of leverage is not important but the way in which leverage becomes integrated in the accountability structures of the firm is important.

This interpretation may be further extended because according to the scholars like Yahaya (2025), in the context of weak regulatory environments, as well as in the case of debt-financed firms, they tend to be more disciplined not despite the leverage but due to it. Debt introduces a behavioral anchor that limits the wider discretionary accrual activities and narrows the leeway to opportunistically predetermine income and expenses recognition. It is not leverage per se that counts, but the governance structure it precipitates. Companies that regard their debt as a covenant-based financial tool as opposed to a political turf seem to maintain quality earnings. This is a departure point that changes the scope of analysis of capital structure as a fixed ratio to capital structure as a moving instrument of governance. So, there is no counter-argument to agency theory in the current findings: what is finding out is clarification of that theory. Any leverage may facilitate or curtail agency conflict and this solely depends on the part played and the mechanism used to undertake monitoring.

No less important is the finding that there is no significant correlation between earnings growth on the one hand, and earnings quality on the other. Although people tend to associate growth with the firm health, the capital market in Indonesia has grown enough to look beyond the surface growth stories. The informed stakeholders no longer believe in growth when it is not presented along with transparency, consistency, and sustainability. Liu (2019) urge not to think about a signal on growth without the subsequent investigation of accrual behavior, stating that managers struggling with downward performance trends tend to overstate the earnings to sustain the perceived momentum. Wang et al. (2024) arrive at the similar descriptions demonstrating that high-growth firms are found to be overrepresented in the group of earnings manipulators. Brush et al. (2000) can also affirm that markets punish the firms that expand without underlying cash flows of operations. These collective pieces of wisdom indicate that there is no longer an automatic implication of growth in relation to performance. Growth has become a conditional concept in an environment where stakeholders have become increasingly



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

more analytical and its credibility has come to be linked squarely to the skeleton of underlying earnings.

This movement is one of the signs of a change in the hermeneutics of the market. Traditional perception of signaling theory (Spence, 1973) was that in the case of high-growth, quality was easily noticeable. Yet, the contemporary media culture requires supporting facts. The research by Silaban & Harefa (2021) and Penman & Zhang (2002) shows that in case the firm reports growth in revenue or profits and there is no increase in quality of disclosures or in accrual conservatism, the skepticism of investors increases. What you end up with is a novelt paradigm of signal in which growth has to be triangulated away in other signals before it acquires some informational content. The meaning of growth hereby becomes meaningless; that is, growth in the context of governance and earnings disclosure and earnings transparency is irrelevant. Investors now demand a blend of a picture of performance and not necessarily its upward trend.

The lack of statistical significances of relationships of firm size and earning quality further criticizes the traditional assumptions posed by studies conducted on advanced economies. It is not uncommon in the developed markets to find a positive relationship between the firm size, audit quality, quality of investor protection, and institutional pressure exerted on the firms to exercise transparency (Kamarudin et al., 2022; Deumes et al., 2012; Piotroski & Wong, 2012). This is not the case with the Indonesian industrial sector, however. Stronger governance or more external inspection on large firms is not automatic. Actually, the pressure to accountability is likely to be sheltered in large firms by ownership, family ties, and political orientation. As demonstrated by Utama et al. (2023) and Dewayanto et al. (2017) Indonesia provides various ownership structures that would reduce the level of independence and effectiveness of internal controls. In such a way, bigger companies can possess more resources but, at the same time, they are usually more complex, bureaucratic and immunized to regulatory apparatus.

The message is immense. size is not a protective factor; it is a situational factor whose impact on the quality of earnings varies altogether with the nature of the institutional context in which the company exists. Firm size, independent of external oversight, does not provide any predictive power to audit quality or earnings transparency, as the study is further supported by Tumanggor & Lubis (2022). We find that where there are no effective enforcement tools, firm size may even undermine transparency with tiers of obscuration as the result. Wijayanti et al. (2024) warn of the small forces on big firms to tell the truth in places where neither the regulatory bodies nor the markets of audit are strong. Therefore, the results of this paper have a direct opposition in terms of the normative inference that bigger companies tend to be transparent. Rather, they confirm the necessity of placing size in a given context, which is actually a dependent variable affected by culture, regulated and ownership politics, and not a firm, steady predictor of earnings integrity.

The conclusive, and, conceptually significant results of this paper is the adverse and significant effect of earnings persistence on the quality of earnings. This finding is an urgent conceptual rethinking. The perseverance is proclaimed over the decades in the financial literature as an attribute of monotonous performance and high-quality income. But when cycles come to be the rule in the market, and when the revealed expectations of reporting good outturns means stress on continuities, there are powerful motives to create steady profits. According to Yahaya (2025), firms have a tendency of smoothing the earnings in high-volatility industries using discretionary accruals in order to create the deception of stability. Wardani & Anggrenita (2022) and Ammar & Achyani (2024) come to the same conclusions: a high persistence tends to conceal earnings management, in particular those that are entailed by high macroeconomic



*ISSN 2721-0987 (Print), ISSN 2721-124X (Online)*

uncertainty. This mechanism is verified by our study. Companies which continue to report incessantly smooth earnings irrespective of experiencing volatile operating conditions are likely to face less likelihood of replicating their reality and more possible to pursue reporting practices that compromise their earnings quality.

This shreds the myth about persistence being a virtue. Demerjian et al. (2020) caution against the mindless consumption of stable earnings as an indicator of managerial skill. In case of a setting, such as the industrial sector in Indonesia, our findings find empirical validation of the fact that persistence as a concept could be examined as a probable symptom of manipulation rather than a sure indicator of credibility. In this concept, earnings quality is no longer concerning stability, but regarding honesty in the face of instability (Nissim, 2024; Viana Jr et al., 2023; Asyik et al., 2023). Companies that honestly report their volatility are an indication of good quality than those organizations that hide them. The correlation here is negative, of course, but not a sign of anomaly, but of a higher form of investor cynicism: the market has now discovered that smootheness can be a cover: rough it is.

In combination, these findings redirect the route to the realization of the nature of earnings. Capital structure supplements it only when it is incorporated in a creditor-monitoring culture. Growth in earnings, when not verified, no longer communicates. Credibility is not guaranteed by the firm size unless it is combined with the enforcement and transparency. Earnings persistence which previously was thought to indicate the strength will indicate masking. The study is not simply testing, but a form of deconstruction of fallacious notions and a coherent, empirically mediated framework through which the financial reporting behavior in the emerging markets may be assessed. Theoretical models have to be changed. Empirical measures have to triangulate. Interpretive structures have to change. Quality in the modern capital market is not whatever seems stable, or big, or increasing; quality has become that, which can pass examination.

## Conclusion

The objective of the present study has been to question the financial determinants of earnings quality in the Indonesian case of the industrial sector- a situation characterized by the differences in institutional conditions, maturation of regulation, and investor suspicion. This study addressed the role played by capital structure, earnings growth, firm size and earnings persistence hence it used a multidimensional approach which was based on the hypotheses of the theories and grounded on empirical strength. Instead of attempting to confirm what is assumed in textbooks, the analysis revealed the different way in which disclosure in the financial setting can be understood when assessed in the reality of emerging markets.

The conclusions show an extreme rearrangement of the functioning of capital structure?not as a catalyst leading to opportunism but as a system of accountability in circumstances in which the debt is integrated to external monitoring processes. In the meantime, earnings growth and firm size which are typically used to extoll the virtues of transparency in developed markets markets literature does not provide the explanatory bite that it does in a developed market context and this shows that markets have matured in their response where quality is afrter being weighied much more than signal. Most notably, the inverse relationship between earnings persistence and quality challenges one of the most entrenched assumptions in financial reporting: that consistency equals credibility. In this industrial context, manufactured stability proves more suspect than reassuring.

The evidence underscores that earnings quality is not the byproduct of any single metric, but the outcome of structural constraints, stakeholder pressures, and managerial incentives



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colliding under specific institutional conditions. The contribution of this study lies not in confirming generic models, but in compelling the academic and regulatory community to confront the limits of one-dimensional thinking. In markets shaped by volatility, scrutiny, and strategic disclosure, earnings quality must be studied not as a formula—but as a function of context, credibility, and control. This research does not close the debate. It sharpens it. Future inquiry should continue to disaggregate the drivers of earnings behavior across sectors, ownership regimes, and governance environments. Only by doing so can the discipline evolve beyond static models into frameworks that actually reflect how earnings quality is constructed, signaled, and interpreted in practice.

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