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The Impact of Earnings Persistence, Company Growth, and Systematic Risk on the Earnings Response Coefficient: The Moderating Role of Auditor Reputation

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ABSTRACT
The Earnings Response Coefficient (ERC) is a measure used in accounting and finance to evaluate the correlation between a company's stock returns and its earnings. The ERC measures the degree to which the market responds to changes in a company's earnings. This study investigates the impact of earnings persistence, corporate growth, and systematic risk on the ERC, with the reputation of the auditor acting as a moderating variable. The research was conducted on the Indonesia Stock Exchange, focusing on 51 companies listed in the Kompas 100 Index from 2018 to 2022. Data analysis was performed using the Moderated Regression Analysis (MRA) method. The findings of this study reveal that earnings persistence has an insignificantly positive effect on the ERC. Conversely, company growth exhibits a significantly positive influence on the ERC, whereas systematic risk has a significantly negative effect. Moreover, auditor reputation moderates the relationship between earnings persistence, corporate growth, and the ERC. However, it does not moderate the impact of systematic risk on the ERC.

Keyword: Earnings Response Coefficient**,** Earnings Persistence**,** Company Growth**,** Systematic Risk**,** Auditor Reputation

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INTRODUCTION

Earnings information, a vital part of financial statements, garners significant attention due to its foundational role in taxation, dividend policies, decision-making, and forecasting (Baroroh et al., 2022). The relevance and predictive value of this information are captured by the Earnings Response Coefficient (ERC), which measures the market's reaction to unexpected earnings changes. If investors trust the financial information, their responses will be reflected in a high ERC, indicating the informativeness and relevance of earnings (Vahdani and Mehr, 2021).

Previous research on ERC has yielded inconsistent results, particularly in the Indonesian capital market, where phenomena such as unexpected earnings and cumulative abnormal returns often contradict ERC theory. For instance, companies like PT Indocement Tunggal Prakarsa Tbk (INTP) and PT Indofarma Tbk (INAF) exhibit unexpected earnings trends that do not align with market reactions, indicating a gap between theory and practice. A company that records earnings should be positively responded to by the market upon publication. However, PT Indocement Tunggal Prakarsa Tbk (INTP) recorded positive earnings and unexpected earnings (UE) but had a negative CAR. Conversely, the circumtances for the company PT Indocement Tunggal Prakarsa Tbk (INTP) reported net earnings in 2022 and 2021 of IDR 1,842,434,000,000 and IDR 1,788,496,000,000. The unexpected earnings were 3.02%, while the cumulative abnormal return (CAR) was -0.11%. PT Indofarma Tbk (INAF) recorded negative earnings (loss) and negative UE but had positive CAR. PT Indofarma Tbk (INAF) reported net losses in 2022 and 2021 of IDR 428,487,671,585 and IDR 37,571,241,226, respectively, as listed in the Consolidated Financial Statements published on March 30, 2023. The unexpected loss was 1040%, but the CAR was 1.88% Understanding factors influencing ERC is essential for making informed investment decisions. Earnings persistence, company growth, and systematic risk are critical variables impacting ERC. Earnings persistence reflects a company's ability to maintain consistent earnings, signaling reliability to investors (Kormendi and Lipe, 1987). This is supported by research conducted by Widiatmiko and Indarti (2018), and Irawan and Talpia (2021), who found that earnings persistence has a significant positive effect on ERC. However, this contrasts with the study by Wijaya et al. (2019), which stated that earnings persistence does not have a significant effect on ERC. Company growth, which indicates a firm's capacity to expand, is attractive to investors (Baroroh et al., 2022). This is supported by research conducted by Irawan and Talpia (2021), and Dewi

and Puspaningsih (2019), who found that company growth has a significant positive effect on ERC. However, this contradicts the research by Baroroh et al. (2022) and Wiguna and Murwaningsari (2022), who found that company growth does not have a significant effect on ERC. Investors, when conducting investment analysis, do not only refer to earnings or returns, but there are other variables that must be considered and are integral to the concept of investment returns, which is risk (Paramita et al., 2020). Low risk tends to be positively responded to by investors because low risk will have a small impact on the likelihood of investor losses; in other words, companies with low systematic risk will send a positive signal to investors. Systematic risk, representing market-wide risks, inversely affects ERC, as higher risk deters investors (Hartono, 2017). This is supported by research conducted by Baroroh et al. (2022) and Wiguna and Murwaningsari (2022), who stated that systematic risk has a significant negative effect on ERC. This contrasts with the research conducted by Basuki, Nahar, and Ridho (2017), who found that systematic risk does not have a significant effect on ERC.

Moreover, non-financial factors such as auditor reputation play a significant role in ensuring the credibility of financial statements. High-quality audits provide assurance of the fairness of financial reports, enhancing investor confidence (Okolie, 2014). This study aims to address the gaps in understanding how earnings persistence, company growth, and systematic risk influence ERC, with auditor reputation as a moderating variable. Conducted on 51 companies listed in the Kompas 100 Index on the Indonesia Stock Exchange from 2018 to 2022, this research employs the Moderated Regression Analysis (MRA) method to analyze the data. The findings of this study contribute to the broader field of financial analysis by clarifying the relationships between these variables and ERC, providing insights for investors and policy makers.

LITERATURE REVIEW AND HYPOTHESIS

Signaling Theory: According to signaling theory, companies send signals to the market through their financial disclosures, which investors interpret to make informed decisions. High-quality financial information serves as a positive signal, leading to favorable market reactions (Spence, 1973).

Value Relevance Theory: One of the critical aspects of the qualitative relevance of information in financial statements is its ability to provide predictive value to information users (Easton & Sommers, 2000). Within the realm of accounting, earnings are considered a predictive tool that can be used to project future earnings and economic events.

Earnings Persistence: Earnings persistence reflects a company's ability to maintain consistent earnings over time. High earnings persistence indicates reliability and stability, positively influencing investor confidence and, consequently, the ERC (Kormendi and Lipe, 1987). Persistent earnings are seen as more predictable, providing valuable information for future earnings forecasts (Widiatmoko and Indarti, 2018).

Company Growth: Company growth represents a firm’s ability to expand and enhance its market position. It acts as a signal of future potential and profitability, attracting investors. Higher growth rates are generally associated with higher ERC, as investors anticipate better returns from growing companies (Baroroh et al., 2022).

Systematic Risk: Systematic risk, or market risk, affects all companies in the market and cannot be mitigated through diversification. Higher systematic risk tends to have a negative impact on ERC, as it introduces uncertainty and potential volatility, deterring investors (Hartono, 2017).

Auditor Reputation: The credibility of financial statements is crucial for investor confidence. High-quality audits, conducted by reputable auditors, provide assurance of the accuracy and fairness of financial reports. Auditor reputation serves as a moderating variable that can enhance the informativeness of earnings, thereby impacting the ERC (Okolie, 2014).

Firm Size

Firm size reflects the categorization of companies into large and small entities, with each firm possessing different dimensions. Larger firms tend to provide more extensive information, including more detailed disclosures, compared to smaller firms (Irawan & Talpia, 2021).

Industry Type

The type of industry describes companies based on their scope of operations, risk, and capabilities. The business environment's conditions will affect various industries differently, resulting in distinct responses from those industries (Balsam et al., 2003).

The Influence of Earnings Persistence on Earnings Response Coefficient

Earnings persistence is the company's ability to maintain consistent earnings and predict future earnings (Scott & O'Brien, 2019). According to signal theory, information on earnings persistence can influence investment decisions and be reflected in stock prices (Bhattacharya, 1979). Earnings persistence is crucial financial information that provides a positive signal to investors about the company's future profitability (Fauziah, 2017). Previous studies have shown that earnings persistence has a significant positive effect on the earnings response coefficient (ERC) (Widiatmiko & Indarti, 2018; Irawan & Talpia, 2021).

H1: Earnings persistence positively affects the earnings response coefficient.

The Influence of Company Growth on Earnings Response Coefficient

Company growth measures the company's ability to expand within the industry and economy overall (Baroroh et al., 2022). Strong company growth attracts investor interest as it is perceived to yield increased dividends (Dewi & Puspaningsih, 2019). Accounting information reflecting company growth is relevant for security market valuation (Burnett, 2020). Previous studies indicate that company growth has a significant positive impact on ERC (Irawan & Talpia, 2021; Dewi & Puspaningsih, 2019).

H2: Company growth positively affects the earnings response coefficient.

The Influence of Systematic Risk on Earnings Response Coefficient

Systematic risk affects the entire market and cannot be minimized through diversification (Fama, 1970). Low risk is positively responded to by investors as it signals a lower likelihood **of losses (Kurniawati & Dwimulyati, 2018). Research shows that systematic risk has a significant negative impact on ERC (Awawdeh et al., 2020; Baroroh et al., 2022; Wiguna & Murwaningsari, 2022).**

H3: Systematic risk negatively affects the earnings response coefficient.

The Influence of Earnings Persistence on Earnings Response Coefficient with Auditor Reputation as a Moderator

External audit quality by independent auditors enhances the credibility of financial statements and provides assurance to investors (Teoh & Wong, 1993). Research indicates that auditor reputation has a significant positive impact on ERC (Sabrina et al., 2020; Heydari, 2015), although some studies found opposite results (Kristanti & Almilia, 2019; Tarmidi et al., 2021). Auditor reputation as a moderating variable can strengthen the relationship between earnings persistence and ERC (Delvira & Nelvirita, 2013).

H4: Auditor reputation strengthens the influence of earnings persistence on the earnings response coefficient.

The Influence of Company Growth on Earnings Response Coefficient with Auditor Reputation as a Moderator

According to signal theory, management signals to investors through financial disclosures reflecting company growth (Ghozali, 2020). Research shows that the relationship between company growth and ERC is positive and strengthened by auditor reputation (Irawati, 2018; Suwarno et al., 2017).

H5: Auditor reputation strengthens the influence of company growth on the earnings response coefficient.

The Influence of Systematic Risk on Earnings Response Coefficient with Auditor Reputation as a Moderator

Low systematic risk provides a positive signal to investors. Research indicates that high systematic risk lowers ERC, while low risk provides a positive signal (Awawdeh et al., 2020). Auditor reputation as a moderating variable can reduce the impact of systematic risk and enhance investor confidence (Gul et al., 2002).

H6: Auditor reputation weakens the influence of systematic risk on the earnings response coefficient.

METHOD

This study involves publicly listed companies included in the Kompas100 index on the Indonesia Stock Exchange over the period from 2018 to 2022. This timeframe is relatively recent and relevant, ensuring that the financial data and market information used in the research reflect the current economic and capital market conditions. The Kompas100 index consists of 100 selected stocks with high liquidity and strong fundamentals,

providing a comprehensive overview of stock market movements to investors and investment managers (Hanoatubun, 2020).

The sampling method used is non-random sampling with purposive sampling technique. This technique selects sample elements based on specific criteria aligned with the research objectives (Sekaran and Bougie, 2016). The criteria for selecting the population elements are as follows: The public company must be listed in the Kompas100 index for five consecutive years (2018-2022). A five-year period is assumed to provide a long-term trend to assess how the market responds to earnings changes.

Variable	Operational Definition	Measurement	References
Earnings Response Coefficient (ERC)	The earnings response coefficient is obtained through regression analysis between cumulative abnormal return (CAR) as a proxy for stock prices and unexpected earnings (UE) as a proxy for accounting earnings.	Steps to Calculate CAR 1) Calculate Abnormal Return $ARit = Rit - Rmit$ Explanation: Ar_{it} = Abnormal Return company i on Day t R_{it} = Actual return company i on day t $Rmit$= Market return of Company i on day t. 2) Menghitung return sesungguhnya (Rit): $Rit = (Pit - Pit-1)/(Pit-1)$ Explanation : R_{it} = Actual return company i on day t P_{it} = Closing stock price company i on day t. P_{it-1}= Closing stock price company i on the Day Before t 3) Calculate market return $RMit = (IHSGt - IHSG\ t-1)/(IHSG_{t-1})$ Explanation : Rmit = market return on day t IHSGt = Composite Stock Price Index on Period (Day) t $IHSG_{t-1}$= Composite Stock Price Index on Period before (Day) t 4) $CARit = CARi(-5+5) = \sum_{t=5}^{+5} ARit$ **Menghitung UE** $UE_{it} = (AE_{it} - AE_{it-i})/AE_{it}$ Keterangan : UE = Unexpected Earnings company i on year t AE_{it} = Accounting Profit After Tax of Company i in Year t AE_{it-1} = Accounting Profit After Tax of Company i in Year t-1 The final step is to perform a regression analysis between Unexpected Earnings (UE) and Capital Adequacy Ratio (CAR) to obtain the value of the Earnings Response Coefficient (ERC). The regression is conducted using the following	Sherlita et al. (2021),

		equation: **CAR = α + β1 UE + e**	
Earnings Persistence	Earnings persistence refers to the tendency of a company to repeatedly generate consistent earnings and its ability to serve as an indicator of future earnings.	Measured through the Regression Coefficient between Accounting Profit in the Current Period and the Previous Period: X_{it}= a + βXit-1 +et Explanation : X_{it} = Profit of Company i in Year t X_{it-1} = Profit of Company i before year t a = Konstan β = Persistence of Earnings Regression Coefficient	Penman & Zhang (2002)
Company Growth	Company growth measures the increase in a company's total assets from the previous period.	$\frac{Total\ Asset_t - Total\ Asset_{t-1}}{Total\ Asset_{t-1}}$	Kusumawati et al. (2022)
Systematic Risk	Systematic risk, which cannot be minimized through diversification, is measured using beta, calculated with the Capital Asset Pricing Model (CAPM).	$R_{it} = \alpha + \beta_{it}\ R_{mt} + e_{it}$ Rit = Stock Return of Company i in Year t α = Konstanta βit = Stock Beta Company i in year t R_{mt} = Market Return on year t eit = Eror	Hartono (2017)
Auditor Reputation	Auditor reputation reflects the quality of the audit performed and is measured as a dummy variable.	Dummy Variable: 1 if the Company is Audited by a Big 4 Auditor, 0 if Not	Gul et al. (2002)
Company Size	Larger companies tend to publish more information compared to smaller companies, which investors can use to make economic decisions.	Ln (Total Aset)	Dewi & Puspaningsih (2019)
Industry Type	The type of industry impacts the business level and associated risk of a company.	Dummy Variable: 1 for Financial Industry, 0 for Non-Financial Industry	Bianconi et al. (2013)

The data analysis techniques used in this study were performed using SPSS software. The analyses included descriptive statistics, classical assumption tests, and Moderated Regression Analysis (MRA). This study employed the interaction test technique, or MRA, using SPSS. MRA is a specific application of multiple regression where the regression equation involves interaction elements between two or more variables that are multiplied together. The MRA model used in this study is as follows:

$$Y = \alpha + \beta_1\ PL + \beta_2\ CG + \beta_3\ RS + \beta_4\ RA + \beta_5\ PL*RA + \beta_6\ CG*RA + \beta_7\ RS*RA + \beta_8\ UP + \beta_9\ JI + e \text{……..……}$$

Explanation:

Y	: ERC
α	: Constant
β1-9	: Regression Coefficient
PL	: Earnings Persistence
CG	: Company Growth
RS	: Systematic Risk
RA	: Auditor Reputation
PL*RA	: Interaction between earnings persistence and auditor reputation
CG*RA	: Interaction between *company growth* and auditor reputation

RS*RA	: Interaction between *systematic risk* and auditor reputation
UP	: Company Size
JI	: Industry Type
e	: *Error* (Residual)

Result

During the sample determination process, 255 observations were obtained over a five-year observation period from 2018 to 2022. After processing the sample, 130 companies were found to be inconsistent in the Kompas100 index during the observation years, and 71 data outliers were identified. Thus, the total sample consisted of 184 companies.

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0,026	9	0,003	11,088	,000[b]
	Residual	0,046	174	0,000		
	Total	0,072	183			

a. Dependent Variable: ERC
b. Predictors: (Constant), RISKxAudit, AUDIT, GRW, INDS, EP, ASSET, EPxAudit, GRWxAudit, RISK

Based on the hypothesis test results, the calculated F value is 11.088 with an F significance value of 0.000, which is less than 0.05. These results indicate that the research model is considered feasible. The variables of earnings persistence, company growth, and systematic risk, moderated by auditor reputation and controlled by company size and industry type, are capable of explaining the earnings response coefficient.

Coefficient

Model		Unstandardized Coefficient B	Unstandardized Coefficient Std.Error	Standardized Coefficient Beta	t	*Sig*
1	(Constant)	1,521	0,412		3,689	,000
	Persistensi Laba	1,484	0,884	0,589	1,679	0,112
	Company Growth	2,149	0,501	0,693	4,294	<0,001
	Risiko Sistematis	-0,409	0,135	-0,548	-3,040	0,003
	Reputasi Auditor	0,005	0,003	0,097	1,583	0,115
	PL*Reputasi Auditor	0,281	0,127	0,244	2,215	0,028
	CP*Reputasi Auditor	2.112	0,555	0,581	3,804	<0.001
	RS*Reputasi Auditor	0,143	0,105	0,201	1,363	0,175
	Ukuran Perusahaan	0,025	0,008	0,430	3,903	0,002
	Jenis Industri	0,053	0,057	0,065	0,914	0,362

$$Y = 1{,}521 + 1{,}484\ X_1 + 2{,}149\ X_2 - 0{,}409\ X_3 + 0{,}005\ Z + 0{,}281\ X_1{*}Z + 2{,}112\ X_2{*}Z + 0{,}143\ X_3{*}Z + 0{,}025\ X_4 + 0{,}053\ X_5 \ldots\ldots$$

The results indicate that the t-significance value is 0.112, greater than α = 0.05, with a regression coefficient of 1.484. This means that H0 is accepted, and H1 is rejected, showing a positive but not significant relationship between earnings persistence and ERC.

The t-significance value is 0.001, less than α = 0.05, with a regression coefficient of 2.149. This means that H0 is rejected, and H2 is accepted, indicating a significant positive relationship between company growth and ERC.

The t-significance value is 0.003, less than α = 0.05, with a regression coefficient of -0.409. This means that H0 is rejected, and H3 is accepted, indicating a significant negative relationship between systematic risk and ERC.

Moderating Effects of Auditor Reputation

The t-significance value is 0.028, less than α = 0.05, with a regression coefficient of 0.281. This means that H0 is rejected, and H4 is accepted, indicating that auditor reputation significantly strengthens the relationship between earnings persistence and ERC.

The t-significance value is 0.001, less than α = 0.05, with a regression coefficient of 2.112. This means that H0 is rejected, and H5 is accepted, indicating that auditor reputation significantly strengthens the relationship between company growth and ERC.

The t-significance value is 0.175, greater than α = 0.05, with a regression coefficient of 0.143. This means that H0 is accepted, and H6 is rejected, showing a positive but not significant moderating effect of auditor reputation on the relationship between systematic risk and ERC.

Control Variables

The t-significance value for company size is 0.002, less than α = 0.05, with a regression coefficient of 0.025. This suggests that company size significantly impacts ERC, as larger companies tend to provide more information, reducing uncertainty and helping investors interpret financial statements effectively (Haryanti & Wirakusuma, 2023). The t-significance value for industry type is 0.362, greater than α = 0.05, with a regression coefficient of 0.053. This indicates that industry type does not significantly impact ERC. The diversity in operational activities leads to variations in ERC, which are more influenced by individual company strategies and performance rather than industry characteristics (Farooq et al., 2017). Industry classification is less relevant in this context, as investors view financial statements of companies within the same industry as relatively similar and diversify their portfolios across industries, reducing the sensitivity of stock prices to specific earnings announcements.\

Conclusion

This study aims to analyze the influence of various factors on the Earnings Response Coefficient (ERC) while considering the moderating role of auditor reputation. The main findings are as follows:

1. **Earnings Persistence:** Persistent earnings do not always provide relevant information for future investment decisions. The market tends to anticipate earnings behavior based on prior information, so persistent earnings announcements do not significantly impact market reactions.
2. **Company Growth:** Shows a significant positive impact on ERC. This aligns with signal theory, where significant company growth attracts investor interest, reflecting good growth prospects and ultimately increasing stock prices.
3. **Systematic Risk:** Exhibits a significant negative impact on ERC. Consistent with efficient market theory, persistent market uncertainty leads to negative reactions to systematic risk, despite good company operations.
4. **Auditor Reputation and Earnings Persistence:** Auditor reputation strengthens the impact of earnings persistence on ERC as a pure moderator. Reputable auditors provide financial information assurance, reduce information asymmetry, and ensure reliable financial statements.
5. **Auditor Reputation and Company Growth:** Auditor reputation also strengthens the impact of company growth on ERC. Financial statements audited by reputable auditors are more trustworthy, enhancing the credibility of financial information.
6. **Auditor Reputation and Systematic Risk:** Auditor reputation weakens the impact of systematic risk on ERC. Although reputable auditors help reduce specific risks related to company financial information, their impact is limited and does not directly reduce market-wide systematic risks.

Recommendations

Based on the findings and discussions in this study, the following recommendations for future research are provided:

1. **Segregation of 2020 Data:** This study uses data from 2020. Future research should separate 2020 data or treat it as a different variable in the analysis. The COVID-19 pandemic caused a significant financial performance decline for many companies, making this year's data potentially incomparable with other

years. By segregating or treating 2020 data differently, the analysis can more accurately reflect normal conditions and pandemic-affected conditions.

2. **Exploration of Other Moderating or Intervening Variables:** This study integrates auditor reputation as a moderating variable. Future research should explore other moderating or intervening variables, such as Corporate Social Responsibility (CSR), adoption of international financial reporting standards, and governance (Environmental, Social, and Governance - ESG), which may influence investor perceptions and market responses. Additionally, comparative studies between countries can help validate or identify factors affecting ERC in various markets.

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