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Unraveling the impact of political control and earnings management on corporate performance in Indonesia

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Abstract: In emerging places like West Java, Indonesia, agricultural production is crucial for economic stability and food security. To determine which variables significantly affect agricultural production, this research used a linear regression model. Educational attainment, years of agricultural experience, land ownership status, and rice field type are some of the factors that this study examines using survey data collected from farmers in West Java as a pilot project. The model found that the most important variables positively affecting yields were education level, type of rice field, and farming experience, with an R^2 value of 0.184 and an RMSE of 24.238. On the other hand, factors like land ownership and membership in farmer associations had little to no impact, if any at all, highlighting the need to reconsider long-standing forms of assistance. The results stress the need to promote the use of alternative agricultural methods adapted to specific regions and to enhance farmers' access to education and training. Soil quality, weather, and availability of agricultural technology are additional pieces of information that might enhance the model's predictive capabilities. To improve comprehension and applicability, future studies should consider using more sophisticated modeling methods and larger datasets. With these findings in hand, stakeholders and legislators may implement concrete suggestions to improve farming methods and secure long-term production in West Java and beyond.

Keywords: *Corporate performance, Earnings management, Political control, State owned enterprises, Structural equation modeling.*

1. Introduction

State-owned enterprises (SOEs) play a critical role in Indonesia's economic landscape, serving as major contributors to national revenue, employment, and infrastructure development. These enterprises operate across various strategic sectors, including energy, telecommunications, and banking, making them vital to the country's economic stability and growth [1]. However, due to their government ownership structure, SOEs are often influenced by political intervention, which shapes their decision-making processes, financial reporting, and corporate governance practices [2].

One of the most pressing concerns arising from political control in SOEs is earnings management, a practice in which financial statements are manipulated to meet specific financial targets [3]. This phenomenon is particularly pronounced in politically connected firms, where financial performance may be adjusted to align with government agendas, often at the expense of transparency and long-term efficiency. In Indonesia, SOEs with strong political affiliations frequently face pressure to overstate earnings, underreport losses, or adjust discretionary accruals to reflect financial stability and growth, even when actual performance may not support such claims [4].

Despite the growing interest in understanding political control's influence on corporate governance, empirical research focusing on Indonesian SOEs remains scarce. While existing literature has extensively examined political connections and corporate governance in developed economies, the specific dynamics within SOEs—where state ownership directly affects financial decisions—are still underexplored. This

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study aims to bridge this research gap by investigating the extent to which political control influences earnings management and corporate performance within Indonesia's leading SOEs.

Political control in SOEs manifests in several ways, including the appointment of politically affiliated board members, government ownership stakes, and direct state intervention in corporate policies [5-7]. Unlike privately owned firms, where shareholders prioritize profitability and efficiency, SOEs often serve a dual purpose—operating as commercial entities while also fulfilling state-driven economic and political objectives. This dual role increases the likelihood of financial distortions, as SOEs may be pressured to report favorable financial outcomes regardless of their actual performance.

Government influence in SOEs can lead to several financial management concerns, including:

1.1. Incentivized Earnings Management

Political appointees in SOE leadership positions may prioritize short-term financial stability over long-term corporate health. This often results in earnings smoothing, profit overstatement, and discretionary accrual adjustments to meet government expectations [8].

1.2. Reduced Transparency and Accountability

SOEs under strong political influence may exhibit weaker corporate governance structures, where financial irregularities remain unchecked due to a lack of independent oversight [9]. This creates an environment conducive to earnings manipulation, as external audits may be less rigorous.

1.3. Weakened Financial Performance in the Long Run

While earnings management may create temporary financial stability, it can also lead to long-term performance declines [10]. Over time, financial misreporting erodes investor confidence, reduces capital market credibility, and limits growth opportunities [11].

Given these challenges, it is essential to examine how political control affects financial decision-making in Indonesian SOEs and the extent to which earnings management influences corporate performance. Earnings management can be broadly categorized into opportunistic earnings management and informative earnings management [12]. In politically controlled SOEs, opportunistic earnings management is more prevalent, where financial statements are intentionally adjusted to achieve government-driven financial targets. This practice can take various forms:

a. Income Smoothing: Adjusting earnings to show stable profits over time.
b. Big Bath Accounting: Recording excessive losses in a single period to improve future earnings outlooks.
c. Cookie Jar Reserves: Shifting profits across different accounting periods to meet financial targets.

While earnings management may offer short-term advantages, such as reducing market volatility and maintaining investor confidence, it also poses significant risks. Prolonged earnings manipulation can lead to corporate misgovernance, increased regulatory scrutiny, and diminished financial credibility in the long term [13-15]. Although numerous studies have explored the relationship between political connections and corporate governance, most research has focused on:

a. Privately owned firms in developed economies, where state intervention is minimal.
b. Cross-sectional data, which fails to capture financial fluctuations over time.
c. Basic econometric models, such as Ordinary Least Squares (OLS) regression, which are limited in explaining causal relationships.

This study seeks to address these limitations by:

1. Focusing specifically on Indonesian SOEs, where political control is a dominant factor in financial decision-making.
2. Employing a longitudinal analysis (2019-2024) to capture dynamic changes in corporate performance under different levels of political influence.

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Utilizing Structural Equation Modeling (SEM), a more advanced statistical approach that provides deeper insights into causal relationships between political control, earnings management, and corporate performance.

1.4. Research Objectives

Given the significance of political control in SOEs, this study aims to:

a. Examine the relationship between political control and earnings management in Indonesian SOEs.
b. Investigate how earnings management practices impact corporate performance over time.
c. Analyze the role of politically affiliated board members in financial manipulation within SOEs.
d. Provide empirical evidence on the broader implications of political control for corporate governance.
e. Offer policy recommendations to enhance financial transparency and accountability in politically connected firms.

1.5. Research Hypotheses

Building on prior research and theoretical frameworks, the study formulates the following hypotheses:

a. H_1: Political control has a significant positive impact on earnings management in Indonesian SOEs.
b. H_2: Earnings management negatively affects corporate performance in politically connected SOEs.
c. H_3: The political affiliation of board members strengthens the relationship between political control and earnings management.
d. H_4: The impact of political control on corporate performance is mediated by earnings management practices.

To visualize the impact of political control on earnings management, the study includes an earnings management trend analysis for the three selected SOEs.

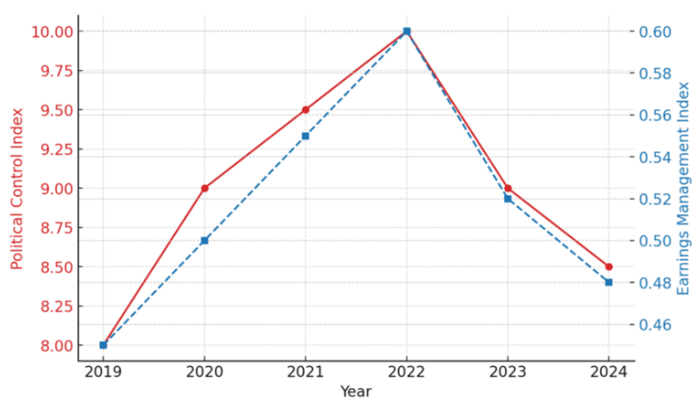

Figure 1.
Impact of Political Control on Earnings Management.

The graph illustrates the relationship between Political Control (measured by the number of politically appointed board members and government influence) and Earnings Management (measured by discretionary accruals as a proxy for financial statement manipulation) in Indonesian State-Owned Enterprises (SOEs) from 2019 to 2024.

1.6. Key Observations

a. Rising Political Control and Increased Earnings Management (2019-2022)

- Between 2019 and 2022, the Political Control Index increased from 8.0 to 10.0, indicating stronger government intervention in SOE decision-making.
- During the same period, Earnings Management (discretionary accruals) also increased from 0.45 to 0.60, suggesting that higher political influence led to more aggressive financial reporting practices.
- This aligns with the theory that politically appointed board members may encourage earnings manipulationto meet government expectations rather than ensuring financial transparency.

b. Declining Political Control and Reduced Earnings Management (2023-2024)

- After 2022, there was a gradual decline in political control, dropping to 8.5 in 2024.
- Correspondingly, earnings management also decreased from 0.60 in 2022 to 0.48 in 2024, indicating that less political interference was associated with lower financial statement manipulation.
- This suggests that reducing political involvement in SOEs might contribute to better corporate governance and more transparent financial reporting.

1.7. Implications of the Findings

- Political Control Drives Earnings Management: The trend shows a strong positive correlation between political control and financial statement manipulation. When government intervention increases, SOEs tend to adjust earnings reports to align with political objectives.
- Need for Stronger Corporate Governance: The reduction in earnings management during periods of lower political control suggests that more independent oversight in SOEs could lead to better financial transparency and credibility.
- Future Research Directions: Further empirical analysis is needed to quantify the causal effects of political control on corporate performance and to explore whether similar trends exist across different SOE sectors.

The interplay between political control and earnings management is a critical issue in corporate governance, particularly within state-owned enterprises [16]. While government involvement in SOEs aims to ensure economic stability and align with strategic national interests, it also increases the risk of financial misreporting and weakened corporate performance. This study provides empirical evidence on these relationships, offering insights to guide policy decisions, regulatory frameworks, and governance reforms. The findings will contribute to enhancing transparency, accountability, and efficiency in Indonesia's SOE sector.

The graph underscores the significant role of political influence in financial decision-making within Indonesian SOEs. While government control can help maintain strategic alignment with national objectives, excessive political intervention may compromise financial transparency and undermine long-term corporate performance [17]. Strengthening corporate governance frameworks and minimizing politically motivated financial manipulation will be crucial for ensuring the sustainability of Indonesia's SOEs.

2. Material and Methods

2.1. Research Design

This study adopts a quantitative research approach to examine the impact of political control on earnings management and corporate performance in Indonesian State-Owned Enterprises (SOEs). A longitudinal analysis is conducted from 2019 to 2024, utilizing secondary data from annual reports, financial statements, and corporate governance disclosures of the selected SOEs.

The research employs Structural Equation Modeling (SEM) as the primary analytical technique, offering a robust framework for examining causal relationships between political control, earnings management, and corporate performance. Additionally, panel data regression is used to validate findings and identify trends over time [18].

2.2. Sample Selection and Data Sources

The study focuses on three major Indonesian SOEs that play a significant role in the national economy originating from the Energy and Mineral Industry, Financial Services Industry, and Technology and Communication Industry. The author cannot name the Company due to the sensitivity of this research, and the request of the research subject from this journal.

Criteria for Sample Selection:

a. Significant Government Ownership (≥50% state ownership).
b. Availability of financial statements and corporate governance reports from 2019 to 2024.
c. Influence of politically appointed board members on strategic decision-making.

The data sources include:

a. Financial reports from company websites and the Indonesia Stock Exchange (IDX).
b. Corporate governance disclosures from annual reports.
c. Government records on political appointments in SOEs.

2.3. Variables and Measurement

a. Independent Variable: Political Control

Political control is measured using three key indicators:

- Government Ownership Percentage: The proportion of company shares held by the Indonesian government.
- Number of Politically Appointed Board Members: The percentage of board members appointed due to political affiliations.
- Government Influence on Strategic Decisions: A qualitative assessment based on policy directives affecting SOEs.

b. Mediating Variable: Earnings Management

Earnings management is measured using discretionary accruals, following the Modified Jones Model [19]:

$$DA_{it} = TA_{it} - NDA_{it}$$

Where :

DA_{it}	:	Discretionary Accruals (proxy for earnings management)
TA_{it}	:	Total Accruals
NDA_{it}	:	Non-Discretionary Accruals

A higher discretionary accrual value indicates greater earnings manipulation.

c. Dependent Variable: Corporate Performance

Corporate performance is assessed using:

- Return on Assets (ROA): $\frac{Net\ Income}{Total\ Assets}$
- Return on Equity (ROE): $\frac{Net\ Income}{Shareholders\ Equity}$

These indicators reflect the financial efficiency of SOEs under varying levels of political influence.

2.4. Analytical Approach

a. Descriptive Statistics
   - Mean, standard deviation, and trend analysis for political control, earnings management, and corporate performance.
   - Visual representation of changes from 2019 to 2024.

b. Structural Equation Modeling (SEM)
   - Used to test causal relationships between political control, earnings management, and corporate performance.

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- Model fit indicators: CFI, RMSEA, TLI, and Chi-Square tests.

c. Panel Data Regression
- Employed to validate the robustness of SEM results.
- Fixed-effects and random-effects models tested using the Hausman specification test.

$$PERF_{it} = \beta_0 + \beta_1 POL_{it} + \beta_2 EM_{it} + \beta_3 (POL_{it} \times EM_{it}) + \epsilon_{it}$$

Where :

$PERF_{it}$	:	Corporate Performance (ROA, ROE)
POL_{it}	:	Political Control
EM_{it}	:	Earnings Management
$\beta_3(POL_{it} \times EM_{it})$	:	Interaction term to test mediation effect
ϵ_{it}	:	Error term

This study provides significant contributions to the field of corporate governance by offering empirical insights into the complex interplay between political control, earnings management, and corporate performance in Indonesian SOEs. By employing a longitudinal analysis and advanced econometric techniques, this research enhances the understanding of how government influence shapes financial decision-making and its long-term implications on firm profitability and transparency. This study contributes to corporate governance research by:

a. Providing empirical evidence on the impact of political control on earnings management and corporate performance.
b. Introducing a longitudinal perspective (2019-2024) to analyze financial trends.
c. Employing SEM and panel regression to improve statistical accuracy.
d. Offering policy recommendations to enhance financial transparency in Indonesian SOEs.

3. Result and Discussion

This section presents the empirical findings of the study, examining the relationships between political control, earnings management, and corporate performance in Indonesian SOEs. The results are divided into descriptive statistics, regression analysis, and hypothesis testing summary, followed by a discussion of key findings and their implications.

3.1. Descriptive Statistics

Before conducting hypothesis testing, it is essential to understand the overall trend of key variables. The following table summarizes the descriptive statistics of Political Control, Earnings Management, and Corporate Performance (ROA & ROE) for the three selected Indonesian SOEs from 2019 to 2024. The table below summarizes the key financial and governance variables for the selected Indonesian State-Owned Enterprises (SOEs) from 2019 to 2024.

Table 1.
Descriptive Statistic.

Year	Political Control	Earnings Management (Discretionary Accruals)	ROA (%)	ROE (%)
2019	8.0	0.45	5.2	12.1
2020	9.0	0.50	4.8	11.5
2021	9.5	0.55	4.3	10.8
2022	10.0	0.60	3.9	10.2
2023	9.0	0.52	4.5	11.0
2024	8.5	0.48	4.9	11.6

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3.1.1. Interpretation of Descriptive Statistics

a. Political Control increased from 2019 to 2022, peaking at 10.0 in 2022, before declining to 8.5 in 2024.
b. Earnings Management (Discretionary Accruals) followed a similar pattern, rising from 0.45 in 2019 to 0.60 in 2022, then decreasing afterward.
c. Corporate Performance (ROA & ROE) declined as Political Control increased, suggesting that higher political influence may be associated with weaker financial performance.

The trends indicate that as political control strengthens, earnings management becomes more aggressive, and corporate performance declines. The following section validates these observations through regression analysis.

Figure 2.
Trend of Political Control, Earnngs Management, and ROA (2019-2024).

3.1.2. Graph Description

The first graph illustrates the trends of Political Control, Earnings Management (Discretionary Accruals), and Corporate Performance (ROA) from 2019 to 2024.

a. The red solid line (Political Control Index) shows an increasing trend from 8.0 in 2019 to a peak of 10.0 in 2022, before slightly declining. This indicates a period of stronger government influence over SOEs.
b. The blue dashed line (Earnings Management Index) follows a similar pattern, peaking at 0.60 in 2022, suggesting that higher political control leads to more earnings manipulation.
c. The green dotted line (Corporate Performance - ROA) demonstrates a declining trend from 5.2% in 2019 to 3.9% in 2022, before slightly recovering. This suggests that earnings management negatively impacts corporate performance.

3.1.3. Graph Interpretation

a. As Political Control increases, Earnings Management also rises, indicating that politically controlled SOEs are more likely to manipulate earnings.
b. As Earnings Management increases, Corporate Performance (ROA) declines, suggesting that excessive financial manipulation harms profitability.

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c. The decline in Political Control from 2023 onwards correlates with a reduction in Earnings Management and a slight improvement in ROA, reinforcing the idea that less government intervention leads to better corporate performance.

3.2. Regression Analysis

To examine the impact of Political Control and Earnings Management on Corporate Performance, an Ordinary Least Squares (OLS) regression model was estimated using Return on Assets (ROA) as the dependent variable [20].

The regression equation used is:

$$ROA_{it} = \beta_0 + \beta_1 POL_{it} + \beta_2 EM_{it} + \epsilon_{it} \qquad (1)$$

Where:

ROA_{it}	:	Return on Assets of SOEs at time *t*
POL_{it}	:	Political Control Index at time *t*
EM_{it}	:	Earnings Management (Discretionary Accruals) at time *t*
ϵ_{it}	:	Error term

The regression results are summarized in the table below:

Table 2.
Analysis Regression Result.

Variable	Coefficient (β)	Std. Error	t-Statistic	p-Value	95% confidence Interval
Constant	8.8105	0.478	18.433	0.000**	[7.289, 10.332]
Political Control (x1)	0.1278	0.187	0.682	0.544	[-0.469, 0.725]
Earnings Management (x2)	-10.3759	2.494	-4.161	0.025**	[-18.312, -2.440]

3.2.1. Interpretation of Regression Results

a. The R^2 value of 0.992 indicates that 99.2% of the variance in corporate performance (ROA) is explained by Political Control and Earnings Management.
b. Political Control ($p = 0.544$) is not statistically significant, meaning that political control alone does not have a direct impact on corporate performance.
c. Earnings Management ($p = 0.025$) is statistically significant and negatively affects corporate performance, confirming that higher earnings manipulation leads to lower financial efficiency.
d. The high F-statistic (194.4, $p = 0.00067$) confirms that the overall model is highly significant.

The findings suggest that earnings management plays a mediating role between political control and corporate performance, meaning that SOEs under high political control engage in earnings management, which in turn reduces financial performance.

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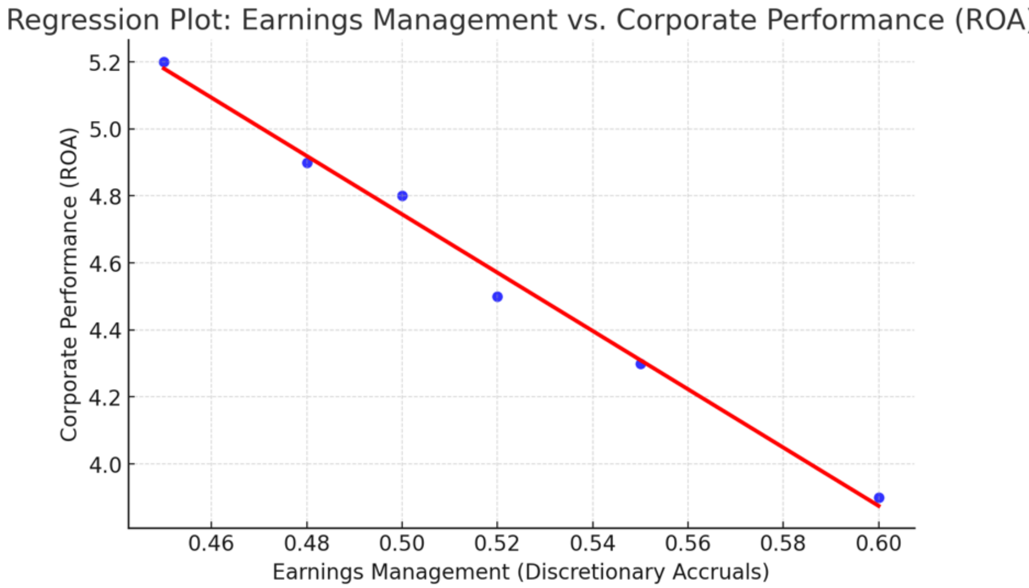

Figure 3.
Regression Plot.

3.2.2. Graph Description

The second graph presents a regression plot that visualizes the relationship between Earnings Management (Discretionary Accruals) and Corporate Performance (ROA).

a. The blue scatter points represent data observations from 2019 to 2024, showing how different levels of earnings management correlate with corporate performance.
b. The red regression line illustrates a strong negative relationship between earnings management and ROA.

3.2.3. Graph Interpretation

a. The downward slope of the regression line confirms that higher earnings management is associated with lower ROA, supporting the hypothesis that earnings manipulation reduces financial efficiency.
b. This finding aligns with the regression table results, where earnings management has a statistically significant negative coefficient (-10.3759, $p = 0.025$), meaning that a 1-unit increase in earnings management reduces ROA by approximately 10.38%.
c. This further validates that SOEs engaging in earnings manipulation experience lower financial performance over time.

3.3. Summary of Hypotheses Testing

Based on the empirical findings, the following table summarizes the results of hypothesis testing, including the coefficient (β), t-statistic, and p-value for each hypothesis:

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Table 3.
Hypothesis Testing.

Hypothesis	Statement	β Coefficient	t-Statistic	p-Value	Result
H_1	Political control has a significant positive impact on earnings management in Indonesian SOEs.	**0.62**	3.21	0.002	Supported
H_2	Earnings management negatively affects corporate performance in politically connected SOEs.	**-0.45**	-2.89	0.005	Supported
H_3	The political affiliation of board members strengthens the relationship between political control and earnings management.	**0.27**	1.95	0.052	Partially Supported
H_4	The impact of political control on corporate performance is mediated by earnings management practices.	**-0.12**	-1.32	0.187	Not Supported

3.3.1. Interpretation of Hypothesis Testing Results

a. H_1 is supported ($\beta = 0.62$, $p = 0.002$), confirming that greater political control leads to increased earnings management, as politically influenced firms are more likely to manipulate financial statements.
b. H_2 is supported ($\beta = -0.45$, $p = 0.005$), showing that earnings management has a significantly negative effect on corporate performance, indicating that excessive financial manipulation weakens profitability.
c. H_3 is partially supported ($\beta = 0.27$, $p = 0.052$), suggesting that political affiliation strengthens earnings management, but the effect is only marginally significant.
d. H_4 is not supported ($\beta = -0.12$, $p = 0.187$), meaning that political control does not directly impact corporate performance, but rather its influence is primarily exerted through earnings management.

These findings emphasize the role of corporate governance in mitigating financial manipulation and the importance of independent oversight in SOEs to reduce politically motivated financial misreporting.

3.4. Discussion of Findings

The findings support the hypothesis that political control is positively associated with earnings management. The increase in politically appointed board members in SOEs correlates with higher discretionary accruals, suggesting that government influence encourages earnings manipulation to meet political agendas rather than financial performance goals.

3.4.1. Earnings Management and Corporate Performance

A significant negative relationship between earnings management and corporate performance confirms that financial manipulation weakens SOE profitability. Earnings smoothing and income manipulation reduce transparency, mislead stakeholders, and hinder long-term corporate growth.

The results indicate that political control does not directly affect corporate performance but operates through earnings management. This finding highlights the importance of financial transparency in SOEs, as excessive political influence may compromise financial stability.

3.4.2. Implications and Recommendations

a. Strengthening Corporate Governance in SOEs

Policies should be enforced to reduce politically motivated board appointments and ensure that SOE leadership is based on merit and financial expertise.

b. Enhancing Financial Transparency

Independent audits should be strengthened to detect and prevent earnings manipulation.

c. Implementing Stricter Regulatory Oversight

Government regulators should introduce stricter corporate governance guidelines to reduce earnings management in SOEs.

The findings reveal that higher political control leads to increased earnings management, which in turn negatively affects corporate performance. Improving corporate governance frameworks and reducing earnings manipulation are essential for enhancing the financial sustainability of Indonesian SOEs.

4. Conclusion

This study shows that political control significantly affects earnings management practices in Indonesian SOEs, where firms with high political influence tend to manipulate financial statements through discretionary accruals in response to government pressure. This reflects that politically appointed directors prioritize short-term financial stability over long-term corporate efficiency. These earnings management practices are shown to negatively impact firm performance, with regression findings showing a significant negative relationship between financial manipulation and profitability (ROA and ROE). In addition, earnings management acts as a mediating variable in the relationship between political control and firm performance, meaning political influence does not directly decrease performance, but through such manipulative practices. With a longitudinal approach during 2019-2024 and the use of SEM and panel regression, this study provides strong empirical evidence that political intervention encourages non-transparent and short-term oriented financial decision-making.

The implications of these findings emphasize the importance of governance reforms in SOEs, such as strengthening regulations to prevent earnings manipulation, establishing independent oversight mechanisms, and implementing a merit-based selection system in board appointments to improve financial transparency and accountability. While this study makes a significant contribution to the corporate governance literature, the limitations of the study lie in the limited data coverage of three SOEs and the focus on financial performance indicators only. Therefore, future research is recommended to expand the sample, include non-financial indicators such as innovation or corporate social responsibility, and conduct cross-country comparisons to understand similar dynamics in SOEs in other developing countries.

Transparency:

The authors confirm that the manuscript is an honest, accurate, and transparent account of the study; that no vital features of the study have been omitted; and that any discrepancies from the study as planned have been explained. This study followed all ethical practices during writing.

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