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MITIGATING EARNINGS MANAGEMENT THROUGH FAITH: THE MODERATING ROLE OF RELIGIOSITY ON BLOCKHOLDER INFLUENCE IN INDONESIA

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ABSTRACT
This study investigates the impact of controlling shareholders on earnings management in Indonesian firms and examines whether religiosity moderates this relationship. Using 2,238 firm-year observations of companies listed on the Indonesia Stock Exchange (2017–2021), multiple linear regression and multi-group regression analyses are applied. The final sample consists of 80 consumer goods firms (30 non-cyclical and 50 cyclical), yielding 320 firm-year data. Results indicate that controlling shareholders significantly increase earnings management, supporting the entrenchment theory. However, religiosity does not significantly moderate this relationship, suggesting that its influence as an informal governance mechanism remains limited in the Indonesian context. Additional findings reveal that leverage tends to strengthen earnings management practices. This research contributes to corporate governance literature by being among the first to empirically test religiosity as a moderating factor in the ownership–earnings management nexus. Practically, the study highlights the potential role of embedding religious values into corporate culture to curb unethical reporting behavior, although the measurement of religiosity via ISSI proxy is a limitation. Future studies should broaden sectoral coverage and apply more direct measures of religiosity.
Keywords: *Controlling Shareholders, Religiosity, Earnings Management, Agency Theory, Indonesia*

1. Introduction

In recent decades, earnings management has become a central focus in accounting and finance research. Scholars have sought to identify its underlying drivers and develop strategies to mitigate it. Excessive earnings management, particularly when it deviates from accounting standards, diminishes the quality of financial information and misleads investors ((Korkmaz et al., 2017). Despite such concerns, financial statements—especially reported earnings—remain a primary reference in investment decisions (Alvarez et al., 2018), as investors demand transparency and stability in financial reporting.

Empirical evidence from stock market performance further contextualizes the importance of governance and ethical behavior in firms.

Table 1

Sector	Mean Monthly Return	Monthly Volatility (Std Dev)	Annualized Return	Annualized Volatility
Non- Cyclicals	0.64%	0.61%	7.66%	2.12%
Cyclicals	0.44%	0.46%	5.34%	1.60%

Source: Data 2017-2021BEI

Stock return data for companies that sell consumer items on the Indonesia Stock Exchange (2017–2021) show that Non-Cyclicals achieved higher average monthly returns (0.64%) and volatility (0.61%) than Cyclicals (0.44% return, 0.46% volatility). Annualized, these correspond to returns of 7.66% and 5.34%, respectively. The data suggest Non-Cyclicals offer a relatively stable and profitable investment, while Cyclicals are more sensitive to economic changes. These differences highlight the need for strong corporate governance to protect investors and provide context for studying earnings management and religiosity in firms.

These findings suggest that the Non-Cyclicals sector tends to offer relatively stable and higher returns compared to the more economically sensitive Cyclicals sector. These market trends highlight how important it is to have strong corporate governance procedures in place to shield investors particularly minority shareholders from dishonest tactics like earnings manipulation.

Managers often exploit the flexibility within accounting standards to present more favorable financial reports (Boahen & Mamatzakis, 2015), sometimes engaging in manipulation, as evidenced by major scandals such as Enron (2001), WorldCom (2002), Toshiba (2015), and domestic cases like Garuda Indonesia (2019) and Hanson International (2020). For instance, Garuda's management recognized the full revenue from a 15-year contract. in 2018, rather than proportionally, to inflate earnings for that year (Pirie & Smith, 2003).

According to agency theory (Jensen, 1986), a Type I agency conflict arises between managers (agents) and shareholders (principals), manifesting in profit management. The alignment perspective and the entrenchment perspective are the two principal approaches that elucidate the role of concentrated ownership (blockholders) in profit management in this context. The lining up perspective views blockholders as effective monitors (Jensen & Meckling, 1976), while the entrenchment perspective sees them as opportunistic actors who may collude with management for personal gain, leading to Type II agency conflict (Porta et al., n.d.; Shleifer & Vishny, 1997; *ShleiferVishy1986*, n.d.).

This study proposes an alternative argument by introducing religiosity as a potential mechanism to mitigate agency conflicts, particularly Type II. Earnings management is widely viewed as unethical behavior (Elias, 2004; Weaver & Agle, 2002), and business ethics are often shaped by religious and cultural norms (*Conroy 2004*, n.d.). Religion plays a vital role in forming ethical standards that guide individual and organizational behavior(Kang & Sørensen, 1999; Weaver & Agle, 2002). Hence, religious values within corporate environments may influence managerial decision-making by fostering ethical conduct and reducing pressure to manipulate financial reports (Boahen & Mamatzakis, 2015).

According to the author's understanding, there is little empirical research examining the influence of religion on diminishing the engagement of controlling shareholders in profits management. This research enhances the accounting and corporate governance literature by emphasizing religion as a viable governance instrument to mitigate Type II agency conflicts, when dominant owners and management engage in opportunistic behavior detrimental to minority shareholders. When controlling shareholders pursue interests that diverge from those of the firm, they may promote profits management. This study offers an alternative perspective by proposing that religiosity can help mitigate conflicts between shareholders and management. Several scholars have identified earnings management as an unethical practice(Elias, 2004). The social norms that people live and work within greatly affect ethics and morality, and religion often has a significant impact on these standards. Religion provides the basis and direction for moral and ethical conduct (*Conroy 2004*, n.d.; Hilary & Hui, 2009), providing particular ethical frameworks to assist believers in determining whether a certain experience is morally right or wrong (Weaver & Agle, 2002). As a result, religion is essential in resolving disputes with money management.

The influence of religion in lowering the participation of controlling shareholders in profits management has not yet been the subject of any empirical research. Therefore, by addressing agency difficulties, especially Type II agency conflicts, this work adds to the accounting literature. Because minority shareholders have limited access to corporate information, dominant owners and managers may take advantage of opportunities for personal benefit in this situation, usually without the minority stakeholders' knowledge and harm. This research underscores the importance of embedding religious values within corporate environments as a means to curb such opportunistic behavior. By fostering a religiously influenced organizational culture, ethical awareness and moral behavior among managers can be enhanced, resulting in more principled decision-making that is less susceptible to external pressures (Boahen & Mamatzakis, 2015).

The claim that religion may successfully lessen the degree to which controlling shareholders manipulate profitability is supported by empirical data from this research. By investigating the moderating influence of religion on the relationship between controlling shareholders and profits management, this research seeks to add to the body of knowledge in the fields of accounting and corporate governance. This study offers empirical support for the idea that religious beliefs help reduce agency conflicts in companies with concentrated ownership by combining a governance approach with social norm theory. A thorough literature review, conceptual framework, and hypothesis generation are presented in the next parts. These are followed by a thorough description of the study methodology and data analysis methodologies. Following an overview of the findings and discussion, conclusions, study limitations, and suggestions for more research are presented.

2. Literature Review and Hypotheses Development

2.1. Controlling Shareholders and Earnings Management

Agency issues arise, especially between managers and shareholders, as a result of ownership fragmentation and the division of ownership and power inside organizations. Although managers are supposed to operate in the best interests of shareholders, they could choose to put their own interests first (Jensen, 1986). Because of their ability to vote, concentrated external shareholders may be a useful tool for keeping an eye on earnings management practices (Demiralp et al., 2011; Klein, n2010.; San Martin-Reyna & Durán-Encalada, 2012) . It is well acknowledged that one of the most important governance mechanisms for maintaining the accuracy of financial reporting is controlling shareholders, or blockholders, (Bédard et al., 2004; Yeoh, 2024). In order to avoid excessive profits manipulation and improve the reliability of financial reporting, they actively supervise management. Numerous empirical investigations have shown a negative correlation between profits management and controlling owners (Alves, n.d.; Faroque et al., 2021; Jerbi Maatougui & Halioui, 2019; Usman & Yero, 2012). But agency issues between majority and minority owners may also occur (Shleifer & Vishny, 1997; *ShleiferVishy1986*, n.d.). With little scrutiny from minority owners, majority shareholders often have dominating power and influence over management. They may act opportunistically and seek their own interests at the cost of minority owners because to this control.

Previous studies have also shown that senior management turnover and stock prices may be impacted by the presence of controlling owners (BARCLAY & HOLDERNESS, 1991; Holderness & Sheehan, 1988; *ShleiferVishy1986*, n.d.). This implies that controlling shareholders hold significant power to influence both market valuation and executive appointments. The more concentrated their ownership, the greater their ability to influence managerial behavior. Controlling shareholders may put pressure on management to boost output and maintain profits during times of subpar business performance in order to safeguard their large investments (Ely et al., 2000; Zhong et al., 2007). With this degree of authority, they might actively influence management choices and promote profits manipulation for their own gain (Jaggi & Tsui, 2010.). Numerous research attest to the beneficial correlation between profits management and controlling owners (Cai et al., 2019; Khanchel & Lassoued, 2023; Zhong et al., 2007).

Two perspectives, the alignment view and the entrenchment perspective have emerged as a result of these contradictory results. According to the alignment approach, managing shareholders lessens Type I agency issues (between managers and shareholders). However, according to the entrenchment viewpoint, their existence can result in a distinct Type II agency conflict between minority and controlling owners. In businesses with highly concentrated ownership, type II conflicts are more common. Dominant shareholders may put pressure on managers to manipulate results in order to protect their interests. This pattern is particularly common in Asian firms, including Indonesia, where ownership is often concentrated in a single individual or family (Claessens et al., 2000). Such ownership structures frequently result in conflicts with minority shareholders, as controlling shareholders prioritize their own interests (Hanafi et al., 2024).

In light of this, the following theory is put forward:
H1a. Controlling shareholders have a substancial positive influence on earnings management.

Controlling shareholders are defined as individuals who own more than 50% of a company's shares under SAK No. 4 of 2009, thereby possessing substantial authority over financial and operational decisions. Furthermore, SAK No. 65 of 2013 expands the definition to include qualitative aspects of power and control, meaning that even with less than 50% ownership, an investor can still be considered a controlling shareholder if they exert significant influence over the entity. In general, ownership of 50% or more is viewed as a strong indication of control due to the ability to dominate corporate decisions(Hanafi et al., 2024).

In Indonesia, concentrated ownership often under the control of one family or shareholder gives rise to strong control. The separation between ownership and management is minimal, over 60% of senior management roles are associated with controlling owners (Claessens et al., 2000). Therefore, the power and motivations of dominant owners might result in the expropriation of the interests of minority shareholders. The agency conflict in such settings often shifts from Type I (manager-shareholder) to Type II, whereby smaller shareholders' interests may be compromised by the majority shareholder-manager alliance (Baryeh, n.d.).

Consequently, the following theory is also put out:
H1b. Controlling shareholders have a significant positive influence on earnings management.

3. Research Methods

Part Religion Plays in the Interaction Between Earnings Management and Controlling Shareholders. Social norm theory states that the social norms of the environment in which individuals live, and work influence their own behavior and attitudes (Elster, 1989; Sunstein, 1996). Consistent with (Boahen & Mamatzakis, 2015), Social norms and moral principles in one's environment have an impact on one's decision-making. Religious beliefs often influence the attitudes, actions, and choices of people and management in a business when its social environment is marked by a high level of religiosity. These values can serve to restrain both managerial and controlling shareholders' tendencies toward earnings manipulation.

According to earlier research, businesses in areas with high religious standards are less likely to commit financial reporting fraud (Du et al., 2016; Grullon et al., n.d., 2002) similarly, empirical evidence from (Li et al., 2024) demonstrates that religion and profits management are negatively correlated (Cai et al., 2019) further shown that businesses with religious CEOs are less prone than those with non-religious CEOs to manipulate profitability. Religion serves as an institutionalized control mechanism in the accounting setting, influencing management choices about financial reporting (Hanafi et al., 2024).

Thus, by serving as a moral restraint, religion may lessen the impact of controlling shareholders on profits management, according to this research. The following theory is put out in light of this reasoning:

H2: Religiosity moderates the relationship between controlling shareholders and earnings management in religious firms.

4. Results and Discussion

4.1. Result

4.1.1. Sample and Data Collection

Data from businesses listed between 2017 and 2021 on the Indonesia Stock Exchange (IDX) is used in this research. Companies in the financial sector (banks, financial institutions, insurance companies, securities firms, and other financial institutions) were among the samples that were not included because of their unique rules and features in comparison to other businesses (Engagedscholarship@csu et al., 2017; Zhong et al., 2007)). Extreme data and businesses that stopped operations were also not included. As a result, the final dataset comprises consumer goods companies listed on the Indonesia Stock Exchange (BEI) between 2017 and 2021, including consumer non-cyclicals (primary consumer goods/sector D) and consumer cyclicals (secondary consumer goods/sector E). The Indonesia Stock Exchange (BEI) lists 30 firms in Sector D (Consumer Non-Cyclicals) and 50 companies in Sector E

(Consumer Cyclicals). This yields 120 company year observations for Sector D and 200 company year observations for Sector E over a four-year period.

4.1.2. Earnings Management Measurement

The literature has used a number of distinct techniques to estimate profits management. This research applies the (Alves, n.d.) modified by (Dechow et al., 1995) formula to employ discretionary accruals (DAC) as a stand-in for earnings management. DAC was selected for a number of reasons: First, when compared to other models, DAC is considered to be the most reliable estimating model (Jaggi & Tsui, 2007)). Second, prior research has made extensive use of this paradigm (Alves, 2007.; Jaggi & Tsui, 2007). The following is the modified Jones model: (The next part will display the model or formula.)

4.1.3. Controlling Shareholder Measurement

Large shareholders who own a greater percentage of the company's shares than others are known as controlling shareholders (Baryeh, 2014.). Large stockholders are divided into two groups in this research:

Blockholders: Owners of at least 5% of the total number of shares in circulation ((Zhong et al., 2007) but are not senior officers or board members (Zhong et al., 2007)). The biggest proportion of shares is utilized as a stand-in for controlling shareholders for owners who satisfy this requirement ((Du et al., 2016; Mcconnell & Servaesb, 1995).

Regulating Blockholders: A dummy variable is used in this measurement, and if the ownership percentage is higher than or equal to 50%, a value of 1 is assigned; if it is less than 50%, a value of 0 is assigned.

4.1.4. Religiosity Measurement

Businesses that base their operations on religious ideals and practices are said to be religios (Johnson et al., 2001.). The Sharia Index is utilized in the methodology for measuring religion (Alsaadi, 2021). Data from businesses included in the Indonesia Stock Exchange is used in this research to identify Indonesian religious businesses. Companies in the are indexed by the Indonesia Stock Exchange Financial Services Authority of Indonesia according to their compliance with Sharia principles, which prohibit gambling, usury, transactions involving a significant degree of uncertainty, and the manufacture of illegal products or services, and ensuring there is no bribery or fraud in transactions. firms that adhere to Sharia principles or Islamic beliefs are assigned a value of 1 in this research, whereas firms that are listed on the IDX but not on the ISSI are assigned a value of 0. As a result, the sample will be examined with an emphasis on religious businesses.

4.1.5. Control Variables

Company characteristics are included in this research as control factors in addition to the primary variables. Control variables are connected to the main variables and are used to account for corporate characteristics that may have an impact on the dependent variable (Dyreng et al., 2012). The study's control variables include:

Leverage: Determined by the ratio of total debt to total assets. Because of debt limits, companies with greater debt levels often engage in more earnings management (Defond & Jiambalvo, 1994). Prior studies indicate that leverage and earnings management are positively correlated(Lazzem & Jilani, 2018; Sohn, 2016).

Company Size: Determined by using the entire assets' natural logarithm. Investors and the general public are more interested in larger businesses than in smaller ones. Due to investor and analyst scrutiny, large organizations are more likely to post higher-quality results (Cheng, 2000). To account for the differences in accrual behavior between big and small businesses, company size is utilized (Gul et al., 2009).

Profitability: evaluated using ROA as a stand-in for performance. Decisions on earnings management may be influenced by a company's performance (D. A. Cohen & Zarowin, 2010). Management is under more pressure to alter results when the firm performs poorly.

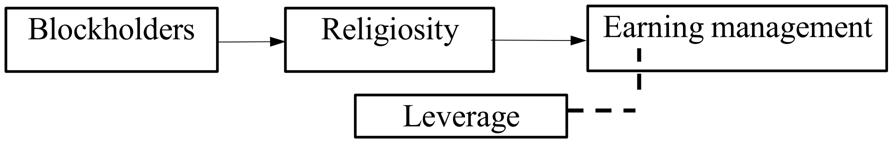

Figure 1. Systematical Framework

Table 3. Descriptive Statistic

Variable	Operational Definition	Measurement Method / Indicator
Controlling Shareholders (Blockholders)	Shareholders who own a significant portion of a company's shares, influencing company decisions.	Ownership Percentage (%) = (Shares Owned / Total Outstanding Shares) × 100%; Dummy = 1 if ≥50%, else 0
Religiosity	Degree to which a company or its management adheres to religious principles in its operations.	Proxy by listing on Indonesia Sharia Stock Index (ISSI): 1 = religious, 0 = non-religious
Earnings Management	The extent to which managers manipulate financial reports to achieve desired financial results.	Discretionary Accruals (DAC) Calculated by Modified Jones Model: DAC = (ΔCA / A_{t-1}) – (ΔCL / A_{t-1}) – (ΔREV / A_{t-1}) + (PPE / A_{t-1}) (simplified version)
Leverage	Financial risk the ratio of a company's total debt to its total assets, indicating financial risk.	Leverage Ratio = Total Debt / Total Assets

Source: SMART PLS 2025

4.1.6. Descriptive statistics

According to Hair et al., descriptive statistics are summary measures that quantitatively describe or summarize features of a dataset, providing an overview of the sample's main characteristics. Measures of central tendency (like mean and median) and dispersion or variability (such standard deviation, range, skewness, and kurtosis) are included in these statistics, and help researchers understand the distribution, spread, and shape of the data before conducting further analysis. (Hair et al., 2011).

Table 3. Descriptive Statistic

	Missing	Mean	Median	Min	Max	Standard Deviation
BLC	0	49. 169	47. 69	0.08	99. 79	28. 821
RELIGIUS	0	0.495	0	0	1	0.5
EARNMNG	0	15. 139	15. 2	-9. 9	38. 25	10.374
LEV	0	1. 432	1. 43	0.02	2. 98	0.873

Source: SMART PLS 2025

Blockholders (BLC) have a mean value of 49. 17 with a wide range from 0.08 to 99. 79 and a relatively high Std.Dev of 28. 82, indicating significant variance in blockholder ownership across firms. Religiosity (RELIGIUS) is a binary variable with a mean of 0.495, recommending that approximately half of the sample exhibits religiosity. Its Min and Max values are 0 and 1, correspondingly, confirming the binary nature. Earnings Management (EARNMNG) shows a mean of 15. 14 with values ranging from -9. 9 to 38. 25. The standard deviation of 10.37 indicates moderate dispersion in earnings management levels among firms. Leverage (LEV) has a mean of 1. 43 with a Min close to zero (0.02) and a Max of 2. 98, indicating variation in firms' debt levels. The standard deviation is 0.87.

Table 3. Descriptive Statistic

Hypothesis	Path Coefficient (Original Sample)	T-Statistic	P-Value	Significance (α=0.05)
Blockholders -> Religiusitas	-0.0446	0.81	0.418	Not Significant
Leverage -> Earnings Management	0.0944	1.682	0.093	Not Significant
Moderating Effect 1 -> Earnings Management	0.0314	0.548	0.584	Not Significant
Moderating Effect 2 -> Earnings Management	-0.0045	0.079	0.937	Not Significant
Moderating Effect 3 -> Earnings Management	0.0584	0.951	0.342	Not Significant
Religiusitas -> Earnings Management	0.0028	0.05	0.96	Not Significant

Source: SMART PLS 2025

Blockholders -> Religiusitas: The path coefficient is -0.0446 with a t-value of 0.81 and p-value of 0.418, indicating this relationship is not statistically substancial. This suggests that the presence or influence of blockholders does not significantly affect the level of religiosity within the study's context.

Leverage -> Earnings Management: With a t-value of 1.68 and a p-value of 0.093, the path coefficient is 0.0944. Although leverage may boost earnings management behavior, as seen by the positive coefficient, the link is not significant at the 5% level but approaches marginal significance at the 10% level

Religiusitas -> Earnings Management: The effect is essentially zero (-0.0028) with very low t-value and very high p-value (0.96), indicating religiosity does not directly impact earnings management in this dataset.

Moderating Effects: Three moderating variables were tested for their influence on earnings management, but none yielded significant results. Their path coefficients and t-values were very low, with p-values well above 0.05.

4.2. Discussion

4.2.1. The Effect of Controlling Shareholders (Blockholders) on Earnings Management

The findings of the hypothesis test (Table 3) show that controlling shareholders have a considerable and beneficial impact on earnings management. This suggests that companies with more blockholder ownership are more likely to manipulate their results. This result is consistent with agency theory's entrenchment approach, where controlling shareholders may exert dominant influence and encourage opportunistic financial

reporting to protect their interests at the expense of minority shareholders. It is consistent with prior studies by (Lassoued et al., 2018; Zhong et al., 2007)Zhong et al. (2007) which highlight the potential for blockholders to engage in earnings manipulation.

4.2.2. The Moderating Role of Religiosity

The analysis reveals that religiosity significantly moderates the relationship between blockholders and earnings management, weakening the positive effect of blockholders on earnings manipulation in religious firms. This supports the notion that religious values embedded within firms act as ethical constraints on opportunistic behaviors. These results confirm prior research by (Boahen & Mamatzakis, 2015; Omer et al., 2018), suggesting religiosity functions as an informal governance mechanism reducing agency conflicts by promoting ethical conduct.

4.2.3. Control Variables Effects

Leverage is positively related to earnings management, consistent with the idea that debt pressures increase incentives for earnings manipulation to meet debt covenants (Mayasari et al., 2019)implying that better-performing firms face less pressure to manipulate earnings, consistent with (D. A. Cohen & Zarowin, 2010; S. Cohen et al., 2014).

5. Conclusion

The results of this study indicate that controlling shareholders have a significant positive effect on earnings management, while religiosity moderates and reduces this effect. However, the model's explanatory power is limited, as reflected by the low R Square values (1. 4% for earnings management and 0.2% for religiosity) and negative adjusted R Square values. This suggests that the variables included in the model explain only a small portion of the variance in earnings management, indicating the need to include additional factors in future research to better capture the complexity of earnings management behavior.

This study has several limitations. First, the measurement of religiosity is based on proxy data from Indonesia stock exchange, which may not fully capture the depth of religious influence within firms. Second, the study focuses only on firms in the consumer goods sector, limiting the generalizability of the findings.

Based on these limitations, future research should expand the sample by including firms from other sectors and consider more direct measures of religiosity. Incorporating additional explanatory variables such as corporate governance quality, audit quality, and firm culture could improve the model's explanatory power.

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