THE IMPACT OF CEO ORIGIN ON EARNINGS MANAGEMENT

THROUGH REAL ACTIVITIES MANIPULATION

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Abstract

This research examines whether CEO origin gives impact on earnings management through real activities manipulation. The sample of this study is 583 observations during 2007-2014. This research uses purposive sampling to collect data from Indonesian Stock Exchange. This research is conducted by using annual reports of manufacturing companies listed in Indonesian Stock Exchange. Independent variable is CEO origin (outside and inside) and dependent variable is earnings management. CEO origin is measured by using dummy variable. Earnings management through real activities manipulation is measured by using abnormal cash flow from operation and abnormal discretionary expenses. To analysis data, this research uses multiple regression model. The results of this research show that CEO origin does not give impact on earnings management through real activities manipulation. It indicates that new outside CEO will not have positive impact on income-increasing manipulation.

Keywords: CEO origin, earnings management, real activities manipulation, return on assets.

CHAPTER I
INTRODUCTION

Background

The accounting information about the company's performance is really crucial for the investors in the capital market to make a decision. One of the sources is financial report. Financial report is the form of management's responsibility in managing the economic resources trusted to them.

According to SFAC no. 8 (2010), the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, holding equity and debt, and providing loans and other forms of credit. The information provided in financial reporting is important to help the users of financial report assess the prospects for future net cash inflows to an entity, identify the reporting entity's financial strengths and weaknesses, and understand the return that the entity has produced on its economic resources. In order to do that, the users need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

Profit is one of the benchmark used by the users of financial report in appraising the company's performance. SFAC no. 1 (1978) stated that the primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components. Financial reports are made by the management of the company.

Managers are employed to run the company on behalf of the owner. They have responsibility to give information about the underlying condition of the company to the owner. Both managers and shareholders have different information. Shareholders as principals give the controls and management of the company to the managers. As the runner of the company, the managers will have more knowledge about internal information and the prospect of the company rather than the shareholders.

Sometimes the information received by the users is not the real underlying condition of the company. It makes the users such as investors and creditors do mistake in making the decisions. The owner's objective is not always in accordance with the objective of the manager. This situation can lead to a problem that is commonly called as conflict of interests. The managers can act only based on their interest that will lead them to take some private gain and ignore the interest of the shareholders.

Managers are competing in the labor market because they are the agent. Managers with good reputation will have opportunities to get better job and vice versa. Their reputation is related with their performance in running the company. If the top management or the CEO position of the company can do their job well, so the company can achieve its main goal. It is important for the CEOs to get achievement every year and fulfill the objective of both the

owner of the company (principal) and the CEOs (agent). The owner of the company can fire the managers if the company under their direction has bad performance.

CEO turnover is a common phenomenon. According to Anderson and Lilja (2013), even if companies put a lot of effort in the choice of CEO, the CEOs turnover increased every decade since 1970 with a more significant change after 1992. Kaplan and Minton (2008) stated that structural changes, emergence, cost saving programs, reorganizations, and increasing demand for short term tenures are some explanations for increasing tenure.

There are at least two factors that can drive the CEO turnover event. First, the tenure of the old CEO is up and the company needs to change the position with the new CEO. This is a normal condition from the CEO turnover event. This condition is often called as CEO turnover routine. CEO turnover routine is a planned process that is known by both the old CEO and the new CEO.

Second, the old CEO cannot run the company well and the company cannot achieve its main goal. CEO turnover is a good strategy for a company that has a bad condition. This CEO turnover is expected to give better prospect. This condition is often called as CEO turnover non-routine. CEO turnover non-routine is an unplanned process and the company has a limited time to choose the new CEO who will replace the position of the old CEO (Wells, 2002). But the company is said to be unstable if the company too often experienced CEO turnover every year.

Turnover in the CEO position is a frequent phenomenon. Nowadays, new CEOs increasingly come from outside the company rather than through internal promotions. The choice of an external hire is not an exogenous shock, but rather is endogenous to CEO and firm characteristics (Kuang et al., 2014), which also could drive firm's earnings management.

Like other countries, in Indonesia, turnover in CEO position is often happen. The turnover of the CEOs can give impact to earnings management because it involves decisions by both the departing and incoming CEOs (Choi et al., 2012). Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the company's economic performance or to influence contractual outcomes that depend on reported accounting numbers (Healy and Wahlen, 1999). Earnings management can be done either through accrual manipulation or real activities manipulation. Real activities manipulation is earnings management done by the managers which deviate from normal business practices aimed of achieving certain earnings (Roychodhury, 2006). Usually manager is more likely to use real activities manipulation rather than accrual manipulation. There are two reasons behind this condition. First, accrual manipulation more often becomes the center of observation or inspection by the auditors and the regulators. Second, focus attention only on accrual manipulation is a risky action because the company may have limited flexibility to manage accrual (Graham et al., 2005).

In Indonesia, many studies about earnings management have been done. Researches on earnings management that have been done in Indonesia mostly

investigated the relationship between earnings management and the investors reaction in the stock market. Studies that examine whether new CEOs in Indonesian companies practice earnings management have not been done so much, those studies are still in a few amounts. Most of prior studies about earnings management in Indonesia are concern about the practice of earnings management from market performance perspective.

The example of CEO turnover event in Indonesia is the CEO turnover in PT Indosat Tbk. The shareholders of PT Indosat Tbk agreed to change the composition of directors and commissioners in the general meeting of extraordinary shareholders. For the position of President and CEO which formerly held by Harry Sasangko Tirtotjondro replaced by Alexander Rusli. This change became effective on November 1, 2012.

Rusli had previously been an Independent Commissioner at Indosat since January 2010. Currently he is a member of the Remuneration Committee and the Audit Committee of Indosat. In the board of commissioner positions, Rudiantara will enter as Independent Commissioner of Indosat from 1 November 2012. Rudiantara is not a new people in the telecommunications industry because he has ever been in the top position in Telkomsel and XL.

This research is different from prior researches about earnings management because this research will examine the behavior of earnings management at the turnover of the CEOs in Indonesia. This research will examine the turnover of the CEOs based on the origin of the CEO. CEO origin is the origin of CEO whether they are promoted from within the company or externally recruited. CEO origin is an important factor for explaining financial reporting strategies (Kuang et al., 2014). Most of the researches about CEO turnover only differentiate between routine and non-routine departures. The researches did not separate whether the incoming is through internal promotion or external recruitment.

There are some motivations for the CEOs in doing earnings management. Those motivations are stock market motivation, signaling or concealing private information, political costs motivation, CEO turnover, bonus plan motivation, debt covenant motivation, and regulatory motivation (Rahman et al., 2013). This research will examine the earnings management done by the CEOs with CEO turnover as the motivation.

There are four patterns of earnings management: taking a bath, income minimization, income minimization, and income smoothing (Scott, 2006). This research will examine the earnings management done by the CEOs with income maximization as the pattern of earnings management through real activity manipulation.

Based on Kuang et al. (2014) research, they find that compared with CEOs promoted from within the company, CEOs recruited from outside have a stronger incentive to demonstrate their abilities in the initial years after their appointment. They also have lower survival expectations. They predict and find that outside CEOs engage in greater income-increasing manipulation after their appointment.

This research is expected to give the same results as in Kuang et al. (2014) research. This study will give empirical evidence that will support the previous research.

Research Problem

This research wants to find whether there is an impact on earnings management from the origin of the CEO. CEO origin is the origin of CEO whether they are promoted from within the company or externally recruited.

As a result, there is a research problem that arises from this study:

a. Does CEO origin give impact on earnings management through real activities manipulation?

Research Objective

This research will give empirical evidence that:

a. CEO origin gives impact on earnings management through real activities manipulation.

CHAPTER II
LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Hypothesis Development

Outside CEOs' capabilities are not known by the market and the board of the company. They want to prove their ability that they can run the company well. They also want to establish a good reputation about themselves. They have a desire to prove that the company under their direction can achieve its main objective. They are worry about dismissal due to unsatisfactory performance, and therefore report earnings more aggressively than inside CEOs who already have established their ability and more concerned with preserving their reputations (Hermalin and Weisbach, 1998).

In addition to their stronger desire to prove their ability, outside CEOs tend to have lower survival expectations than inside CEOs. Prior study indicates that outside CEOs tend to remain in office for shorter times than their inside peers. Hostility from existing senior managers and the outside CEO's own lack of firm-specific knowledge may work against an outside CEO's efforts to initiate strategic changes to achieve initial objectives. A corporate board also could have overestimated the outsider's abilities during the CEO selection process because it lacked sufficient information about the abilities of the external candidates (Kuang et al., 2014).

Outside CEOs have lower expectation to stay with the firm for the long term. Because they have lower expectation, they tend to act in ways that benefit them immediately. They tend to have short-term decision making that makes them more willing to increase the earnings management immediately after their appointment. They do not consider about the adverse consequences of their actions for the future. They are less likely to bear the long-term consequences of their actions because they will have already left the firm for their next appointment (Kuang et al., 2014).

Based on the argument—confronted with outside CEOs' desire to prove their ability and their lower survival expectations--this study can formulate the hypothesis as follow:

H1 : *New outside CEOs will have positive impact on income-increasing manipulation.*

CHAPTER III
RESEARCH METHODOLOGY

Sample

The samples that will be used in this research include manufacturing firms listed on Indonesia Stock Exchange (IDX) from 2007 until 2014. This research wants to use longer period of time in order to get more accurate data. The data is taken from Kantor Bursa Efek Indonesia at Mangkubumi Street 111, Yogyakarta and Indonesian Stock Exchange website (www.idx.co.id). The available data is from the year of 2007 until 2014.

This research will use secondary archival data. The data obtained is in the form of annual reports that have been audited from 2007 until 2014. The data include financial statement and composition board of director.

The samples in this research are conducted by means of purposive sampling. Based on the criteria used as consideration to decide the sample in this research, the sample selection process as follows:

No	Explanation	Total
1	The number of manufacturing companies listed in Indonesia Stock Exchange during 2007-2014	125
2	The number of manufacturing companies whose annual reports were not available during 2007-2014	20
3	The number of manufacturing companies that did not use Indonesian currency (Rp) on their annual reports	20
4	The number of manufacturing companies that did not have infomation about president directors	0
	Total data for this research 85 x 8	680

Variables

There are three variables in this research. The three variables are independent variable, dependent variable, and control variables. The independent variable is CEO origin. The dependent variable is earnings management through real activities manipulation. The control variables are firm size, leverage, and return on assets (ROA).

Independent Variable

Independent variable is variable that is not affected by other variable. The independent variable in this research is CEO origin. This research defines an outside CEO as one who has been with the firm for one year or less before

being appointed (Huson et al., 2004; Murphy and Zabojnik, 2007). An inside CEO is one who has been with the firm for more than one year before being promoted.

This research will use dummy variable OUT to measure the independent variable, which is CEO origin. OUT equals to 1 if the new CEO is an outside CEO. OUT equals to 0 if the new CEO is an inside CEO.

Dependent Variable

Dependent variable is variable that is affected by other variable. The dependent variable in this research is earnings management. This research will use real activities manipulation in measuring the earnings management.

There are three measurements of real earnings management: abnormal cash flows, abnormal production costs, and abnormal discretionary expenditures. This research defines real earnings management as the negative of the sum of abnormal cash flows and abnormal discretionary expenditures, so that a higher value suggests more upward earnings management (Cohen and Zarowin, 2010). This study does not include abnormal production costs in the measurement of real earnings management for the main tests because, as stated in Cohen and Zarowin (2010), the same activities that lead to abnormally high production costs also lead to abnormally low CFO; thus, adding abnormal production costs leads to double counting.

Managers try to temporarily increase sales during the year by offering price discounts. This action is intended to generate additional sales from the next fiscal year into the current year. As a result, the total earnings in the current period are higher due to the positive margins. But, when the company re-establish the old prices, the increased sales volumes as a result of the discounts will disappear. The decreasing sales cause the cash inflow per sale becomes lower as margins decline. The lower margins due to price discounts cause production cost relative to sales to be abnormally high (Roychowdhury, 2006).

Managers try to manage earnings upward by producing more goods than necessary (overproduction). Because of this higher production levels, fixed overhead costs are spread over a large number of units, lowering fixed costs per unit. This reduction of fixed costs per unit lead to the declining of total cost per unit if there is no any increasing in marginal cost per unit. This implies that reported COGS is lower and the company reports better operating margins. Nevertheless, the company incurs production and holding costs on the over-produced items that are not sold in the same period. As a result, cash flow from operations are lower than normal given sales levels. The incremental marginal costs incurred in the overproduction result in higher annual production costs relative to sales (Roychowdhury, 2006).

So, it can be concluded that price discounts and overproduction lead to abnormally high production costs and abnormally low CFO.

$$\frac{CFO_t}{Assets_{t-1}} = \alpha_0 \ \frac{1}{Assets_{t-1}} + \alpha_1 \ \frac{Sales_t}{Assets_{t-1}} + \alpha_2 \ \frac{\Delta Sales_t}{Assets_{t-1}} + \acute{\varepsilon}_t \qquad (1)$$

$$\frac{PROD_t}{Assets_{t-1}} \quad \alpha_0 \quad \frac{1}{Assets_{t-1}} + \alpha_1 \quad \frac{Sales_t}{Assets_{t-1}} + \alpha_2 \quad \frac{\Delta Sales_t}{Assets_{t-1}} +$$

$$\alpha_3 \quad \frac{\Delta Sales_{t-1}}{Assets_{t-1}} + \acute{\varepsilon}_t \tag{2}$$

$$\frac{DIXS_t}{Assets_{t-1}} = \alpha_0 \quad \frac{1}{Assets_{t-1}} + \alpha_1 \quad \frac{Sales_{t-1}}{Assets_{t-1}} + \acute{\varepsilon}_t \tag{3}$$

Where:

- CFO = cash flow from operations as reported on the statement of cash flows
- PROD = production costs, defined as the sum of cost of goods sold and change in inventory
- Assets = total assets
- Sales = total revenues
- DISX = discretionary expenditures, defined as the sum of advertising expenses, R&D expenses, selling, general and administrative expenses (SG&A) minus salaries.

  SG&A is a composite of several different types of costs. One of the cost is salaries. Salary is regulated in the Indonesian Regulation, so it is important to remove this cost from SG&A.

  The abnormal cash flows (ACFO), abnormal production costs (APROD), and abnormal discretionary expenditures (ADISX) are computed as the difference between the actual values and the normal levels predicted (i.e., they are the residuals) from Regressions (1) until (3). Abnormal cash flows and abnormal discretionary expenditures are multiplied by -1, so that a higher value in all cases indicates greater upward earnings management. This study defines real earnings management as the sum of ACFO and ADISX.

Control Variable

Control variable is used to control the influence of independent variable on dependent variable and reduce the level of error or confounding variables. The control variables in this study are firm size, leverage, and return on assets (ROA).

Firm Size

The amount of assets owned by the company can be the indicator of firm size. The greater the company's total assets, the greater the size of company. There is a negative relation between firm size and earnings management. The bigger the firm is, the less earnings management is used (Andersson and Lilja, 2013). Bigger firms have more advanced and sophisticated internal control system. They also have more qualified internal auditors. Larger companies usually have auditors from bigger accounting firms who tend to be more experienced and can prevent earnings manipulations. This condition can limit the ability to do earnings management. Sánchez-Ballesta et al. (2007) in Anderson and Lilja (2013) found that smaller firms tend to report more discretionary current accruals. Those smaller firms seem to operate with less scrutiny and therefore may engage in more earnings management than bigger firms.

FS = In (Total Assets)

Leverage

Leverage ratio is used to identify financial risk of a company and combination of capital used by the company. Greater leverage indicates the debt of the company is higher than the owned asset of the company. High financial leverage also related with the future of the firms. The firms need to have sufficient fund to pay off their debt and finance their business. According to Scott (2006), company that has a lot of leverage will do earnings management by raising profits, because the rise reported earnings will reduce the possibility of failure to pay its debts in the future.

$$Leverage = (Total\ Liabilities)/(Total\ Assets)$$

Return on Assets

Return on Assets (ROA) is an indicator of how profitable a company is relative to its total assets. It explains how efficient management is in using its assets to generate earnings. The higher the return, the more efficient management is in utilizing its asset base. ROA is displayed as a percentage. ROA for public companies can vary substantially and will be highly dependent on the industry. Companies that require large initial investment will generally have lower ROA. ROA over 5% are generally considered good.

$$ROA = (Net\ Income)/(Total\ Assets)$$

Hypothesis Testing

To test the hypothesis, this research will use the following multiple linear regression model:

$$EM = \beta_0 + \beta_1\ OUT + \beta_2\ FS + \beta_3\ LEVERAGE + \beta_4\ ROA + \varepsilon$$

Where:
- OUT = an indicator equal to 1 if the CEO is an outside CEO, and 0 if the CEO is an inside CEO.
- FS = firm size.
- LEVERAGE = the ratio of total liabilities to total assets at the end of the year.
- ROA = return on assets of the firm during the year
- ε = an error term

For the hypothesis test, this research will use multiple linear regression analysis to get the information about the relationship between independent variable and dependent variable. This research will use t-test to examine the significant level of each independent variable to dependent variable. The level of confidence is 95%. If the significance $t < 0.05$ and $\beta > 0$, hypothesis is accepted. If the significance $t > 0.05$, hypothesis is rejected.

Data Analysis Methods
Normality Test

Normality test aims to test whether the data in this research is normally distributed or not. The decision that can be made based on one sample Kolmogorov-Smirnov test with significance level (α) = 0.05 in confidence level of 95% is:

1. If Asymp. Sig. Value > 0.05, then the data is said to be normally distributed.
2. If Asymp. Sig. Value < 0.05, then the data is said to be not normally distributed.

Multicollinearity Test

Multicollinearity test aims to test whether there is a correlation between independent variables in the regression model. Multicollinearity can be seen from the value of tolerance or variance inflation factor (VIF), the criteria is:

1. If VIF value > 10 or tolerance value < 0.10, then there is a multicollinearity between independent variables.
2. If VIF value < 10 or tolerance value > 0.10, then there is no multicollinearity between independent variables.

Heteroscedasticity Test

Heteroscedasticity test aims to test whether the regression model residual variance inequality occurred from one observation to the other observation. Glejser test is used to detect heteroscedasticity. There is significance column (Sig.) in the Glejser test. If the numbers above 0.05 significance mean residual values do not correlate significantly with independent variables.

Autocorrelation Test

Autocorrelation test aims to test whether there is a correlation between observation errors in one period to the other period in the regression model. Detection of the autocorrelation is done by using Durbin Watson (DW) test.

1. DW < dL   There is a positive autocorrelation
2. dU < DW < 4-dU   There is no autocorrelation
3. DW > 4dL   There is a negative autocorrelation

CHAPTER IV
RESULTS AND ANALYSIS

Normality Test

Preliminary data of this research is 680, after trimming is done, the final data of this research is 583 (97 data is eliminated). Asym. Sig. Value is 0.058, where 0.058 > 0.05, it means that the research data is normally distributed.

Multicollinearity Test

VIF value of CEO origin (OUT), Firm Size (FS), Leverage (LEVERAGE), and Return on Assets (ROA) is less than 10 (1.002<10; 1.087<10; 1.111<10; 1.196<10) and tolerance value of OUT, FS, LEVERAGE,

and ROA is more than 0.1 (0.998>0.01; 0.920>0.1; 0.900>0.1; 0.836>0.1). In conclusion, there is no multicollinearity between independent variables.

Heteroscedasticity Test

Significant value (Sig.) of CEO origin (OUT), Firm Size (FS), Leverage (LEVERAGE), and Return on Assets (ROA) is more than 0.05 (0.674>0.05; 0.199>0.05; 0.191>0.05; 0.668>0.05). In conclusion, there is no heteroscedasticity in this research.

Autocorrelation Test

DW value is 2.008 which is to be among Du 1.810 and 4-du 2.190, where $1.810 < 2.008 < 2.190$. Basic decision making is that if $dU < DW < 4\text{-}dU$, then there is no autocorrelation, so it means that this regression model does not possess autocorrelation.

Hypothesis Testing

The results of multiple regression analysis are as follows:

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.236[a]	.056	.049	.24417

a. Predictors: (Constant), ROA, OUT, FS, LEVERAGE

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.575	.180		3.192	.001
	OUT	-.076	.048	-.064	-1.579	.115
	FS	-.013	.006	-.085	-2.021	.044
	LEVERAGE	.079	.026	.128	2.993	.003
	ROA	-.234	.095	-.109	-2.466	.014

a. Dependent Variable: EM

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.029	4	.507	8.506	.000[a]
	Residual	34.460	578	.060		
	Total	36.489	582			

a. Predictors: (Constant), ROA, OUT, FS, LEVERAGE

b. Dependent Variable: EM

From the results of the regression analysis on the table above, it can be made a model of multiple linear regression equation as follows:

EM = 0.575 – 0.076OUT – 0.013 FS + 0.079 LEVERAGE – 0.234ROA

The independent variable impacts dependent variable if Sig. < 0.05. Impact positively when β > 0 and impact negatively when β < 0. The independent variable does not impact dependent variable if Sig. > 0.05.

a. **CEO origin (OUT)**

Based on the table above, it can be seen that the significant value (Sig.) of OUT is 0.115, where 0.115 > 0.05. It means that CEO origin does not impact earnings management. Thus, H1 is not supported.

b. **Firm Size (FS)**

Based on the table above, it can be seen that the significant value (Sig.) of FS is 0.044, where 0.044 < 0.05. It means that firm size impacts real activities manipulation. The coefficient value (β) of FS is -0.013, where -0.013 < 0. It means that firm size impacts real activities manipulation negatively. Thus, the bigger the firm size, the lower the real activities manipulation.

c. **Leverage (LEVERAGE)**

Based on the table above, it can be seen that the significant value (Sig.) of LEVERAGE is 0.003, where 0.003 < 0.05. It means that leverage impacts real activities manipulation. The coefficient value (β) of LEVERAGE is 0.079, where 0.079 > 0. It means that leverage impacts real activities manipulation positively. Thus, the higher the leverage, the higher the real activities manipulation.

d. **Return on Asset (ROA)**

Based on the table above, it can be seen that the significant value (Sig.) of ROA is 0.014, where 0.014 < 0.05. It means that return on asset impacts real activities manipulation. The coefficient value (β) of ROA is -0.234, where -0.234 < 0. It means that return on asset impacts real activities manipulation negatively. Thus, the higher the return on asset, the lower the real activities manipulation.

F test

F test is used to test whether the regression model fulfill the goodness of fit. A regression model is said fulfill the goodness of fit when significant value (Sig.) < 0.05. Based on the table above, significant value (Sig.) is 0.000, where 0.000 < 0.05. It indicates that the regression model meets the goodness of fit.

Coefficient Determination Test

Based on the test results, it is obtained that Adjusted R Square (Adj. R2) is 0.049. It means that OUT, FS, LEVERAGE, and ROA can explain REM as many as 0.049 or 4,9%, the rest 95.1% is affected by other factors.

Discussion

The result of multiple regression test shows that H1 is not supported. New outside CEOs will not have positive impact on income-increasing manipulation. Anderson and Lilja (2013) found that the use of income manipulation decreased from the year prior CEO change and year after CEO

turnover. The test revealed that there is no impact of CEO origin on the development of the use of income manipulation from the year prior the turnover and the following year. This means that there is no difference between internal and external appointed CEOs and the use of income manipulation upon arrival even though earnings management occurs between years with CEO change in the sense that income manipulation is less used for the year of a new CEO.

The research result is inconsistent with the previous research. The previous research is done in different country. In that country, new CEOs increasingly come from outside the companies rather than through internal promotions. As stated by Kuang et al. (2014), the choice of an external hire is not an exogenous shock, but rather is endogenous to CEO and firm characteristics. Every firm in every different country will have different characteristics. The firm characteristics in Indonesia are different with the characteristics of the firms where the previous study took place.

In Indonesia, most of the listed companies hire CEO from inside the companies rather than outside CEO. Sanjaya (2011b) found that 68.49% public companies in the manufacturing industry are controlled or owned by family. Companies ownership in Indonesia is dominated by the family who becomes the ultimate owner or controlling shareholder. Manager of the family company in Indonesia is dominated by family members of controlling shareholder. In the phenomenon of the family company, the founders of the company continue their ownership in both the top management and the board of commissioner position. The comparison amount of outside CEOs and inside CEOs are not balance. From 680 data, the total amount of outside CEO only 31, while the total amount of inside CEO is 649.

La Porta et al. (1999) in Siregar (2007) classified controlling shareholder into five: the family, the government, financial institutions with extensive holdings, a company with extensive holdings, and the other controlling shareholders. Controlling shareholder is an individual, a family, or an institution that has control of a company either directly or indirectly on the level of certain control rights cutoffs (Claessens et al., 2000b in Siregar, 2007). Ultimate ownership is a direct and indirect ownership to a public company. Based on the concept of ownership, a series of ownership must be traced until the ultimate owner can be identified. A public company is categorized as a family-controlled company if the company's largest controlling shareholder is an individual at a certain level of control rights. La Porta et al. (1999) in Siregar (2007) identified the family based on common last name and the relationship of marriage. With a cut-off of 10% of control rights, family is the most dominant controlling shareholder.

Family company is a company where the founding members of the company continue their ownership position in the top management. Family company characterized by concentrated ownership of the company's founding family and actively involves members of this family in the management of the company (Sanjaya, 2014). A family company is often related to high family involvement and the long period in management. The company tends

to hire its family members rather than hire professional parties. There are two perspectives in the family company, the ownership and management. Based on the standpoint of ownership, the family controlled company assets. Meanwhile, from the standpoint of management, members of the family became the company's top management.

CHAPTER V
CONCLUSION

Conclusion

This research investigates the impact of CEO origin on earnings management through real activities manipulation. This research is using sample of 85 manufacturing firms listed in Indonesian Stock Exchange during period 2007-2014. It concluded that CEO origin does not give impact earnings management. As the research result shows, the hypothesis of new outside CEOs will have positive impact on income-increasing manipulation is not supported.

Research Limitation and Suggestions

The limitation of this research is that the observation period of this study is only 7 years. It starts from 2007 to 2014. This research is expected to provide ideas for future research related to CEO origin as one of the motivations for managers in doing earnings manipulation. Related to the result that has been documented in this study, there are several opportunities for future research. Future research can use non-manufacturing companies as sample beside manufacturing companies in order to test the consistency of the findings in this research. Future research can also extend the period of the research, so that the data will be more accurate.