The Relationship Between Performance, Innovation, Earnings Management and Firm Value: An Indonesian Case

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This study aims to identify the effect of firm innovation and earnings management on firm value with firm performance as an intervening variable. Using 652 manufacturing companies listed on Indonesian Stock Exchange in 2012-2016, hypotheses are tested by using path analysis. The results of this study indicate that (1) firm innovation affects firm performance, (2) earnings management does not significantly affect firm performance, (3) firm performance affects firm value, (4) firm innovation affects firm value, (5) earnings management affects firm value and, (6) firm performance is able to mediate the effect of firm innovation to firm value, but not able to mediate the effect of earnings management to firm value.

Key words: Earnings management; firm innovation; firm performance; firm value.

Introduction

Increased interstate dependence needs disintegration of money flow as well as information and technology across countries leading to market integration (Hitt et al., 2015: 10). Market integration provides opportunities for companies to expand globally. Companies entering the global market are faced with a dynamic environment and more intense competition and to maintain a position in the market, the company must find a competitive advantage.

One strategy for achieving competitive advantage is to achieve innovation by optimising a company's ability to create high-value, scarce, difficult to replicate, and non-replaceable outputs (Hitt et al., 2015: 84). The innovation strategy leads the company to be superior to
its competitors. According to Nohong (2016), innovative companies are not just companies that produce new products, but also companies that introduce new production methods, open new markets, have new raw materials, or create new organisational structures.

Three world technology manufacturing companies Apple, Samsung, and Nokia respond to the demands of innovation with different steps. Apple and Samsung have a high development commitment. This is marked by the opening of research centres in various locations to respond to market demand more quickly. Apple puts forward the technological innovation by developing its own software, while Samsung puts forward marketing innovation by developing more products with wide marketing reach (Madani et al., 2014). In contrast to Apple and Samsung, Nokia did not promote innovation based on market demand. Products that were not in accordance with the consumers’ request and this caused Nokia to fail to adapt to the new competition environment and Nokia ended up being acquired by Microsoft (Jia and Yin, 2015).

Based on the stakeholder theory, management must make decisions that fulfill all stakeholder interests. To be able to provide added value for stakeholders, the company must be able to survive in the market and keep it as a going concern. The way to survive in the global market is to innovate appropriately (Tabas and Beranova, 2014).

Czarniewski (2015) describes the basic evaluation process of innovation and its impact on corporate value. When an innovation idea has been advanced, an innovation feasibility assessment is undertaken. Once tested, innovations will be applied and related information will be disclosed to the public. Such disclosure and implementation will affect future earnings of the company and will also affect the value of the company. Good innovation will produce better quality output with lower cost or produce output with specifications that are able to attract consumers (Czarniewski, 2015).

Firm innovation is an effort to improve the resources that have been owned to improve company performance (Karabulut, 2015). Al-Matari et al. (2014) define company performance as the efficiency and effectiveness of corporate activities. Performance management needs to be done in order for the company to stay on track to achieve its goals. Assessment of firm performance can include financial performance, customer, internal business, and learning and development (Karabulut, 2015).

Santos (2014) states that innovation is closely related to corporate knowledge. Firm innovative capacity reflects the knowledge of the company's market. The knowledge will be used to support the company's internal activities. Innovation can be done to improve operational efficiency, accelerate lead times, increase production flexibility and reduce
operational expenses. Companies that are able to achieve these features will experience a better performance than their competitors.

Karabulut’s research (2015) provides empirical evidence that innovation has a significant impact on firm performance. Innovations in the form of new product development, changes in production methods, changes in promotional methods, and use of databases to improve knowledge share have proven to improve company performance. Contrary results presented by Santos (2014) provide empirical evidence that innovation has no effect on firm performance. The insignificance caused by the impact of innovation on performance cannot be felt directly in the same year.

Al-Tuwajri et al. (2004) defines the value of a firm as a growth opportunity. Growth of opportunity represents the ratio of market value of equity to book value of equity. The ratio measures the difference between the value of the firm based on the market valuation and the estimated value of the accounting transactions.

Rubera and Kirca’s research (2017) proves that innovation has a significant positive effect on the firm value. The increase in the firm value is due to an increase in cash flows arising from the introduction of new products. The influence of innovation on firm value is stronger in companies that implement corporate branding strategy because of the small cost used for product introduction.

On the other hand, Meng et al. (2015) proves that innovation and firm value have no significant relationship because (1) innovation that is an intangible asset cannot increase value separately but also influences the value creation environment, asset quality management and profitability, as well as strategy and company background; (2) the number of inefficient innovations that do not meet market expectations; and (3) the weak protection of minority shareholders and the problem of information asymmetry.

Another factor that affects company value is earnings management. Suffian et al. (2015) define earnings management as a deliberate act by management to manipulate the figures of financial statements in order to present financial statements with positions that attract investors.

Based on the agency theory, shareholders and management are utility maximisers. Shareholders have an interest in maximizing return on invested capital. Management is concerned to maximise the compensation received. Management as an internal company has more information than the owner and hence manipulates earnings to appear impressive so that management can still maximise its interest (Jensen and Meckling, 1976).
Puspitarini (2016) argues that the increase in value is due to investor satisfaction over reported earnings that is actually the result of earnings management; thus earnings management has a positive impact on firm value. On the contrary, Yorke et al. (2016) provide empirical evidence that earnings management has no significant effect on firm value. This happens because of the practice of corporate governance that provides a limiting effect on earnings management.

Dela Cruz (2015) states that earnings management is related to the use of management judgments on financial statements and structuring transactions to conceal actual company performance. Earnings management indicates the condition of the company that is not flourishing to influence the investor's evaluation of the firm performance based on the analysis of financial statements submitted to the capital market (Moshi, 2016).

Yamaguchi's research (2015) provides empirical evidence that earnings management practices affect the firm performance. Yamaguchi (2015) states that the practice of earnings management is used to improve profitability so that corporate performance appears successful in the eyes of investors. In contrast, Saidu et al. (2017) argue that because the level of earnings management is so low, it does not have a significant effect on firm performance.

Firm performance also affects the firm value. One measure of firm performance is profitability. Increased profitability will increase earnings per share. Such an increase in earnings per share may attract investors. Investors consider that the company is able to manage its resources well and has good prospects. The interest of these investors can increase the firm value along with increasing stock prices (Sabrin et al., 2016).

Sabrin et al. (2016) provided empirical evidence that ROA positively affects firm value. The higher the ROA, the company is considered to have good prospects so that investors are willing to pay higher for the company. Kodongo et al. (2015) provides empirical evidence that firm performance measured by leverage ratio has no effect on firm value. This is because the companies go public in Kenya tend not to be involved in the bond market.

Because of the different results of these studies, it is important to do a re-research related to the effect of innovation and earnings management on the firm value with firm performance as an intervening variable.
Theoretical Foundations and Hypotheses Development

Agency Theory

Jensen and Meckling (1976) argue that agency relations occur when one or more people (principal) hire another person (agent) in which the principal provides a service and delegates decision-making authority to the agent with compensation in return. Both shareholders and management are utility maximisers with different interests. Differences of interest and information asymmetry lead to agency conflicts (Sebayang and Veronica, 2014).

Stakeholders Theory

According to Gray et al. (1997), stakeholders are all groups or parties which affect the company. Stakeholders are the one who put into consideration of the company decision in reveal any information. This is done because the company's survival depends on stakeholder support.

Firm innovation - Firm Performance Relationship

Based on stakeholder theory, the survival of the company depends on the support of stakeholders. Support is obtained when the company is able to meet the interests of stakeholders. Firm performance is an important indicator for investors in measuring the success of a company. Innovation is one of the company's efforts to improve its performance. Innovation has an impact on increased sales due to increased market share. Increased sales will increase the profit earned. Increased profit is defined as an improvement in firm performance (Camison and Villar-Lopez, 2014; Karabulut, 2015; Rajapathirana and Hui, 2018; and Lee et al., 2017).

Karabulut (2015) and Lee et al. (2017) state that innovations in the form of new product development, changes in production methods, changes in promotion methods, and the use of databases to increase knowledge share have proven to be able to improve company performance. Camison and Villar-Lopez (2014) state that organisational innovation can improve processes and products so that performance will increase.

H₁: Firm innovation affects firm performance
Earnings management- Firm Performance Relationship

Based on the agency theory, principal-agent relationships lead to differences in interest and information asymmetry. It is used by management to perform earnings management. Earnings management is done so that the financial statements look attractive to investors who are satisfied with the firm performance and the compensation given to management can increase (Yamaguchi, 2017; Capalbo et al., 2014).

H2: Earnings management affects firm performance

Firm performance- Firm Value Relationship

Companies with good prospects will be worth more for investors. The importance of investor satisfaction is in accordance with the theory of stakeholders. Companies with good performance are companies that are able to generate high profits. The high profit will improve investors' perception of the company. This causes an increase in stock prices. An increase in stock prices will have an impact on the increase in firm value (Nawaiseh, 2017; Sucuachi and Cambarihan, 2016; and Setiabudi and Agustia, 2012).

According to Nawaiseh (2017), the impact of company performance is significant on company value because it is used by shareholders for decision making. Moreover, investors expect dividend payments with high profitability. These investors' expectations increase the value of the company (Sabrin et al., 2016).

H3: Firm performance affects firm value

Firm Innovation - Firm Value Relationship

Based on stakeholder theory, the survival of the company depends on the support of stakeholders. Support is obtained when the company is able to meet the interests of stakeholders. Firm performance is an important indicator for investors in measuring the success of a company. Innovation is one of the company's efforts to improve its performance and will lead to an increase in market share. Increased market share will increase sales and will increase profits earned. Investors' perceptions of the firm increase as earnings increase. Increased investor perception will increase stock prices and increase firm value (Berzkalne and Zegrave (2014), Tabas and Beranova (2014), Rubera and Kirca (2017), Usman et al. (2017), and Warusawitharana (2015)).

H4: Firm innovation affects firm value
Earnings Management- Firm Value Relationship

Based on the agency theory, the information asymmetry becomes the motivation of earnings management to maximise the interests of the related parties. Higher values can be achieved if the firm performance is better. One of the steps taken by management to make firm performance look better is by undertaking earnings management. Earnings management deals with the implementation of accounting policies that can reduce fluctuations in firm performance. The policies applied will cause the firm performance to be in line with shareholder expectations. This enables the shareholders to believe in the company's operational capability and will have an impact on increasing the firm value (Puspitarini, 2016; Suffian et al., 2015).

H5: Earnings management affects firm value

The Mediating Effect of Firm Performance

Innovation is one of the company's efforts to improve its performance. Innovation has an impact on increased sales due to increased market share. Increased sales will increase the profit earned. Increased profit is defined as an improvement in firm performance. The other alternative, earnings management, is done to embellish the financial statements so that investors are satisfied with the firm performance and the compensation given to management can increase. Investors interpret good firm performance as evidence that the company has high quality and has good prospects. The importance of investor satisfaction is in accordance with the theory of stakeholders. Companies with good performance are companies that are able to generate high profits. The high profit will increase investors' perception of the company. This causes an increase in stock prices. An increase in stock prices will have an impact on the increase in firm value (Rajapathirana and Hui, 2018; Yamaguchi, 2017; and Nawaiseh, 2017).

H6: Firm performance mediates the effect of firm innovation and earnings management on the firm value

Research Methodology

Variable Operational Definition

Firm Innovation

Innovation is the implementation of a product (goods or service), process, marketing method, organisational practice, or new or significant external relationships (OECD, 2005). In this study, innovation is measured by the research and development expense (R & D). R & D
expense is used as a proxy because it shows the company's commitment to innovate through investments that are willing to be issued. In Hagedoorn and Cloodt (2003), firm innovation is formulated as follows

\[ INOV = \frac{Research\ and\ development\ expense}{Total\ asset} \]

**Earnings Management**

Earnings management according to Scott (2012: 423) is a managerial behavior in choosing a specific accounting policy (accrual), or in certain real activities, which aims to affect other specific advantages or goals. The measurement model used is the Modified Jones Model (1995). The model was chosen because it is the best model and produces strong measurements (Agustia, 2013). The following steps calculate the value of discretionary accruals with the Modified Jones Model:

1. Calculate *total accruals* with the equation:
   \[ TA_{it} = NI_{it} - CFO_{it} \]
   
   **Note:**
   - \( NI_{it} \) = net income in year \( t \)
   - \( CFO_{it} \) = operating cash flow in year \( t \)

2. Calculating the accruals value with a simple linear regression equation or Ordinary Least Square (OLS) with equation:
   \[ \frac{TA_{it}}{A_{it-1}} = \alpha_1 \left( \frac{1}{A_{it-1}} \right) + \alpha_2 \left( \frac{\Delta REV_{it}}{A_{it-1}} \right) + \alpha_3 \left( \frac{PPE_{it}}{A_{it-1}} \right) + e \]
   
   **Note:**
   - \( TA_{it} \) = Company total accrual i year \( t \)
   - \( A_{it-1} \) = Total asset period \( t-1 \)
   - \( \Delta REV_{it} \) = Revenue period \( t \) minus period \( t-1 \)
   - \( PPE_{it} \) = gross property, plant, equipment period \( t \)
   - \( \alpha \) = fitted coefficient
   - \( e \) = Error term year \( t \)
3. Calculating nondiscretionary accruals (NDA) with equation:

\[ NDA_{it} = \alpha_1 \left( \frac{1}{A_{it-1}} \right) + \alpha_2 \left( \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} \right) + \alpha_3 \left( \frac{PPE_{it}}{A_{it-1}} \right) \]

Note:
- \( NDA_{it} = \text{nondiscretionary accruals year t} \)
- \( \Delta REC_{it} = \text{Receivable i period t minus period t-1} \)

4. Calculating discretionary accruals:

\[ DAC_{it} = \left( \frac{TA_{it}}{A_{it-1}} \right) - NDA_{it} \]

Note:
- \( DAC_{it} = \text{discretionary accruals in year t} \)

Firm Value

According to Miles and Clieaf (2016), firm value is a financial measure used to understand the true value of a company in current market value as a long-term survival indicator. In this study, firm value will be measured by Tobin's Q. Tobin's Q is chosen to measure firm value because it is able to reflect the company's internal conditions and market expectations so that there is little possibility of manipulation (Singhal and Parkash, 2016). In Singhal and Parkash (2016), Tobin's Q is formulated as follows:

\[ Q = \frac{(StockpricexStockamount) + Totaldebt}{Totalasset} \]

Firm Performance

Firm performance according to Al-Matari et al. (2014) is a measure of the efficiency and effectiveness of corporate activities. According to Kaplan and Norton (1996), the performance of one company can be measured through financial performance, which can be measured by return on assets (ROA). ROA is a company's ability to generate profits from assets owned (Gibson, 2009: 299). Performance measurements using ROA have been used in similar researches such as Setiabudi and Agustia (2012). In Gibson (2009: 299), ROA is formulated as follows:

\[ ROA = \frac{Earningsbeforeextraordinaryitems}{Totalasset} \]
Type and Source Data

The data type of this research is quantitative data with secondary data source. Secondary data in this research is obtained from audited annual financial statements of manufacturing companies in BEI year 2012-2016. The financial statements are obtained from the Indonesia Stock Exchange website www.idx.co.id

Population Sample

The population of this research is manufacturing company listed in BEI from 2012 to 2016. Among the population of 692 companies, as many as 5 companies experienced delisting, 19 companies did not have financial reporting date end of December 31, and 16 companies did not provide the required data. In accordance with the purposive sampling criteria, the observable sample for this study is 652 firms.

Analytical Techniques

Classical Assumption Test

This research uses the path analysis model. Prior to path analysis, a classical assumption test was performed in the form of a normality test, multicollinearity test, and heteroscedasticity test for results free of bias.

Hypotheses Test

In this study, path analysis is completed by multiple regression test with 5% significance level. This test examines the effect of independent variables on the intervening variable and the influence of the intervening variable on the dependent variable using the SPSS software.

Results and Discussion

The Effect of Firm Innovation on Firm Performance

Table 1: The Effect of Firm Innovation on Firm Performance

<table>
<thead>
<tr>
<th>Variable</th>
<th>Beta</th>
<th>Sig</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>INOV</td>
<td>0.436</td>
<td>0000</td>
<td>Positive affect</td>
</tr>
</tbody>
</table>

Source: Data processed, 2018.
Based on statistical analysis, firm innovation has a positive significant effect on company performance. This can be seen from the test results that show the significance value of t test of 0.000.

To maintain position in the market, the company is required to be able to find a competitive advantage. One strategy for achieving competitive advantage is to optimise a company's ability to create high-value, scarce, difficult to replicate, and non-replaceable outputs (Hitt et al., 2015: 84). To achieve this, the company applies innovation which is one effort in order to provide good performance in the eyes of stakeholders. The kind of innovation and level of innovation applied to each company varies depending on the company's strategic orientation. This research sample applies innovation in the form of new product introduction, application of new technology, employee training, and marketing research for positioning interest. The application of these innovations has an impact on increasing market share which is achieved by retaining old customers and capturing new customers through innovative products. Increased market share will increase sales. As sales increase, profits earned by the company will increase. By measuring profitability ratios, the increase in profit can be interpreted as an improvement of firm performance.

Stakeholder theory by Gray et al. (1997) supports the result of this study. All companies try to minimise possible losses for stakeholders (Gray et al., 1997) who stated that the survival of the company depends on stakeholder support. Support is obtained when the company is able to meet the interests of stakeholders. Firm performance is an important indicator for investors. Investors measure the success of a company from its performance. Therefore, the company seeks to improve performance by applying innovation.

The result of this study is in line with studies conducted by Camison and Villar-Lopez (2014), Karabulut (2015), Rajapathirana and Hui (2018), and Lee et al. (2017).

**The Effect of Earnings Management on Firm Performance**

**Table 2: The Effect of Earnings Management on Firm Performance**

<table>
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<th>Variable</th>
<th>Beta</th>
<th>Sig</th>
<th>Conclusion</th>
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</thead>
<tbody>
<tr>
<td>DA</td>
<td>0.047</td>
<td>0.274</td>
<td>Positive non significant</td>
</tr>
</tbody>
</table>

*Source: Data processed, 2018.*

Based on statistical analysis, earnings management has a positive non significant effect on firm performance. This can be seen from the test results that show the significance value of t test of 0.274.
The results of this study prove earnings management has no significant effect in improving firm performance. This is due to the company's earnings management being at a low level. The level of earnings management performed by each company is different depending on how far the management wants to improve the firm performance. In this study sample, DA averages close to zero (0.062) are classified as low-level earnings management. The small average DA in this study shows that management has no motivation to undertake earnings management. Good performances reported to investors do show actual performance, not the impact of earnings management. Firm performance in this study is considered good because 76.1% of the total companies report earnings and 44.5% companies have ROA above average. The insignificant influence of earnings management on firm performance occurs because the company is basically not using earnings management.

The results of this study are based on the agency theory of Jensen and Meckling (1976) about the difference of interest between agent and principal. Both shareholders and management are utility maximisers (Jensen and Meckling, 1976). Shareholders have an interest in maximising return on invested capital, while management is concerned to maximise the compensation received. Management as an internal party of the company has more information and knows the information in advance of the shareholders. Management that has more information manipulates earnings so that firm performance appears healthy in the eyes of investors so that management can still maximise its importance.

The results of this study are in line with research conducted by Saidu et al. (2017).

**The Effect of Firm Performance on Firm Value**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Beta</th>
<th>Sig</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.055</td>
<td>0.003</td>
<td>Positive affect</td>
</tr>
</tbody>
</table>

*Source: Data processed, 2018.*

Based on statistical analysis, firm performance has a positive and significant effect on firm value. This can be seen from the test results that show the significance value of t test of 0.003.

Maximizing the welfare of shareholders by increasing the firm value is the main goal of the company. The firm value is able to reflect the firm performance and future prospects (Sudana, 2011: 7). Companies with good value attract more investors and others to engage with those companies. High firm values reflect that the company is a reliable place for investment by investors. The results of this study prove that a good firm performance will be
able to make the company look good in the eyes of investors and other stakeholders in the company. Such a positive view will increase the firm value in the eyes of investors. Investors interpret good firm performance as evidence that the company has high quality and has good prospects. Companies with good prospects will be worth more for investors. The high sales indicate the company has a strong position in the market and investors will respond positively because of high sales impact on high net income which also impacts on high return of investment (Setiabudi and Agustia, 2012).

Stakeholder theory by Gray et al. (1997) is any attempt to minimise possible losses to stakeholders. This is done because the company's survival depends on stakeholder support obtained when the company is able to meet the interests of stakeholders. The theory supports the result of this study. Firm performance is an important indicator for investors. Investors measure the success of a company from its performance. Good firm performance shows the company generates high profits and is able to provide high returns for investors. This will increase investors' perceptions of the company and cause an increase in stock prices. An increase in stock price will have an impact on the increase of firm value.

The result of this study is in line with research conducted by Nawaiseh (2017), Sucuachi and Cambarihan (2016), Sabrin et al. (2016), and Setiabudi and Agustia (2012).

The Effect of Firm Innovation on Firm Value

Table 4: The Effect of Firm Innovation on Firm Value

<table>
<thead>
<tr>
<th>Variable</th>
<th>Beta</th>
<th>Sig</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>INOV</td>
<td>0.909</td>
<td>0.000</td>
<td>Positive affect</td>
</tr>
</tbody>
</table>

Source: Data processed, 2018.

Based on statistical analysis, firm innovation has a positive and significant effect on firm value. This can be seen from the test results that show the significance value of t test of 0.000.

To maintain position in the market, the company is required to be able to find a competitive advantage. One strategy for achieving competitive advantage is to optimise a company's ability to create high-value, scarce, difficult to replicate, and non-replaceable outputs (Hitt et al., 2015: 84). To achieve this, the company applies innovation which is one feature highly valuable in the eyes of stakeholders. The kind of innovation and level of innovation applied to each company varies depending on the company's strategic orientation. This research sample applies innovation in the form of new product introduction, application of new technology, employee training, and marketing research for positioning interest.
The result of this study proves that the company's innovation will be able to increase the firm value in the eyes of investors. The high innovation of the company gives hope to investors to gain more profit in the future. This increases the investor's appreciation of the company so investors will be willing to increase investment in the company. This situation will lead to an increase in firm value in the eyes of investors. Innovation has a large effect on firm value because innovation has an effect on the internal and external environment of the company. Innovation not only affects the company's financial condition, but also affects the company's ability to compete and survive the company. Innovations that have the greatest and longest impact on corporate value are product-related innovations that competitors cannot duplicate (Tabas and Beranova, 2014).

Stakeholder theory by Gray et al. (1997) states the survival of the company depends on stakeholder support. Firm performance is an important indicator for investors who measure the success of a company from its performance. One of the company's efforts to improve performance is by applying innovation. The success of the innovations applied can convince investors of good prospects in the future. Such confidence will increase investors' perceptions of the company and lead to an increase in stock prices. An increase in stock price will have an impact on the increase of firm value. This causes investors to keep supporting the company.

The result of this study is in line with research conducted by Berzkalne and Zegrave (2014), Tabas and Beranova (2014), Usman et al. (2017), Rubera and Kirca (2017), and Warusawitharana (2015).

**The Effect of Earnings Management on Firm Value**

**Table 5: The Effect of Earnings Management on Firm Value**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Beta</th>
<th>Sig</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>DA</td>
<td>0.082</td>
<td>0.000</td>
<td>Positive affect</td>
</tr>
</tbody>
</table>

*Source: Data processed 2018.*

Based on statistical analysis, earnings management has a positive and significant effect on firm value. This can be seen from the test results that show the significance value of t test of 0.000.

Maximsing the welfare of shareholders by increasing the firm value is the main goal of the company. The firm value is able to reflect the firm performance and future prospects (Sudana, 2011: 7). The firm performance is an important aspect that is used as the basis of
evaluation and decision of shareholders of the company's operations. The results of this study prove that earnings management conducted will be able to increase the firm value in the eyes of investors. It is done with the pattern of income maximising to produce a higher rate of profit than the actual. Shareholders interpret the high profits as evidence that the company has high quality and has good prospects. This will increase stock prices and will increase the firm value. Companies with good prospects will be worth more to investors.

The result of this study is based on the agency theory of Jensen and Meckling (1976) about the difference of interest between agent and principal. Both shareholders and management are trying to maximise the utility (Jensen and Meckling, 1976). Shareholders have an interest in maximising return on invested capital, while management is concerned to maximise the compensation received. Management as an internal party of the company has more information in advance of the shareholders. Management that has more information manipulates earnings so that firm performance looks good in the eyes of investors so that management can still maximise its importance. The good performance of the company will increase investors' perceptions of the company and cause an increase in stock prices. An increase in stock price will have an impact on the increase of firm value.

The result of this study is in line with research conducted by Puspitarini (2016) and Suffian et al. (2015).

**Firm Performance as Intervening Variable of the Effect of Firm Innovation and Earnings Management on Firm Value**

**Figure 1.** Path Analysis
The result of path analysis shows that there is indirect influence between firm innovation to firm value (beta 0.024). The result of Sobel test with t value 2.87 greater than t table (1.96) also proves indirect influence.

Innovation is an effort to provide good performance in the eyes of stakeholders. The kind of innovation and level of innovation applied to each company varies depending on the company's strategic orientation. This research sample applies innovation in the form of new product introduction, application of new technology, employee training, and marketing research for positioning interest. The application of these innovations has an impact on increasing market share. Increased market share is achieved by retaining old customers and capturing new customers through innovative products. Increased market share will increase sales. As sales increase, profits earned by the company will increase. By measuring profitability ratios, the increase in profit can be interpreted as an improvement of firm performance. Investors interpret good corporate performance as evidence that the company has high quality and has good prospects. Companies with good prospects will be worth more for investors. The high sales indicate the company has a strong position in the market. Investors will respond positively because of high sales impact on high net income which also impact on high return of investment (Setiabudi and Agustia, 2012).

The results of path analysis showed no indirect influence between earnings management on firm value because the influence of earnings management on company performance is not significant. Sobel test result with t value 1.027 smaller than t table (1.96) also proves no indirect effect. The small average DA in this study shows that management has no motivation to use earnings management. Good performances reported to investors do show actual performance, not the impact of earnings management. The insignificant results cause the company's performance to fail to be an intervening variable for the independent variables of earnings management.

The results of this study are in accordance with research from Rajapathirana and Hui (2018), Nawaiseh (2017), and Saidu et al. (2017).

Limitation

1. Not all firms report R&D expense explicitly in their financial report.

Conclusion

1. Firm innovation has a significant effect on firm performance. This is due to the implementation of innovation that is expected to impact on increasing market share.
Increased market share will further increase sales. As sales increase, profits earned by the company will increase and the firm performance improves.

2. Earnings management has no significant effect on firm performance. This is due to the level of earnings management being low. The low level of earnings management is due to good performance. Good performance lowers the motivation of management to perform earnings management.

3. Firm performance has a significant effect on firm value. Investors interpret good firm performance as evidence that the company has high quality and has good prospects. Companies with good prospects will be worth more for investors.

4. Firm innovation has a significant effect on firm value. The high innovation of the company gives hope to investors to gain more profit in the future. This situation will lead to an increase in firm value in the eyes of investors.

5. Earnings management has a significant effect on firm value. Investors interpret the high profits as evidence that the company has high quality and has good prospects. This will increase stock prices and will increase the value of the company.

6. Firm performance is proven to indirectly affect the firm innovation variable to firm value, or in other words the firm performance is an intervening variable. Firm performance is proven as not being able to indirectly affect the variable earnings management to firm value, ie, the firm performance is not an intervening variable.

**Suggestion**

1. Questionnaire may be used in the next research for variable firm innovation in order to obtain more complete information.
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