



The Influence Of Business Strategy And Earnings Management On The Potential Bankruptcy With Profitability As A Moderating Variable

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ABSTRACT

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This research was carried out with the aim of knowing how much influence business strategy (cost leadership strategy and differentiation strategy) and earnings management have on potential bankruptcy with profitability as a moderating variable in consumer goods industry sub-sector manufacturing companies listed on the Indonesia Stock Exchange for the 2016 - 2020 period. With purposive sampling technique, the sample companies in this study were 15 companies. This study uses multiple regression models and types of secondary data from 2016 to 2020. This study tested the hypothesis with a regression model. The results of the study conclude that the cost leadership business strategy has a negative influence on the potential for bankruptcy, the differentiation business strategy has a negative influence on the potential for bankruptcy, and earnings management has a positive influence on the potential for bankruptcy. While profitability is able to moderate the effect of cost leadership strategy and differentiation strategy on bankruptcy potential, it is unable to moderate the effect of earnings management on bankruptcy potential.

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1. Introduction

There are several ways that management can do to influence the numbers in the financial statements, including earnings management and business strategy. Earnings Management is a management action in the process of designing financial statements so that it can increase or decrease accounting profit as desired (Scott, 2015). Earnings management practices are suspected by financial statement makers to obtain a benefit from the practices carried out, but can reduce the quality and credibility of the financial statements.

Earnings management is generally grouped into two, namely earnings management through the accounting approach (accrual) and earnings management through real activities. Earnings management through the accounting approach (accrual) refers to the profit numbers game that is carried out with accounting techniques and policies. Meanwhile, earnings management through real activities refers to profit-numbering games carried out through activities originating from normal business activities or related to operational activities, for example delaying product promotion activities or accelerating sales by giving large discounts.

In the current millennial era, earnings management has become a hot topic and has become a common phenomenon that is endemic in several industries. Banks and non-financial industries in Nigeria, such as Afribank Plc, Bank PHB, Oceanic Bank Plc, and African Petroleum Plc, went bankrupt in the 2000s. Most of these corporate bankruptcy cases are caused by high earnings management practices, poor management, and weak corporate governance structures (Akingunola, Olusegun and Adidipe, 2013). One of the causes of Oceanic Bank's bankruptcy was Cecilia Ibru as the company's CEO who laundered 23 billion Naira of investor funds into personal wallets. The move was carried out with the help of Waves Nigeria Ltd, a company owned by Ibru's son.

In contrast to earnings management which is disastrous for business continuity, business strategy makes the company's business more flexible in accordance with world developments and is profitable, and reduces the risk of bankruptcy that will harm the company in the future (Bryan et al, 2013). A business can



implement a general strategy which is divided into 2 according to Porter (1980), namely a cost leadership strategy which is implemented through cost efficiency and a differentiation strategy which focuses on the uniqueness of products that are not owned by competitors.

However, if the company does not have a business strategy to face the challenges that will come, then the chances of bankruptcy risk are great. This was felt by a global company, The Eastman Kodak Company or Kodak in 2012. The company failed to implement a differentiation strategy and a cost leadership strategy. In terms of differentiation strategy, companies are not ready to prepare funds quickly to develop their products so that they experience delays in creating innovations and fail to anticipate rapid technological developments. Meanwhile, Kodak incurs too much production costs and suffers a loss of \$60 per unit of product because it has to drop its selling price in order to compete with other products.

Previous studies have been conducted to investigate the relationship between earnings management and bankruptcy potential as well as business strategy and bankruptcy potential. One of them by Widyaningdyah and Listiyana (2009) who used samples from textile companies. The result of this study is that there is a tendency for earnings management in the financial statements of textile companies that are predicted to go bankrupt in the period 2004 to 2006. Another study conducted by Lestari (2016) used manufacturing companies as samples for the 2015 financial statements. The results of research conducted by Lestari explained that the earnings management component has no partial effect on the potential for bankruptcy. The relationship between business strategy and the potential for bankruptcy has been studied before, among them by Yovalia and Wibowo (2016) who used manufacturing companies as samples. The results of this study indicate that the cost leadership strategy and differentiation strategy have no effect on the potential for bankruptcy. However, this study has different results from those carried out by Banjarnahor and Ariani (2016), where the results of the study say that differentiation strategy has an effect on the potential for bankruptcy and cost leadership strategies have no effect on the potential for bankruptcy. The results of this study indicate that the cost leadership strategy and differentiation strategy have no effect on the potential for bankruptcy. However, this study has different results from those carried out by Banjarnahor and Ariani (2016), where the results of the study say that differentiation strategy has an effect on the potential for bankruptcy and cost leadership strategies have no effect on the potential for bankruptcy. The results of this study indicate that the cost leadership strategy and differentiation strategy have no effect on the potential for bankruptcy. However, this study has different results from those carried out by Banjarnahor and Ariani (2016), where the results of the study say that differentiation strategy has an effect on the potential for bankruptcy and cost leadership strategies have no effect on the potential for bankruptcy.

Saputra (2016) in his research on the effect of business strategy on the potential for bankruptcy with green products as a moderating variable in medium and large institutions in the provinces of the Special Region of Yogyakarta and Central Java. The results of the study say that green products weaken the influence of business strategy and the potential for bankruptcy.

With the moderating variable in previous studies which still resulted in uncertain research, the researcher wanted to use other variables. In this study, the profitability ratio is used as a variable that moderates the relationship between variables, where the profitability ratio is applied as a measure of the company's performance in manifesting the profits that have been embraced by the company. Profitability ratios are considered to have a very important role for the survival of the company because the profits obtained by the company from business activities will determine the company's business strategy in the future and management policies in managing and recording company profits.

Research related to the potential for bankruptcy in a company with various sectors has generally been widely researched in Indonesia. However, research on the topic of potential bankruptcy by comparing the status of potential bankruptcy seen from the perspective of earnings management and also the perspective of a company's business strategy that uses profitability as a moderator in manufacturing companies is still very limited.

2. Method

2.1 Research Method

The research method applied in this scientific work is a quantitative research method with a regression model. Quantitative methods are methods that require a researcher to explain how one variable affects other

variables (Creswell, 2012:13). According to Walpole (1995:340), the regression model is a mathematical equation that can predict the value of a dependent variable from the value of an independent variable.

2.2 Research Object

According to Supranto (2000:21), the object of research is a set of elements that can be in the form of people, organizations or goods to be studied. The objects of this research are manufacturing companies in the consumer goods industry sector that have been registered on the Indonesia Stock Exchange for the 2016 - 2020 period.

2.3. Sampling technique

Sugiyono (2017:115) defines population as a generalization area consisting of objects or subjects that have certain qualities and characteristics determined by researchers to be studied and then drawn conclusions. The population in this study are manufacturing companies in the consumer goods industry which are listed on the Indonesia Stock Exchange during 2016 to 2020.

2.4. Data Types and Sources

This type of research is quantitative research using secondary data archives. Secondary data is a source of data that has been processed and obtained by third parties through intermediary media such as print media, internet, and others. In this study, secondary data used in the form of annual financial statements of companies engaged in the manufacturing sector of the consumer goods industry listed on the Indonesia Stock Exchange (IDX) in 2016 - 2020. The data for these financial statements were obtained from the BEI database, namely www.idx.co.id.

2.5. Data analysis technique

The analytical technique used to research methods of business strategy, earnings management, profitability and bankruptcy potential is as follows:

- Collecting data in the form of financial reports that have been audited and published annually for manufacturing companies in the consumer goods industry for the period 2018 - 2020;
- Selecting financial data in accordance with the equation variables of business strategy, earnings management, profitability and potential for bankruptcy;
- The calculation of these variables is carried out starting with per year then averaged;
- Entering the data from the equation calculation of each variable that has been averaged into the XLSTAT software to run classical and statistical assumption tests;
- Perform classical assumption tests and statistics calculated from XLSTAT software;
- The interpretation of classical and statistical assumption tests is based on the results of the XLSTAT software calculations in the study.

2.6 Variables and Operational Definitions

To test the hypothesis in this study, the variables to be used need to be given limits and determined indicators. The variables are:

a. Dependent Variable

In this study, the dependent variable is the potential for bankruptcy. The researcher uses the modified Altman Z-Score model, the following are the equations:

$$Z\text{-Score} = 6.56X1 + 3.26X2 + 6.72X3 + 1.05X4$$

Information:

- X1 : Working capital to total assets (*Working Capital / Total Assets*)
 X2 : Retained earnings to total assets (*Retained Earnings / Total Assets*)
 X3 : Income before tax and interest to total assets (*Earnings Before Interest and Tax / Total Asset*)
 X4 : Book value of equity to book value of debt (*Book Value of Equity / Book Value of Debt*)

With the Altman Z Score classification, the modifications are as follows:

- If the Z value < 1.1 is included in the category of bankrupt companies
- If the value of $1.1 < Z < 2.6$ is included in the category of companies in the gray area
- If the value of $Z > 2.6$ is included in the category of companies that are not bankrupt

b. Independent Variable

In this study, the independent variables are (X1) Cost Leadership Strategy, (X2) Differentiation Strategy, (X3) Earnings Management. The researcher uses the Operating Asset Turnover formula which according to Wu et al (2015) the following equation:



$$\text{Operating Asset Turnover} = \frac{\text{Sales}}{\text{Operating Asset}}$$

Where: $\text{Operating Asset} = \text{Total asset} - \text{cash short term investment}$

Wu et al (2015) differentiation strategy is a strategy that emphasizes achieving competitive advantage through the uniqueness and features of goods and services offered to customers. Selling and Stickney (1989) say that differentiation strategy is closely related to maximizing profit margin, where a business aims to maximize its profits by offering superior products. Meanwhile, making unique and different products, the company strives to be a constant product developer by conducting research and development (R&D). Following the research of Wu et al (2015), profit margin is used as a proxy for differentiation strategy. The formula is as follows:

$$\text{Profit Margin} = \frac{(\text{Operating Income} + \text{R\&D Exp})}{\text{Sales}}$$

Several models have been developed to measure earnings management, including the Roychowdhury model. According to Roychowdhury (2006), earnings management can be detected through three things, namely operating cash flow, production costs, and discretionary costs. This study uses an operating cash flow approach. The following is the Roychowdhury operating cash flow equation used in this study:

$$\text{CFO}_t/\text{At}_{t-1} = 0 + 1 (1/\text{At}_{t-1}) + 2 (\text{St}/\text{At}_{t-1}) + 3 (\Delta\text{St}/\text{At}_{t-1}) + e_t$$

Information:

CFO_t : Cash flow from operating activities of company i in year t

At_{t-1} : Total assets of company i in year t-1

S_t : Sales of company i in year t

S_t : Sales of firm i in year t minus year t-1

β : Regression coefficient

e_t : Error term in year t

c. Moderating Variables

In this study, the moderating variable is profitability. Profitability is proxied by using Return on Equity (ROE) with a ratio scale obtained from the financial statements. According to Jefriyanto (2021), Return on Equity shows management's ability to effectively manage sources of operational financing from shareholders to generate net income so that it is more attractive to other investors. The following is the Return on Equity (ROE) formula:

$$\text{Return on Equity (ROE)} = \frac{(\text{Net Income})}{\text{Equity}}$$

Regarding the definition of operational variables that are the material in this study, they are presented in table 1.

Table 1
Operational Variables

Variable	Draft	Indicator	Scale
Cost leadership strategy X1	Cost leadership strategy is the ability to design products and markets that are more efficient than competitors (Porter, 1998)	$\text{Operating Asset Turnover} = \text{Sales} / \text{Operating Assets}$ (Wu et al., 2015)	Ratio
Differentiation strategy X2	Differentiation strategy is the ability to produce unique goods and services and have superior value for buyers in the form of product quality, special characteristics and other services. (Porter, 1998)	$\text{Profit Margin} = (\text{Operating Income} + \text{R\&D Expenditure}) / \text{Sales}$ (Wu et al., 2015)	Ratio
Earnings Management X3	Management's choice of accounting policies or real actions that affect earnings in order to achieve some profit objectives to be reported. (Scoot, 1997)	$\text{CFO}_t/\text{At}_{t-1} = 0 + 1 (1/\text{At}_{t-1}) + 2 (\text{St}/\text{At}_{t-1}) + 3 (\Delta\text{St}/\text{At}_{t-1}) + e_t$ (Roychowdhury, 2006)	Ratio
Bankruptcy Potential Y	The entire spectrum of events and possibilities for a business to experience financial distress may or may not lead to bankruptcy filing. (Altman, 1968)	$Z\text{-Score} = 6.56X1 + 3.26X2 + 6.72X3 + 1.05X4$ (Altman, 1995)	Ratio
Profitability	Management's ability to effectively	$(\text{ROE}) = \text{Net Income} / \text{Equity}$	Ratio

Z manage sources of operational financing from shareholders to generate net profit so that it is more attractive to other investors. (Jefriyanto, 2021)

2.7 Data Presentation Method

The results of data processing in this study will be presented in the form of tables, graphs, and the like to make it easier to understand the results of this study and can reflect information to support the achievement of the objectives and the process of discussing the results of this study.

2.8. Data analysis method

1. Descriptive statistics
2. Classic assumption test
 In conducting research, it is necessary to carry out statistical tests to determine the condition of the data. The statistical test consists of:
 - a. Normality test
 - b. Multicollinearity Test
 - c. Autocorrelation Test
 - d. Heteroscedasticity Test
3. Multiple Linear Regression Test
4. Statistic test
 - a. R2 . test
 - b. T Uji test

3. Results and Discussion

3. 1. Result

a. Descriptive Statistical Analysis

Table 2
Descriptive Statistical Results

Statistics	Minimum	Maximum	mean	Standard deviation
Z Score	1.3270	10.3558	5.6928	2.5009
CLS	0.4981	3.5821	1.3917	0.6692
DS	-0.0334	0.1973	0.0798	0.0498
EM	-1.8508	0.9289	-0.0753	0.5604
PROF	-0.0294	0.2347	0.0979	0.0719

Source: XLSTAT processed data

Based on the results of the analysis in the table above, it shows that the Z Score has an average of 5.6928 with a standard deviation of 2.5009, where the smallest value is 1.3270 which occurred in BUDI issuers in 2018 and the largest was 10.3558 which occurred in TCID issuers in 2016. Variable cost leadership strategy has an average of 1.3917 with a standard deviation of 0.6692, where the smallest value is 0.4981 which occurred in ICBP issuers in 2020 and the largest was 3.5821 which occurred in RANC issuers in 2018. The differentiation strategy variable has an average of 0.0798 with a standard deviation of 0.0498, where the smallest value of -0.0334 which occurred in TCID issuers in 2020 and the largest was 0.1973 which occurred in ICBP issuers in 2020. The earnings management variable has an average of -0.0753 with a standard deviation of 0.5604, where the smallest value is -1.8508 which occurred in SKBM issuers in 2018 and the largest was 0.9289 which occurred in RANC issuers in 2020. The return on equity variable has an average of 0.0979 with a standard deviation of 0.0719, where the smallest value is 0.0719. -0.0294 which occurred in TCID issuers in 2020 and the largest was 0.2347 which occurred in CPIN issuers in 2018.

b. Classical Assumption Test Analysis

Testing the regression model with moderating variables in testing the hypothesis must avoid the possibility of deviations from the classical assumptions. Therefore, before performing regression testing, the classical assumption test was first tested on the research data. In this study, the classical assumption tests performed and fulfilled were normality test, multicollinearity test, autocorrelation test, and heteroscedasticity test.



c. Normality Test Analysis

Variable error (*e*) of a regression is required to be normally distributed in order to have a zero mean disturbance. If the variable *e* is normally distributed, the variables studied are also normally distributed. This study used the Kolmogorov-Smirnov normality test. The stipulation is that if the P-value obtained is greater than the research significance level of 0.05, then the data is normally distributed. The following is a table of normality test results:

Table 3
Normality Test Results

<i>Kolmogorov-Smirnov test:</i>	
D	0.1032
p-value	0.3904
alpha	0.05

H₀: residual data is normal
H₁: residual data is not normal

From table 3 above the Kolmogorov-Smirnov test results show that the probability value is 0.3904 > 0.05 so it can be concluded that H₀ is accepted or the residual data is normal.

d. Multicollinearity Test Analysis

The method to detect the presence of multicollinearity can be seen from the Variance Inflation Factor (VIF) or Tolerance Value. If the tolerance value is more than 0.10 or VIF is less than 10, it can be concluded that there is no multicollinearity. The amount of VIF and tolerance value from the results of the analysis can be seen in table 4 as follows:

Table 4
Multicollinearity Test Results

<i>Multicollinearity statistics:</i>				
Statistics	CLS	DS	EM	PROF
Tolerance	0.9592	0.8202	0.7936	0.6958
VIF	1.0426	1.2192	1.2601	1.4371

Source: XLSTAT processed data

From the results of the multicollinearity test in table 4.5 it can be seen that none of the variables have tolerance value less than 0.10 or VIF more than 10. The variable cost leadership strategy (X1) has a tolerance value of 0.9592 and a VIF of 1.0426. The differentiation strategy variable (X2) has a tolerance value of 0.8202 and a VIF of 1.2192. Earnings management variable (X3) has a tolerance value of 0.7936 and a VIF of 1.2601. The conclusion is that the research variables do not experience multicollinearity in the regression model, which means that there is no strong relationship between the existing X variables.

e. Autocorrelation Test Analysis

To detect the presence or absence of autocorrelation in a regression model, the Durbin-Watson test (DW test) can be used. The following are the results of the autocorrelation test which are presented in table 5:

Table 4
Autocorrelation Test Results

<i>Durbin-Watson test:</i>	
U	2.3068
p-value	0.7801
alpha	0.05

H₀: data is not autocol
H₁: data is autocol

From the results of the autocorrelation test in the table above, it shows that the probability value is 0.7801 > 0.05 or H₀ rejected. So, it can be concluded that the data used in this study does not occur autocorrelation.

f. Heteroscedasticity Test Analysis

The following are the results of the heteroscedasticity test in table 6

Table 6
Heteroscedasticity Test Results

<i>Breusch-Pagan test:</i>	
LM (Observed value)	9.7165
LM (Critical value)	15.5073
DF	8
p-value (Two-tailed)	0.2855
alpha	0.05

H₀: Data is homogeneous
H₁: Data is not homogeneous

The results of the heteroscedasticity test in the table above show that the probability value is 0.2855 > 0.05 or H₀rejected, so it can be concluded that the regression model does not have symptoms of heteroscedasticity.

g. Coefficient of Determination Test Analysis

The higher the R square value, the better the model. R values square itself from 0 to 1. Below are the results of the coefficient of determination test:

Table 7
Coefficient of Determination Test Results

<i>Goodness of fit statistics:</i>	
Observations	74,0000
Sum of weights	71636.6249
DF	690000
R ²	0.6847
Adjusted R ²	0.6846
DW	2.3068

Source: XLSTAT processed data

From the test results in the table7 obtained an R square value of 68.47% or it can be said that the independent variable (independent) in this case the cost leadership strategy, differentiation strategy, and earnings management of 68.47% is able to explain the dependent variable, namely the potential for bankruptcy and the remaining 31.53% is explained by the variable others that are not used in the regression model of this study.

h. T . Test Analysis

T test is calculated through the ratio of T_{count}with T table at a significant level of 5% (0.05). If Tcount > Ttable, the independent variable can describe the relationship, meaning that there is an influence between the independent variable and the dependent variable. The following are the results of the T test in table 8 below:

Table 8
T . Test Results

Source	Value	Standard error	t	Pr > t
Intercept	5.2240	0.1359	38.4494	< 0.0001
CLS	-0.7037	0.0120	-58.4142	< 0.0001
DS	-5.8821	0.2177	-27.0218	< 0.0001
EM	0.4154	0.0135	30.8560	< 0.0001
PROF	2.0551	0.0645	31.8840	< 0.0001
CLS*Z	-0.4287	0.0150	-28.6224	< 0.0001
DS*Z	-3.9031	0.8585	-4.5466	< 0.0001
EM*Z	0.7311	0.1713	4.2680	0.0655
AR(1)	0.3754	0.0046	80.7616	< 0.0001

Source: XLSTAT processed data

i. Regression Model

$$Y = 5.2240 - 0.7037 CLS - 5.8821 DS + 0.4154 EM + 2.0551 PROF - 0.4287 CLS * Z - 3.9031 DS * Z + 0.7311 EM * Z + 0.3754 AR(1)$$

Based on the results of the t test in table 8 shows that:

- 1) Cost Leadership Strategy against Potential Bankruptcy
- 2) Differentiation Strategy against Potential Bankruptcy



- 3) Earnings Management against Bankruptcy Potential
- 4) Profitability in Moderating the Relationship between Cost Leadership Strategy and Potential Bankruptcy
- 5) Profitability in Moderating the Relationship between Differentiation Strategy and Potential Bankruptcy
- 6) Profitability in Moderating Earnings Management Relationship to Bankruptcy Potential

3.2 Discussion

This study discusses the influence of business strategy (*cost leadership strategy* and differentiation strategy) and earnings management against potential bankruptcy with profitability as a moderating variable. This study uses a multiple linear regression analysis model, which is divided into 6 (six) discussions, namely:

- a. *Cost Leadership Strategy* Negative Effect on Potential Bankruptcy
- b. *Differentiation Strategy* Negative Effect on Potential Bankruptcy
- c. Earnings Management Has Positive Effect on Bankruptcy Potential
- d. Profitability Moderates the Relationship between Cost Leadership Strategy and Potential Bankruptcy
- e. Profitability Moderates Differentiation Strategy's Relationship to Potential Bankruptcy
- f. Profitability Does Not Moderate Earnings Management Relationship to Bankruptcy Potential

4. Conclusion

Based on the observations that have been completed and the detailed assessment completed, the following conclusions can be reached: 1) The cost leadership strategy has a negative effect on the potential for bankruptcy. The company makes efficient use of assets so that the production and operational costs received are not high which of course makes the price offered to market share lower than competitors so that the company leads in price competition and attracts buyers or consumers; 2) The differentiation strategy has a negative effect on the potential for bankruptcy. The company creates products that are unique and different from competitors that can be accepted by the market for a long period of time and of course the company dares to offer high prices; 3) Earnings management has a positive effect on the potential for bankruptcy. Management changes information or data that is not suitable for personal interest in the financial statements so that it is misleading for users of financial statements when the company's financial condition is not good; 4) Profitability is able to strongly moderate the relationship between cost leadership strategy and the potential for bankruptcy. Profitability can be used as a benchmark for analysis to gain profit and support companies to be more efficient in managing production and operational costs while maintaining quality and features; 5) Profitability is able to strongly moderate the relationship between differentiation strategy and the potential for bankruptcy. Profitability as a benchmark in achieving company profits supports the company's decision to focus more on research and product development in creating unique products that can be accepted by many markets for a long period of time; 6) Profitability is not able to moderate the relationship of earnings management to the potential for bankruptcy. Management tends not to care about profitability which is the basis for making future corporate strategies. Management is more interested in making changes in the company's financial reporting for the purpose of personal interest without looking at the actual condition of the company. 6) Profitability is not able to moderate the relationship of earnings management to the potential for bankruptcy. Management tends not to care about profitability which is the basis for making future corporate strategies. Management is more interested in making changes in the company's financial reporting for the purpose of personal interest without looking at the actual condition of the company. 6) Profitability is not able to moderate the relationship of earnings management to the potential for bankruptcy. Management tends not to care about profitability which is the basis for making future corporate strategies. Management is more interested in making changes in the company's financial reporting for the purpose of personal interest without looking at the actual condition of the company.

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