

Earnings Quality: An Analysis of Indonesia Manufacturing Companies with Dividend Policy as a Moderating Variable

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ABSTRACT

This study aimed to examine the factors that influenced earnings quality in manufacturing sector companies listed on the Indonesia Stock Exchange for the 2018-2020 period. Earnings quality is the ability of company-generated profit information to influence the decisions of financial statement users. Earnings information is used as a basis for consideration in making decisions so companies are required to provide quality earnings information. Earnings quality in this study was measured by the Earnings Response Coefficient (ERC). ERC is a measure of the magnitude of the abnormal return of a stock in response to unexpected earnings reported by the company. In this study, the factors that were predicted to affect ERC were profitability, leverage, firm size, and liquidity with dividend policy as a factor that could moderate the relationship with ERC. Based on the results, it can be concluded that profitability, firm size, and liquidity had a significant positive effect on earnings quality (ERC), with dividend policy as a moderating variable. Meanwhile, leverage (DER) had no effect on earnings quality with dividend policy as a moderating variable.

Keywords: dividend, earnings response coefficient, leverage, profitability, size

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INTRODUCTION

Earnings information is essential information in financial statements. The income statement contains earnings information. Internal and external parties use earnings information in financial statements. Internal parties, such as company managers, will make decisions related to earnings information, for example when the company experiences profits, managers consider paying out dividends to investors or making investments such as purchasing machinery to increase production to boost sales. Investors, creditors, and the government are external parties that use financial reports. Investors use financial reports related to profit information to make investment decisions. Investors make investment decisions by buying, holding, or selling company stock. When investors already own company shares, investors can get benefit from dividend distribution and capital gains. For creditors, the use of financial reports related to earnings information helps to evaluate risks in granting credit to companies. Lastly, for the government, the use of financial reports related to profit information is to implement policies in terms of taxation (Weygandt et al., 2019).

Earnings information is used as a basis for consideration in making decisions. Therefore, companies are required to provide high-quality earning information. Earning quality can describe actual company performance (Ayem & Lori, 2020). Earnings quality in this study was measured by the Earnings Response Coefficient (ERC). Donleavy (2018) stated that ERC is a measure of the abnormal return of a security in response to unexpected earnings reported by the company issuing the security. Positive unexpected earnings are indicated by an increase in company profits, explicitly the company's actual profit is higher than the profit expected by investors. If unexpected earnings are positive, it will be good news for investors because the company is expected to be able to provide dividends. Investors will respond positively to this by buying company shares. When there is an increase in the number of requests for purchasing stock, it will be followed by an increase in stock prices which will have an impact on increasing actual returns so that abnormal returns are positive. Positive abnormal returns will be followed by positive cumulative abnormal returns (CAR) which reflects a positive response from the market to published earnings information.

In investing, investors certainly expect returns, both in the form of capital gains and dividends. Dividend is a distribution of profits given by the company and comes from the profits generated by the company. Dividends are given after obtaining approval from shareholders at the General Meeting of Shareholders. Dividend is one of the important policies in the company because it can influence investments made by investors. When a company has great potential to pay dividends, the company shows a signal to investors that the company is in good and profitable condition, so that it will cause investors to be interested in investing and will make the potential for investors to invest in the company. The existence of a dividend policy can help investors to consider whether to invest in the company or not. Investors who expect benefits from dividends will invest in companies that have a high dividend policy. This dividend policy can make investors react to profit information in financial reports. Dividend policy is measured using the Dividend Payout Ratio (DPR). DPR describes the amount of profit from each share allocated in the form of dividends. The higher the DPR, the more dividends paid from the company's net profit.

Factors that are expected to affect earnings quality in this study were profitability, leverage, company size, and liquidity with dividend policy as a moderating variable. Based on the background that has been described previously, the problems in this study can be formulated as follows:

1. Does profitability (ROA) has a positive effect on earnings quality with dividend policy as a moderating variable?
2. Does leverage (DER) has a negative effect on earnings quality with dividend policy as a moderating variable?
3. Does firm size (SIZE) has a positive effect on earnings quality with dividend policy as a moderating variable?
4. Does liquidity (CR) has a positive effect on earnings quality with dividend policy as a moderating variable?

LITERATURE REVIEW

Signalling Theory

The signalling theory argues that the existence of asymmetric information can also be taken as a reason for good companies to use financial information to send signals to the market (Yimenu & Surur, 2019). Asymmetric information is the situation where managers have different (better) information about firms' prospects than do investors (Brigham dan Houston, 2019). Managers will normally have better information about the business than its investors. Moreover, both managers and investors recognise this fact. An important consequence of this information asymmetry, is that investors examine managers' decisions in search for clues about future prospects (Atril, 2020). The signalling theory shows that managers edit and change earnings to show the companies' inside information and their prospect (Saleh et al., 2020) which could affect the quality of information.

Earnings Quality

Earnings quality can describe the actual company performance. Earnings quality in this study was measured by the Earnings Response Coefficient (ERC) (Ayem & Lori, 2020). Earnings Response Coefficient is a measure of the abnormal return of a security in response to elements of unexpected earnings reported by the company issuing the security (Donleavy, 2018). The market response to the company's published earnings information, which can be observed by moving stock prices during the announcement period could be reflected in ERC (Awawdeh et al., 2020). Earnings quality can be indicated as the ability of earnings information to respond to the market. The strong market reaction to earnings information is reflected in the high ERC, which indicate quality reported earnings (Paramita et al., 2020). High earnings quality will provide more information about the characteristics of the company's financial performance that is relevant to the specific decisions made by decision makers (Elviani et al., 2022). ERC is calculated by finding the regression coefficient of CAR and UE (Rizqi et al., 2020).

Dividend Policy

Dividend policy is the company's decision to allocate profits earned by the company in the current year to be distributed to shareholders in the form of dividends or will be retained and used to add to the balance of retained earnings aimed at increasing equity and financing investment in the future (Lie & Osesoga, 2020). In this study, dividend policy was measured by the Dividend Payout Ratio (DPR). DPR is a ratio that shows the proportion of profits earned and distributed to shareholders in the form of money (Gunawan & Harjanto, 2019).

A higher dividend policy will benefit investors, but it does not apply to the company because it will weaken the company's finances, but conversely, a lower dividend policy will strengthen the company's finances and will harm investors, because the dividends distributed to investors are not as expected (Kurnia et al., 2019). Payment of dividends is a signal of the company's financial health which indicates that management is able to manage the company to make a profit and that management is able to provide good and appropriate policies in distributing the number of dividends to investors (Dewi & Astika, 2019). When dividend policy has stimulated the positive movement of market price, it is used to disseminate the available signal as a communication process to grab a high investor's trust (Siladjaja et al., 2022). Nguyen and Bui (2019) found that dividend payers' earnings quality is higher than that of dividend non-payers. Therefore, dividend policy can be a reliable information source in decision making for investors.

Profitability

Profitability in this study was measured by Return on Assets (ROA). ROA is a profitability ratio used to measure a company's effectiveness in generating profits by utilizing the company's assets (Lie & Osesoga, 2020). The greater this ratio, the better the company's performance, because the return on investment is greater (Ardianti, 2018). Profitability is a reflection of the company's effectiveness in influencing investors' response to profit information in making investment decisions. Profitability is one of the factors to assess the performance and efficiency of a company so that it is related to the profit it generates. Investor confidence increases if the profitability generated by the company is greater, so that the quality of the

profits generated will be better (Yulianti et al., 2021). Sarahwati and Setiadi (2021) and Elviani et al. (2022) show that profitability has a positive and significant effect on earnings quality. Meanwhile, the results of research conducted by Angela and Iskak (2020) and Ramadanti and Rahayu (2019) show that profitability has no effect on earnings quality.

Ha1: Profitability has a positive effect on the earnings quality with dividend policy as a moderating variable.

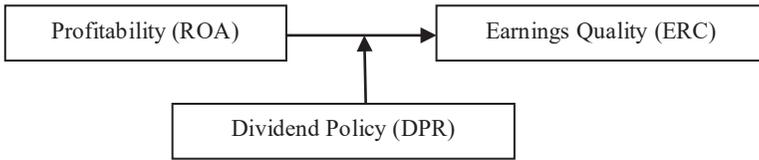


Figure 1: Research Framework Hypothesis 1

Leverage

Leverage ratio shows the amount of capital originating from loans used to finance company operations and investment. In this study leverage was measured by Debt to Equity Ratio (DER). DER used to measure the ratio between total debt and total equity in company financing sources. The higher the percentage of DER, the greater the risk that the company may be unable to meet its maturing obligations. Also, the higher the percentage of leverage, the greater the risk of the company not being able to meet its obligations when they fall due (Lie & Osesoga, 2020). Creditors and investors usually choose a company with low DER value because their interests are better protected if there is a decline in the business of the company (Silanno & Loupatty, 2021). The research conducted by Dewi (2020) and Elviani et al. (2022) showed that leverage has a negative and significant effect on earnings quality. Meanwhile, Anggita and Hidayati (2021) argued that leverage has no effect on earnings quality.

Ha2: Leverage has a negative effect on the earnings quality with dividend policy as a moderating variable.

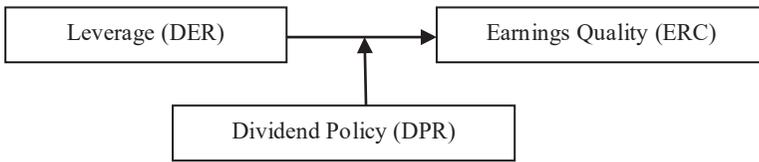


Figure 2: Research Framework Hypothesis 2

Firm Size

Firm size is a scale used to classify the size of a company based on total assets owned. Firm size can be assessed by the natural logarithm of total assets (Agustina et al., 2017). Firm size is a determining factor in generating profits; investors usually have more confidence in large companies with large amounts of assets because large companies are considered capable of continuously improving their company performance and always striving to increase earnings quality (Tangngisalu et al., 2020; Abbas et al., 2020). Nariman and Ekadjaja (2020) state that firm size has significant positive influence to the earnings quality but Hasanuddin et al. (2021) argue that firm size do not affect earnings quality.

Ha3: Firm size has a positive effect on the earnings quality with dividend policy as a moderating variable.

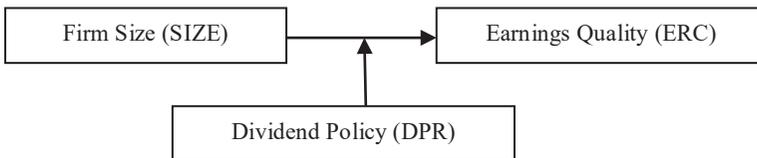


Figure 3: Research Framework Hypothesis 3

Liquidity

Liquidity is the company's ability to meet its current obligations. In this research, liquidity was measured by the Current Ratio (CR). The Current Ratio is a ratio to measure a company's ability to meet its short-term obligations that are due soon by using available current assets (Weygant et al., 2019). In line with the signalling theory which states that a company that is able to pay off its short-term obligations is a good signal for investors regarding future performance providing future developments. Companies

that can pay off short-term obligations give a positive signal to investors in determining their asset decisions because they have high net income so that they are still able to pay the obligations of a company (Diyanti & Anwar, 2021). Assagaf (2022) showed that liquidity has a positive and significant effect on earnings quality. While research conducted by Yusuf et al. (2019) showed that liquidity has a negative and significant effect on earnings quality.

Ha4: Liquidity has a positive effect on the earnings quality with dividend policy as a moderating variable.

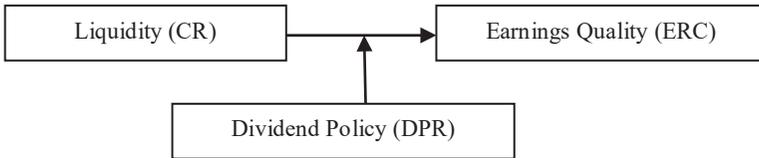


Figure 4: Research Framework Hypothesis 4

METHODOLOGY

Research Object

The objects used in this study were manufacturing companies listed on the Indonesia Stock Exchange (IDX) consecutively in the 2018-2020 period. These manufacturing companies covered 3 sectors, namely basic and chemical industry sector, various industrial sector, and consumer goods sector. This study used secondary data from financial statements of manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) and stock price from Yahoo Finance.

Research Variables

The measurement of the independent variables is summarized in Table 1.

Table 1: Summary of Measurements of Variables

Variable	Acronym	Measurement	Prior studies
Dependent: Earnings Quality	ERC	the slope coefficient in the regression of cumulative abnormal stock returns (CAR) and unexpected earnings (UE) CAR uses 5 days before and 5 days after the earnings announcement (-5, +5)	
Moderating: Dividend Policy	DPR	$DPR = \frac{\text{Cash Dividends per Share}}{\text{Earnings per Share}}$	Siladjaja et al (2022), Nguyen & Bui (2019)
Independent: Profitability	ROA	$ROA = \frac{\text{Net Income}}{\text{Average Total Assets}}$	Sarahwati and Setiadi (2021), Elviani et al (2022), Angela and Iskak (2020), Ramadanti and Rahayu (2019)
Leverage	DER	$DER = \frac{\text{Total Debt}}{\text{Total Equity}}$	Dewi (2020), Elviani et al (2022), Anggita and Hidayati (2021)
Firm Size	SIZE	SIZE = Ln Total Assets	Nariman & Ekadjaja (2020), Hasanuddin et al (2021)
Liquidity	CR	$\text{Current Ratio (CR)} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$	Assagaf (2022), Yusuf et al (2019)

Data Analysis Method

The data analysis method used in this research was the Moderated Regression Analysis (MRA) to test the effect of the independent variable on the dependent variable whose relationship is influenced by the moderating variable. MRA uses an analytical approach that maintains sample integrity and provides a basis for controlling the influence of moderator variables (Ghozali, 2018).

RESULTS AND DISCUSSION

Data used in this study were manufacturing public firms listed on Indonesian Stock Exchange from the year 2018 until 2020. Sample selection using purposive sampling was as follows:

Table 2: Sample Selection

Criteria	Firm years
Manufacturing firms listed in Indonesia Stock Exchange from 2018 to 2020:	
Firm-year observations:	456
Less did not publish financial statements	(12)
Less different closing date	(9)
Less USD presentation	(84)
Less did not experience positive net income consecutively during 2018-2020	(300)
Less conduct stock split/reverse split or rights issue during 2018-2020	(6)
Less did not declare cash dividends consecutively during 2018-2020	(12)
Final observations	33

Table 3: List of Samples

No.	Code	Company
1	BUDI	PT Budi Starch & Sweetener Tbk
2	CAMP	PT Campina Ice Cream Industry, Tbk.
3	CEKA	PT Wilmar Cahaya Indonesia Tbk.
4	DLTA	PT Delta Djakarta Tbk
5	ICBP	PT Indofood CBP Sukses Makmur Tbk
6	INDF	PT Indofood Sukses Makmur Tbk
7	MLBI	PT Multi Bintang Indonesia Tbk
8	MYOR	PT Mayora Indah Tbk
9	ROTI	PT Nippon Indosari Corpindo Tbk
10	SKLT	PT Sekar Laut Tbk
11	ULTJ	PT Ultrajaya Milk Industry & Trading Company Tbk

The final results of the sample were 11 manufacturing companies with 3 period (2018-2020) or 33 firm-years observations. The result for descriptive statistics were as follows:

Table 4: Descriptive Statistics Result

	N	Range	Minimum	Maximum	Mean	Std. Deviation
ERC5	33	4.37285	-.67962	3.69323	.136126	1.165846
DPR	33	3.41047	.082167	3.49264	.614735	.625595
Size	33	5.38588	27.3397	32.7256	29.23794	1.599711
CR	33	12.5353	.731923	13.2672	3.765204	3.388877
ROA	33	.437728	.015939	.453667	.113089	.099696
DER	33	1.63628	.130144	1.76642	.705330	.482814
Valid N (listwise)	33					

Following are the MRA results of all independent variables namely profitability, leverage, firm size, and liquidity on earnings quality were

calculated by the earnings response coefficient with dividend policy (Dividend Payout Ratio) as a moderating variable.

Table 5: MRA Result for ROA

	Coef.	T
(Constant)	0.775	0.012
ROA	4.434	0.053*
DPR	0.572	0.038**
ROA*DPR	3.018	0.015**
Number of observations	33	
F-value	4.866**	
R ²	0.382	
Adjusted R ²	0.380	

* Statistical significance at the 0.10 level; ** Statistical significance at the 0.05 level; *** Statistical significance at the 0.01 level

The results of the coefficient of determination (Adjusted R²) for the relationship between ROA, DPR, and the interaction between ROA and DPR and ERC are shown in Table 5. The Adjusted R² value was 0.380 which indicated that ROA, DPR as moderating variable, and the interaction between ROA and the DPR was able to explain the earnings quality (ERC) by 38%. The remaining 62% was explained by other variables not tested in this study. The F value for the Ha1 test, which included the effect of the independent variable ROA, the moderating variable DPR, and the interaction between ROA and DPR on ERC was 4.866 with a significance level of 0.032. The significance value of 0.032 was lower than 0.05 so it can be concluded that the independent variable ROA, the DPR moderating variable, and the interaction of ROA with the DPR simultaneously had a significant influence on the dependent variable, earnings quality (ERC).

The significance level for the DPR and the interaction of ROA and DPR was 0.038 and 0.015 which was lower than 0.05. Thus, the DPR (β_2) and the interaction between ROA and DPR (β_3) were significant. This showed that the DPR was a quasi-moderator for the influence of ROA on ERC. The DPR was related to ERC and/or ROA and interacts with the ROA variable. Thus Ha1 was accepted, so that profitability (ROA) had a significant positive effect on earnings quality with dividend policy (DPR) as a moderating variable.

Table 6: MRA Result for Leverage (DER)

	Coef.	T
(Constant)	-0.044	0,067
DER	-0.298	0,067*
DPR	0.180	0,078*
DER*DPR	0.309	0,124
Number of observations	33	
F-value	4.422**	
R ²	0.220	
Adjusted R ²	0.201	

* Statistical significance at the 0.10 level; ** Statistical significance at the 0.05 level; *** Statistical significance at the 0.01 level

The results of Adjusted R² for the relationship between the independent variable (DER), moderating variable (DPR,) and the interaction between DER and DPR and ERC are shown in Table 6. The Adjusted R² value was 0.201 which indicated that DER, DPR, and the interaction between DER and the DPR was able to explain the earnings quality (ERC) by 20.1%. The remaining 79.9% was explained by other variables not tested in this study. The F value for Ha2 testing was 4.422 with a significance level of 0.045. The significance value of 0.045 was lower than 0.05 so it can be concluded that the DER, DPR, and the interaction of DER with the DPR simultaneously had a significant influence on the earnings quality (ERC).

The significance level for the DPR and the interaction of DER and DPR was 0.078 and 0.124 which is higher than 0.05. Thus, the DPR (β_2) and the interaction of DER and DPR (β_3) were not significant. This showed that the DPR is not a quasi-moderator for the influence of DER on ERC. Thus, Ha2 was rejected, so leverage (DER) did not affect earnings quality with dividend policy (DPR) as a moderating variable.

Table 7: MRA Result for Firm Size (SIZE)

	Coef.	T
(Constant)	-16.721	0.057
SIZE	0.583	0.056*
DPR	12.656	0.048**
SIZE*DPR	-0.446	0.050**
Number of observations	33	
F-value	4.396**	
R ²	0.363	
Adjusted R ²	0.341	

* Statistical significance at the 0.10 level; ** Statistical significance at the 0.05 level; *** Statistical significance at the 0.01 level

The results for the relationship between SIZE, DPR, and the interaction between SIZE and DPR and ERC are shown in Table 7. The Adjusted R² value was 0.341 which indicated that SIZE, DPR, and the interaction between SIZE and the DPR was able to explain the earnings quality (ERC) by 34.1%. The remaining 65.9% was explained by other variables not tested in this study. The F value for Ha3 test was 4.396 with a significance level of 0.025. The significance value of 0.025 was lower than 0.05 so it can be concluded that SIZE, DPR, and the interaction between SIZE and DPR simultaneously had a significant influence on earnings quality (ERC).

The significance level for the DPR and the interaction of SIZE and DPR was 0.048 and 0.05 which was lower and equal to 0.05. Thus, the DPR (β_2) and the interaction of SIZE and DPR (β_3) were significant. This showed that the DPR is a quasi-moderator for SIZE's influence on ERC. To conclude, Ha3 was accepted, so company size (SIZE) had a significant positive effect on earnings quality with dividend policy (DPR) as a moderating variable.

Table 8: MRA Result for Liquidity (CR)

	Coef.	T
(Constant)	0.611	0.157
CR	0.115	0.315
DPR	0.439	0.031**
CR*DPR	0.093	0.048**
Number of observations	33	
F-value	4.562**	
R ²	0.355	
Adjusted R ²	0.343	

* Statistical significance at the 0.10 level; ** Statistical significance at the 0.05 level; *** Statistical significance at the 0.01 level

The results of the relationship between CR, DPR, and the interaction between CR and DPR and ERC are shown in Table 8. The Adjusted R² value was 0.343 which indicated that CR, DPR, and the interaction between CR and the DPR was able to explain earnings quality (ERC) by 34.3% while the remaining 65.7% was explained by other variables not tested in this study. The F value for Ha4 test was 4.562 with a significance level of 0.037. The significance value of 0.037 was lower than 0.05 so it can be concluded that CR, DPR, and the interaction of CR with the DPR simultaneously had a significant influence on earnings quality (ERC).

The significance levels for the DPR and the interaction of CR and DPR were 0.031 and 0.048 which were lower than 0.05. Thus, the DPR (β_2) and the interaction of CR and DPR (β_3) were significant. This shows that the DPR was a quasi-moderator for the influence of CR on ERC. H_{a4} is accepted, or liquidity (CR) had a significant positive effect on earnings quality with dividend policy (DPR) as a moderating variable.

DISCUSSION

Based on moderated regression analysis, profitability had a positive effect on earnings quality. This result supports research conducted by Sarahwati and Setiadi (2021) and Elviani et al. (2022). Dividend policy was proven to be able to strengthen the positive relationship between profitability and earnings quality. This proved that investors reacted more positively to companies that experienced profits and pay dividends (Nguyen & Bui, 2019). The profit that the company gets if it is distributed in the form of dividends will make investors more interested in the company's shares and cause a positive reaction in the form of an increase in the number of requests for shares. An increase in demand will increase the stock price. There is a natural positive relation between expected earnings and stock prices because stockholders expect dividends, which are paid out of earnings (Easton et al., 2021). High stock prices cause the actual stock return to increase. Thus, high actual returns above market returns will cause high abnormal returns. The high abnormal return around the date of the earnings announcement is then accumulated to become a high cumulative abnormal return (CAR). Conditions in which the unexpected earnings increase and is followed by a high CAR indicate that there is a positive reaction to the earnings announcement, which is marked by a high ERC. A high ERC indicates that earnings information can influence investors' decisions in investing so that earnings information is considered to have high quality.

The greater the company's assets, the higher the quality of earnings. These results are in accordance with research by Nariman and Ekadjaja (2020). Large assets accompanied by dividend distribution make the demand for shares increase which will cause the stock price to increase. High stock prices cause the actual stock return to increase and then will cause high abnormal returns. The high abnormal return around the date of the earnings

announcement is then accumulated to become a high cumulative abnormal return (CAR). Conditions in which the unexpected earnings increase and is followed by a high CAR indicate that there is a positive reaction to the earnings announcement, which is marked by a high ERC. A high ERC indicates that earnings information can influence investors' decisions in investing so that earnings information is considered to have high quality.

The high liquidity of the company causes the quality of the company's earnings to increase. This result in line with research conduct by Assagaf (2022). Companies with high liquidity and paying dividends will attract investors to buy the company's shares, which will cause the stock price to increase. High stock prices cause the actual stock return to increase. High actual returns above market returns will cause high abnormal returns. The high abnormal return around the date of the EU announcement is then accumulated to become a high cumulative abnormal return (CAR). Conditions in which the unexpected earnings increase and is followed by a high CAR indicate that there is a positive reaction to the earnings announcement, which is marked by a high ERC. A high ERC indicates that earnings information can influence investors' decisions in investing so that earnings information is considered to have high quality.

In this study, leverage did not affect earnings quality and dividends did not mitigate the relationship between leverage and earnings quality. This supports the results of research by Anggita and Hidayati (2021). Leverage did not affect earnings quality because from 33 observations, 24 of them have low DER values. The majority of the sample uses more equity to carry out operations, which causes an increase in sales. As many as 70.04% (17 out of 24) observations had an increase in sales by an average of 9.12% followed by an increase in COGS by an average of 9.5%, and a decrease in operating expenses by 2.17%. However, the efficiency of operating expenses was not significant and could not increase the company's net income. Moreover, 11 out of 17 (64.70%) observations experienced an average increase in profit for the year by 25.21% which came from an increase in other income. So it can be seen that the company relies on other income to increase its profits. Thus, investors did not respond the increase in profit even though the value was significant because the increased profit was not from the company's main activities, but from other income such as revaluation of assets, gain on foreign exchange, and adjustments to investment values.

CONCLUSION

Based on the results of the research above, it can be concluded that profitability, firm size, and liquidity had a significant positive effect on earnings quality measured with ERC, with dividend policy as a moderating variable. Meanwhile, leverage (DER) had no effect on earnings quality with dividend policy as a moderating variable. There are some limitations in this research. First, the objects used in this study were only manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2018-2020 period, so the research results cannot be generalized to all sectors or all companies listed on the IDX. Second, there are other variables that can affect going concern audit opinions that were not examined in this study. This can be seen from the limited Adjusted R² results.

Future research could extend the research period and companies sector so that the results can be more generalized and add other independent variables that are expected to affect the earnings quality, such as corporate governance, audit quality, or company growth. The results of this study prove that profitability, firm size, and liquidity influence earnings quality, and also prove that dividend policy could affect the interaction between these variables and earnings quality. This causes management to pay attention to the effectiveness of company assets and the dividend policy because it is proven could increase the earnings quality.

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