Daengku: Journal of Humanities and Social Sciences Innovation *ISSN: 2775-6165 (online)*
Vol. 6 No. 4 (2026)
https://doi.org/10.35877/454RI.daengku5021

When Earnings Management Becomes a Signal: Information Asymmetry, Corporate Governance, and Firm Value

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Abstract

This study examines how information asymmetry, financial distress, and earnings management are associated with firm value, and investigates the role of corporate governance in conditioning the market valuation of discretionary reporting behavior. The study adopts a quantitative explanatory research design using firm-level secondary data from non-financial publicly listed firms operating in manufacturing and manufacturing-related sectors in Indonesia. The final sample consists of 1,321 firm-year observations. The empirical analysis employs a path analysis approach with observed variables, enabling the simultaneous estimation of direct effects, indirect effects through earnings management, and moderating effects involving corporate governance. Model estimation is conducted using maximum likelihood techniques. The results indicate that information asymmetry and earnings management are negatively associated with firm value, while financial distress does not exhibit a significant direct effect. Earnings management does not mediate the relationships between information asymmetry or financial distress and firm value. However, corporate governance plays a significant moderating role by attenuating the negative association between earnings management and firm value. This finding suggests that the market evaluates discretionary reporting behavior conditionally, depending on governance quality. The study relies on accounting- and market-based proxies within an associative empirical framework, which limits causal interpretation. The findings nevertheless highlight the importance of incorporating governance-related conditional mechanisms when examining the economic consequences of financial reporting practices. This study contributes to the literature by positioning corporate governance as an interpretive mechanism that conditions the valuation consequences of earnings management rather than merely constraining managerial discretion. By integrating moderation and mediation structures within a unified empirical framework, the study offers a more nuanced understanding of how the market evaluates financial reporting behavior in an emerging economy context.

Keywords: Corporate governance, Earnings management, Firm value, financial distress, Information asymmetry.

Received: 20 June 2026 Revised: 8 August 2026 Published: 31 August 2026

1. Introduction

Firm value represents a key indicator of corporate performance and market confidence, particularly in emerging capital markets where information transparency and governance quality vary substantially across firms (Nguyen et al., 2021). In such environments, investors face greater uncertainty and rely not only on reported financial outcomes but also on the credibility of financial information and the governance structures that frame managerial behavior. As a result, understanding how information-related factors influence firm value is essential for both financial decision-making and corporate governance design (Landu et al., 2025).

Prior research highlights information asymmetry, financial distress, and earnings management as essential factors affecting firm value. Information asymmetry increases uncertainty for market participants and may lead to valuation discounts. Financial distress reflects a firm's exposure to financial risk and has been associated with adverse market reactions (Habib et al., 2020; Vo, 2023). Earnings management, as a manifestation of managerial discretion in financial reporting, remains a particularly debated issue (Bansal, 2024; Baskaran et al., 2020). While some studies suggest that

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earnings management can stabilize reported performance and reduce information risk, others document negative market responses driven by concerns over opportunistic behavior and reduced reporting credibility. These mixed findings suggest that the valuation effects of earnings management are context dependent.

A limitation of existing studies is the tendency to treat earnings management as a mechanical channel through which firm conditions are translated into market value. This perspective assumes that discretionary reporting automatically conveys underlying economic conditions to investors. However, such an assumption may not fully reflect how financial markets operate, especially in emerging economies where institutional frameworks, disclosure practices, and enforcement mechanisms differ from those in developed markets.

Corporate governance is often positioned as a mechanism to limit managerial opportunism and protect shareholder interests (Karpoff, 2021; Stoelhorst et al., 2024). Nevertheless, governance may also play a broader role in shaping how the market interprets financial information, even including employee engagement (Haryanto et al., 2022, 2023). Most previous studies implicitly assume that earnings management directly affects firm value or functions merely as a mediating mechanism linking firm characteristics to market valuation. Such an approach overlooks an important question: how do investors determine whether discretionary reporting should be interpreted as informative managerial signaling or as opportunistic financial manipulation? This question has become increasingly relevant because investors no longer evaluate accounting numbers in isolation. Instead, they increasingly consider the governance environment surrounding financial reporting when assessing the credibility of reported earnings. Consequently, corporate governance should not only be viewed as a mechanism that constrains managerial opportunism but also as an institutional signal that influences how capital markets interpret discretionary accounting choices.

This perspective is particularly relevant in emerging economies. Compared with developed markets, many emerging countries are characterized by concentrated ownership structures, weaker legal enforcement, lower transparency, and relatively limited investor protection. These institutional characteristics increase agency conflicts and information risk, making governance mechanisms substantially more important in reducing uncertainty surrounding financial reporting. Accordingly, the valuation implications of earnings management observed in emerging markets may differ from those documented in developed economies because investors operate under different institutional constraints. Therefore, findings from emerging economies contribute not only to country-specific evidence but also to broader discussions regarding the role of institutions in corporate valuation.

Indonesia provides an especially appropriate empirical setting for examining these relationships. As the largest economy in Southeast Asia, Indonesia combines relatively rapid capital market development with governance characteristics commonly observed across emerging economies, including concentrated ownership, family-controlled firms, varying governance quality, and evolving regulatory enforcement. These features create an environment where investors face substantial information asymmetry and where corporate governance plays a crucial role in establishing reporting credibility. Consequently, Indonesia represents a valuable institutional laboratory for examining how governance conditions investors' interpretation of earnings management, with implications extending beyond the Indonesian capital market to other emerging economies that exhibit similar institutional characteristics.

Although prior studies have investigated the relationships among corporate governance, earnings management, and firm value, three important research gaps remain. First, previous research has predominantly examined corporate governance as a direct determinant of firm value or as a mechanism for reducing earnings management, while giving limited attention to its role as an interpretive mechanism that shapes investors' responses to discretionary reporting. Second, relatively few studies have simultaneously integrate direct, mediating, and moderating relationships within a unified empirical framework, making it difficult to distinguish whether governance primarily constrains managerial behavior or alters market interpretation of that behavior. Third, evidence from emerging markets remains fragmented, with limited comparative discussion regarding how institutional characteristics influence the valuation consequences of earnings management across different governance environments.

Accordingly, this study investigates the relationships among information asymmetry, financial distress, earnings management, corporate governance, and firm value using evidence from Indonesian manufacturing and manufacturing-related firms. Specifically, this study examines whether earnings management mediates the effects of information asymmetry and financial distress on firm value and whether corporate governance moderates the relationship between earnings management and firm value. By positioning corporate governance as an institutional mechanism that conditions investor interpretation of discretionary reporting rather than merely constraining managerial discretion, this study extends the literature on corporate governance and financial reporting. Furthermore, the findings provide broader implications for regulators, institutional investors, and policymakers operating in emerging markets that share institutional characteristics similar to those of Indonesia, thereby contributing to a more comprehensive understanding of firm valuation under conditions of institutional uncertainty.

2. Literature Review

2.1. Information Asymmetry and Firm Value

Information asymmetry arises when managers possess superior information relative to external investors, creating uncertainty regarding firm performance and future prospects (M. M. Ahmad et al., 2023; Bergh et al., 2019). In capital markets, particularly in emerging economies, higher information asymmetry increases perceived risk and weakens investor confidence, leading to valuation discounts (Yildiz, 2021). Investors tend to price firms more conservatively when transparency is limited, and disclosure quality is uneven (Arévalo et al., 2025; Lang et al., 2012). Beyond agency concerns, information asymmetry negatively affects firm value through market-based mechanisms such as higher cost of capital and reduced stock liquidity. Firms characterized by opaque information environments face greater adverse selection risk, prompting investors to require higher expected returns. This increase in the cost of equity capital directly lowers firm valuation. Additionally, lower transparency reduces market liquidity by widening bid–ask spreads and discouraging trading activity, further depressing stock prices and overall firm value.

Empirical studies generally document a negative association between information asymmetry and firm value, especially in settings characterized by heterogeneous disclosure practices. In such environments, information asymmetry becomes a central determinant of how the market values firms (Fosu et al., 2016; Gim et al., 2023; Huynh et al., 2020).

H1: Information asymmetry has a negative effect on firm value.

2.2. Financial Distress and Firm Value

Financial distress reflects a firm's exposure to financial risk and its reduced ability to meet financial obligations (Farooq et al., 2022). Conventional valuation theory suggests that financially distressed firms should experience lower market valuation due to increased uncertainty and bankruptcy risk (F. Ahmad, 2025; Bhattacharya et al., 2024). Distressed firms are often perceived as having weaker governance and limited financial flexibility, which raises doubts about their ability to sustain operations and invest in value-enhancing projects. Consequently, investors demand higher risk premiums or shift capital toward financially healthier firms, reinforcing the negative valuation effect associated with distress.

However, empirical evidence shows that market reactions to financial distress are not always uniform, particularly in emerging markets (Viana Jr et al., 2022). In contexts where financial distress is perceived as temporary or manageable, investors may not immediately penalize firm value, especially when financial reporting remains credible (Barth et al., 2010; Hail, 2013). Nevertheless, based on traditional risk-based valuation arguments, a negative association is expected.

H2: Financial distress has a negative effect on firm value.

2.3. Earnings Management and Firm Value

Earnings management represents managerial discretion in financial reporting intended to influence reported earnings (Bansal, 2024). Two competing perspectives dominate the literature. The opportunistic perspective argues that earnings management reduces reporting credibility and misleads investors, resulting in negative market responses (Baskaran et al., 2020; Wu et al., 2022). In contrast, the informational perspective suggests that discretionary reporting may convey private information about future performance (Miller, 2002; Tran et al., 2023). Under this view, earnings management can enhance the informativeness of earnings by smoothing transitory shocks or communicating long-term prospects, potentially leading to neutral or even positive market responses.

In emerging markets with varying governance quality, investors may be more sceptical of discretionary reporting practices. Limited investor protection and inconsistent monitoring increase concerns about managerial opportunism, reducing the credibility of earnings signals. As a result, earnings management is more likely to be interpreted as opportunistic rather than informative (Hammond et al., 2022; Salem et al., 2021).

H3: Earnings management has a negative effect on firm value.

2.4. Information Asymmetry and Earnings Management

Firms that are characterized by high information asymmetry grant their managers greater leeway in financial reporting due to limited external oversight. This context can create opportunities for managers to engage in earnings management, potentially influencing investor perceptions or reducing contracting costs (Eliwa et al., 2025; Habib et al., 2022). Elevated information asymmetry weakens effective monitoring and increases the likelihood of managerial opportunism. When external stakeholders cannot easily verify reported financial outcomes, managers may exploit private information to adjust earnings in ways that serve their own interests, potentially at the expense of shareholders. This dynamic is particularly pronounced in settings where disclosure standards are uneven, and enforcement mechanisms are relatively weak.

Empirical evidence supports a positive relationship between information asymmetry and earnings management, particularly in environments with weaker disclosure and monitoring mechanisms (Abad et al., 2018; Salem et al., 2021). Understanding these dynamics can help organizations improve transparency and accountability in their financial reporting, thereby fostering greater trust with investors.

H4: Information asymmetry has a positive effect on earnings management.

2.5. Financial Distress and Earnings Management

Financial distress creates incentives for managers to manage earnings in order to avoid covenant violations, maintain access to external financing, or signal financial stability (Duong et al., 2025; Dyreng et al., 2022). Managers of distressed firms may therefore engage more intensively in discretionary reporting practices (Moscariello et al., 2020). Under heightened financial pressure, managers face strong incentives to present favorable accounting outcomes to ensure firm survival and mitigate the immediate consequences of deteriorating financial performance. In this context, earnings management serves as a strategic response to contractual constraints and liquidity pressures that intensify during periods of financial distress. Beyond contractual motivations, earnings management also plays an important role in shaping external perceptions of firm performance and risk. Managers may seek to portray more stable or improved financial results in order to reassure investors, creditors, and other stakeholders about the firm's financial condition. Such behavior is particularly relevant when distressed firms are subject to increased scrutiny from capital markets, as negative signals associated with financial distress may lead to higher costs of capital, reduced investor confidence, and limited financing opportunities. Consequently, discretionary financial reporting becomes a mechanism through which managers attempt to influence stakeholder expectations and reduce uncertainty surrounding the firm's future prospects.

As financial distress deepens, managers are increasingly likely to exploit the flexibility embedded in accounting standards through discretionary accruals, revenue recognition timing, or expense classification. Prior studies document that financially constrained firms exhibit a higher propensity to engage in earnings management, although the strength of this relationship varies across institutional environments. Differences in legal enforcement, accounting regulation, and corporate governance quality may either constrain or amplify managerial discretion in financial reporting. Prior studies document that financially constrained firms are more likely to manage earnings, although the strength of this relationship varies across institutional contexts.

Financial distress has a positive effect on earnings management.

2.6. Earnings Management as a Mediating Mechanism between Information Asymmetry and Firm Value

The literature frequently assumes that earnings management serves as a mechanism through which information asymmetry influences firm value (Abu Afifa, Saleh, & Taqatqah, 2023). Under this view, higher information asymmetry leads to increased earnings management, which in turn affects how the market values the firm (Dang et al., 2023). However, whether this mediation mechanism holds in emerging markets remains an open empirical question, given increasing investor awareness of discretionary reporting behavior (Abu Afifa, Saleh, & Haniah, 2023; Al-Shouha et al., 2024).

From an information processing perspective, investors rely heavily on earnings as a primary signal in valuing firms, particularly in environments characterized by high information asymmetry. When transparency is limited, reported earnings become a key channel through which private information is reflected in market prices (Dang et al., 2023). In this context, earnings management may alter how information asymmetry is translated into firm value by shaping investors' perceptions of firm performance.

However, recent studies indicate that investors in emerging markets are increasingly capable of detecting discretionary reporting behavior and adjusting their valuation decisions accordingly (Abu Afifa, Saleh, & Haniah, 2023). This growing awareness suggests that earnings management may not always function as an effective transmission mechanism between information asymmetry and firm value. Instead, its mediating role depends on the extent to which investors interpret managerial discretion as informative or opportunistic (Al-Shouha et al., 2024). Therefore, examining earnings management as a mediating variable provides a more nuanced understanding of the indirect effect of information asymmetry on firm value.

H6: Earnings management mediates the relationship between information asymmetry and firm value.

2.7. Earnings Management as a Mediating Mechanism between Financial Distress and Firm Value

Similarly, prior studies suggest that financial distress may influence firm value indirectly through earnings management (Abu Afifa, Saleh, & Taqatqah, 2023; Al-Shouha et al., 2024; Mukhtaruddin et al., 2022). Managers of distressed firms may attempt to improve market perceptions through discretionary reporting, thereby affecting valuation outcomes (Charitou et al., 2007). Despite its theoretical appeal, this mediation pathway has produced mixed empirical results, particularly in markets with heterogeneous governance practices.

Financial distress increases information risk and heightens investor sensitivity to accounting signals. Managers of financially distressed firms may engage in earnings management to mitigate negative market reactions by presenting a more stable financial performance (Charitou et al., 2007; Mukhtaruddin et al., 2022). As a result, earnings management may serve as an intervening mechanism through which financial distress influences firm value.

Nevertheless, empirical evidence suggests that the effectiveness of this mediation pathway varies across institutional environments. In markets with heterogeneous governance quality, discretionary reporting by distressed firms is often interpreted as opportunistic behavior, leading to stronger valuation discounts (Al-Shouha et al., 2024). This indicates that earnings management does not automatically translate financial distress into firm value but operates within a broader informational and governance context.

H7: Earnings management mediates the relationship between financial distress and firm value.

2.8. *Corporate Governance and Firm Value*

Corporate governance mechanisms are designed to align managerial actions with shareholder interests and enhance transparency (Roohani et al., 2009). Strong governance is generally associated with lower agency costs, improved disclosure quality, and higher firm value (Assidi, 2020; Siagian et al., 2013). In emerging markets, governance quality varies substantially across firms and may serve as an important signal of credibility to investors (Ararat et al., 2021).

In emerging markets, corporate governance plays a crucial role in enhancing firm value by reducing agency conflicts and information risk. Strong governance mechanisms signal managerial commitment to transparency and accountability, thereby increasing investor confidence (Assidi, 2020; Ararat et al., 2021). Firms with superior governance structures are more likely to achieve higher market valuations due to improved disclosure quality and reduced uncertainty.

H8: Corporate governance has a positive effect on firm value.

2.9. *Corporate Governance and Earnings Management*

Corporate governance also plays a critical role in shaping managerial reporting behavior (Cooray et al., 2020; Salehi et al., 2023). Strong governance mechanisms are expected to constrain opportunistic earnings management by enhancing oversight and monitoring effectiveness (Wasan et al., 2020). Empirical evidence generally supports a negative association between governance quality and earnings management (Abbadi et al., 2016).

H9: Corporate governance has a negative effect on earnings management.

Effective corporate governance strengthens internal monitoring mechanisms that limit managerial discretion in financial reporting. By increasing oversight and accountability, strong governance reduces incentives for opportunistic earnings management practices (Abbadi et al., 2016; Salehi et al., 2023).

2.10. *Corporate Governance as a Moderator of the Earnings Management–Firm Value Relationship*

Beyond its direct effects, corporate governance may influence how investors interpret earnings management (Man et al., 2013; Shen et al., 2007). In firms with stronger governance structures, discretionary reporting may be perceived as more constrained and credible, reducing its negative valuation impact (Pham et al., 2019). This perspective emphasizes governance as an interpretive framework rather than solely a behavioral constraint, particularly relevant in emerging market contexts (de Villiers et al., 2021; Moscariello et al., 2020).

Corporate governance influences how investors interpret earnings management. In firms with strong governance, discretionary reporting is perceived as more controlled and credible, thereby weakening its negative impact on firm value (Pham et al., 2019). Conversely, weak governance amplifies investor skepticism and strengthens the adverse valuation effects of earnings management, highlighting governance as an interpretive framework rather than merely a control mechanism (de Villiers et al., 2021).

H10: Corporate governance moderates the relationship between earnings management and firm value.

Figure 1 illustrates the conceptual research model linking information asymmetry, financial distress, earnings management, corporate governance, and firm value. The model proposes that IA and FD influence firm value both directly and indirectly through earnings management, while corporate governance plays a conditioning role by moderating the relationships between IA, FD, and EM as well as between EM and firm value. This structure reflects the view that earnings management does not operate as a uniform value-reducing mechanism, but rather as a context-dependent signal whose valuation consequences depend on governance quality and firms' informational and financial conditions.

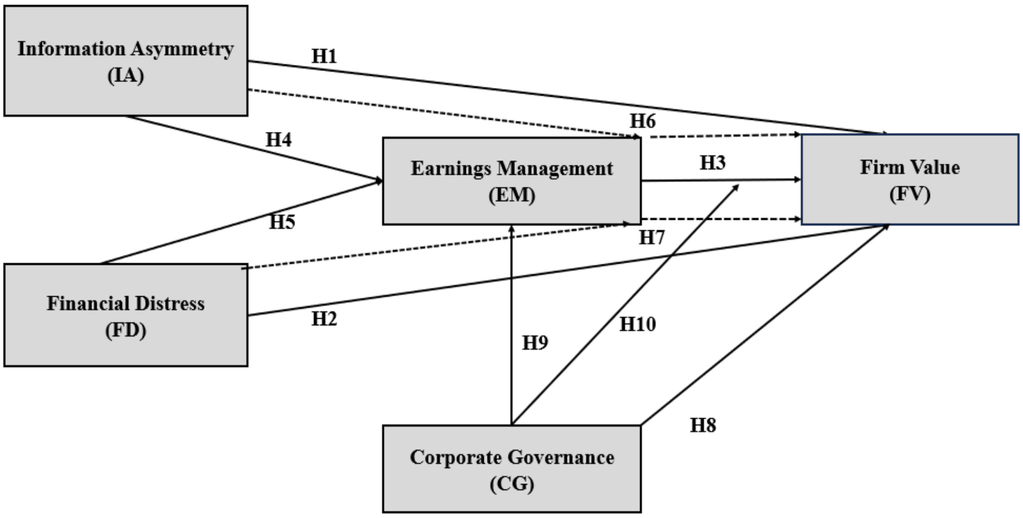

Fig. 1. Research Framework

3. Research Method and Materials

3.1. Research Design

This study employs a quantitative explanatory research design to examine how firm value is associated with information asymmetry, financial distress, earnings management, and corporate governance. The research framework is conceptually informed by a fishbone-style problem-structuring approach, which is used to identify potential causal factors underlying the research problem and to guide the formulation of the empirical model. In particular, the study investigates whether earnings management operates as a market-evaluated signal and whether corporate governance conditions the valuation consequences of discretionary reporting behavior.

Given the interdependent nature of the proposed relationships and the presence of mediating and moderating mechanisms, the study adopts a path-based structural modeling approach using observed variables. This approach allows for the simultaneous estimation of direct effects, indirect effects through earnings management, and interaction effects involving corporate governance, in line with the empirical structure of the research model.

3.2. Data and Sample

The empirical analysis relies on firm-level secondary data obtained from publicly available financial statements and market data sources. The study population consists of non-financial public listed firms operating in the manufacturing and manufacturing-related sectors on the Indonesia Stock Exchange. These sectors include basic materials, consumer goods, industrials, chemicals, food and beverage, pharmaceuticals, metals, and production-oriented mining activities. Financial institutions and pure service firms are excluded due to their distinct regulatory environments and financial reporting characteristics.

The sample is selected using a purposive sampling approach. Firms are included if they are listed during the observation period, publish complete annual financial statements and corporate governance disclosures, and provide sufficient data to measure all research variables. Observations with missing values on key variables are excluded to ensure internal consistency in model estimation. After applying these criteria, the final dataset consists of 1,321 firm-year observations, forming an unbalanced panel. This sample size is adequate for estimating interaction effects and indirect relationships within a structural modeling framework.

3.3. Variable Operationalization

All variables are operationalized using established measures commonly applied in the accounting and finance literature to ensure transparency, comparability, and replicability. Table 1 summarizes the definitions, measurement approaches, and analytical roles of all variables included in the empirical model.

Table 1. Variable Operationalization

Variable	Definition	Measurement	Scale
Firm Value (FV)	Market-based firm valuation reflecting investor assessment of firm performance	Tobin's Q = (Market Value of Equity + Book Value of Debt) / Total Assets, where the market value of equity equals the stock price multiplied by shares outstanding and the book value of debt equals total liabilities (Chung et al., 1994; Tobin, 1969)	Ratio
Information Asymmetry (IA)	Degree of information opacity between managers and investors	Relative Bid–Ask Spread = (Ask − Bid) / [(Ask + Bid) / 2] (McInish et al., 1992; Said et al., 2009)	Ratio
Financial Distress (FD)	Firm-level financial pressure and bankruptcy risk	Altman Z Score calculated using accounting and market-based ratios (Altman, 1968)	Index
Earnings Management (EM)	Managerial discretion in financial reporting	Discretionary accruals estimated using the Modified Jones Model (Dechow et al., 1995; Enomoto et al., 2015)	Ratio
Corporate Governance (CG)	Strength of firm-level governance structures	Composite governance index based on board independence, board size, audit committee activity, institutional ownership, board meeting frequency, and gender diversity (Ammann et al., 2011; Carter et al., 2003; Said et al., 2009; Siregar et al., 2008)	Index (0–1)
Firm Size (SIZE)	Firm scale and operational magnitude	Natural logarithm of total assets (Fosu et al., 2016)	Log ratio
Leverage (LEV)	Capital structure risk reflecting debt intensity	Total debt divided by total equity (Rajan et al., 1995)	Ratio

3.4. Constructs Measurement

Earnings management is conceptualized as managerial discretion in financial reporting rather than as an inherently opportunistic activity. It is measured using discretionary accruals estimated through the Modified Jones Model, which separates discretionary components of accruals from normal reporting behavior. This approach captures accrual-based earnings management while controlling for firm-specific operating conditions.

Information asymmetry is measured using a market-based indicator reflecting the degree of informational opacity faced by external investors. Financial distress is measured using the Altman Z Score, which captures firm-level solvency risk based on a combination of accounting and market indicators. Corporate governance is measured using a composite index reflecting the strength of monitoring and control mechanisms at the firm level. Firm size and leverage are included as control variables to account for scale effects and differences in capital structure.

3.5. Model Specification

To test the proposed hypotheses, the study estimates a system of two structural equations incorporating direct, indirect, and interaction effects. The model specification follows the empirical structure of the conceptual framework.

3.5.1. Earnings Management Equation

$$EM_i = \alpha_0 + \alpha_1 AI_i + \alpha_2 FD_i + \alpha_3 (CG \times AI)_i + \alpha_4 (CG \times FD)_i + \varepsilon_{1i} \quad (1)$$

This equation examines whether information asymmetry and financial distress influence earnings management and whether these relationships are conditioned by corporate governance.

3.5.2. Firm Value Equation

$$FV_i = \beta_0 + \beta_1 AI_i + \beta_2 FD_i + \beta_3 EM_i + \beta_4 SIZE_i + \beta_5 LEV_i + \beta_6 (CG \times EM)_i + \varepsilon_{2i} \quad (2)$$

This equation captures the direct effects of information asymmetry, financial distress, and earnings management on firm value, as well as the moderating role of corporate governance in the earnings management–firm value relationship.

3.6. Estimation Technique

The estimation of the equations uses a path analysis approach within a structural equation modeling framework, focusing on observed variables. By applying maximum likelihood estimation for parameters, we gain robust insights. This method effectively analyzes structural relationships, exploring mediation and moderation within a coherent empirical framework. For this analysis, the software utilized was Stata MP-16, which supports the rigorous examination of these relationships.

3.7. Indirect and Conditional Effects

To evaluate the indirect relationships proposed in the hypotheses, the study examines whether earnings management mediates the associations between information asymmetry, financial distress, and firm value. In addition, moderated mediation structures are assessed by evaluating whether corporate governance conditions both the formation of earnings management and its valuation relevance. These effects are interpreted as context-dependent associative mechanisms rather than dominant causal pathways.

4. Results and Discussion

4.1. Descriptive Statistics

Table 2 presents the descriptive statistics for all variables included in the empirical analysis. The final sample consists of 1.321 firm-year observations, indicating complete data coverage across all main variables, control variables, and interaction terms.

FV shows substantial variation, with a mean of 1.5189 and a standard deviation of 1.6883, reflecting heterogeneous market valuation outcomes across firms. EM is centered close to zero, with a mean of –0.0016 and a relatively low standard deviation (0.0309), indicating that discretionary accrual practices are generally modest in magnitude but vary across firms.

FD displays pronounced dispersion, with a standard deviation of 6.2847, suggesting considerable heterogeneity in firms' solvency conditions. IA also exhibits wide variation, consistent with differences in disclosure quality and trading frictions across firms. CG demonstrates moderate dispersion, indicating meaningful variation in governance quality within the sample.

Among the control variables, SIZE appears relatively stable, while LEV exhibits substantial variability, reflecting diverse capital structure positions. The interaction terms involving corporate governance show sufficient spread, supporting their relevance for moderation analysis.

4.2. Structural Model

The baseline structural model estimates the direct relationships among information asymmetry, financial distress, earnings management, and firm value without interaction terms. The model yields an R-squared of 0.0100, indicating limited explanatory power when only direct effects are considered. This result suggests that firm value is not sufficiently explained by direct associations alone, underscoring the importance of incorporating conditional mechanisms into the empirical framework.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. dev.	Min	Max
FV	1.321	1.5189	1.6883	0.1996	26.0816
EM	1.321	-0.0016	0.0309	-0.2471	0.4345
FD	1.321	3.6985	6.2847	-27.6575	85.6235
IA	1.321	1.9464	2.8477	0.0000	52.9192
CG	1.321	0.3353	0.0648	0.0794	0.5756
SIZE	1.321	28.6393	1.6745	24.6024	33.7900
LEV	1.321	1.4581	5.0212	-30.1534	114.2896
CG × EM	1.321	-0.0005	0.0104	-0.0737	0.1378
CG × IA	1.321	0.6429	0.9541	0.0000	16.8722
CG × FD	1.321	1.2299	2.1272	-9.2967	35.3916

4.3. Direct Effects on Firm Value

Table 3 reports the direct effects of information asymmetry, financial distress, earnings management, and control variables on firm value. Information asymmetry is negatively and statistically significantly associated with firm value (coefficient = –0.0386; p = 0.020), indicating that firms operating in more opaque information environments tend to receive lower market valuations.

Earnings management also exhibits a negative and statistically significant relationship with firm value (coefficient = –3.8756; p = 0.010), suggesting that discretionary accrual behavior is penalized by the market. In contrast, financial distress does not display a statistically significant direct effect on firm value. Among the control variables, firm size is negatively associated with firm value, whereas leverage has no statistically significant effect.

Table 3. Direct Effects on Firm Value

Variable	Coefficient	Std. Error	t-statistic	p-value
IA	-0.0386	0.0166	-2.33	0.020
FD	0.0000	0.0001	0.00	0.997
EM	-3.8756	1.5022	-2.58	0.010
SIZE	-0.0589	0.0280	-2.10	0.036
LEV	-0.0006	0.0095	-0.06	0.950

Based on the research results in table 3, the following equation is obtained:

$$\widehat{FV} = \alpha_0 - 0.0386IA + 0.0000FD - 3.8756EM - 0.0589SIZE - 0.0006LEV + \varepsilon \quad (3)$$

The estimated structural equation indicates that firm value is negatively associated with information asymmetry and earnings management. Specifically, a one-unit increase in information asymmetry decreases firm value by 0.0386 units ($\beta = -0.0386$, $p = 0.020$), indicating that firms operating in more opaque information environments tend to receive lower market valuations. Earnings management exhibits a much stronger negative effect, whereby a one-unit increase in discretionary accruals reduces firm value by 3.8756 units ($\beta = -3.8756$, $p = 0.010$), suggesting that investors penalize firms engaging in discretionary reporting. In contrast, financial distress has an estimated coefficient close to zero ($\beta = 0.0000$, $p = 0.997$), indicating that financial distress does not exert a statistically significant direct effect on firm value. Among the control variables, firm size negatively affects firm value ($\beta = -0.0589$, $p = 0.036$), whereas leverage does not have a significant influence ($\beta = -0.0006$, $p = 0.950$).

4.4. Direct Effects on Earnings Management

Table 4 presents the direct effects of information asymmetry and financial distress on earnings management. Information asymmetry is not statistically significant in its association with earnings management. Financial distress shows a weak negative association with earnings management, indicating marginal statistical significance. Overall, these findings suggest that earnings management is not strongly driven by information asymmetry or financial distress in isolation, implying that additional contextual or governance-related factors may influence discretionary reporting behavior.

Based on the research results in table 4, the following equation is obtained:

$$\widehat{EM} = \beta_0 + 0.0004IA - 0.0002FD + \varepsilon \quad (4)$$

The estimated earnings management equation shows that information asymmetry has a small positive coefficient (β = 0.0004, p = 0.179), indicating that firms with greater information asymmetry tend to exhibit slightly higher discretionary accruals. However, this relationship is not statistically significant, suggesting that information asymmetry alone is insufficient to explain earnings management practices. Financial distress has a weak negative coefficient (β = −0.0002, p = 0.078), implying that financially distressed firms tend to reduce discretionary accruals, although the effect is only marginally significant. Overall, these findings indicate that neither information asymmetry nor financial distress serves as a dominant determinant of earnings management within the sampled firms.

Table 4. Direct Effects on Earnings Management

Variable	Coefficient	p-value
IA	0.0004	0.179
FD	-0.0002	0.078

4.5. Indirect Effects via Earnings Management

The mediation analysis examines whether earnings management transmits the effects of information asymmetry and financial distress to firm value. No statistically significant indirect effects are observed for either pathway. These findings indicate that earnings management does not mediate the relationship between information asymmetry or financial distress and firm value in the baseline specification.

Table 5. Indirect Effects via Earnings Management

Path	Result
IA → EM → FV	Not significant
FD → EM → FV	Not significant

The equation is as follows:

$$IA \rightarrow EM \rightarrow FV = 0.0004 \times (-3.8756) = -0.0016 \quad (5)$$
$$FD \rightarrow EM \rightarrow FV = (-0.0002) \times (-3.8756) = 0.0008 \quad (6)$$

The indirect effects indicate that earnings management does not significantly mediate the relationships between information asymmetry and firm value or between financial distress and firm value. The indirect effect of information asymmetry on firm value is estimated at −0.0016, whereas the indirect effect of financial distress is approximately 0.0008. Although these coefficients indicate the direction of the indirect relationships, both effects are statistically insignificant, suggesting that earnings management does not function as the transmission mechanism linking information asymmetry or financial distress to firm value.

4.6. Moderation Role of Corporate Governance

To examine the conditional role of corporate governance, interaction terms are introduced into the structural model. The moderated specification yields an R-squared of 0.3698, representing a substantial improvement in explanatory power relative to the baseline model.

4.7. Moderation Effects on Firm Value

Earnings management remains negatively associated with firm value. Importantly, the interaction between corporate governance and earnings management is positive and highly significant, indicating that stronger governance mitigates the negative valuation consequences of earnings management.

Table 6. Moderation Effects on Firm Value

Variable	Coefficient	p-value
EM	-44.7941	< 0.0001
CG × EM	122.8940	< 0.0001

Based on the research results in table 6, the following equation is obtained:

$$\widehat{FV} = \alpha_0 - 44.7941EM + 122.8940(CG \times EM) + \varepsilon \quad (7)$$

The moderation model demonstrates that earnings management has a substantial negative direct effect on firm value (β = −44.7941, p < 0.001). This finding indicates that, in firms with relatively weak governance, higher earnings management substantially reduces market valuation. However, the interaction term between corporate governance and earnings management is positive and highly significant (β = 122.8940, $p < 0.001$), indicating that stronger corporate governance weakens the adverse impact of earnings management on firm value. In other words, corporate governance acts as a buffering mechanism that enhances the credibility of discretionary reporting, thereby reducing investors' negative reactions toward earnings management.

4.8. Moderation Effects on Earnings Management

The interaction between corporate governance and information asymmetry is not statistically significant. The interaction between corporate governance and financial distress is marginally statistically significant, suggesting a limited conditional influence of governance on earnings management behavior.

Table 7. Moderation Effects on Earnings Management

Variable	Coefficient	p-value
CG × IA	0.0012	0.187
CG × FD	-0.0007	0.067

The results indicate that firm value is negatively associated with information asymmetry and earnings management, while financial distress does not exert a significant direct effect. Earnings management does not mediate the relationships between the main explanatory variables and firm value. Corporate governance plays a meaningful conditional role by moderating the association between earnings management and firm value, whereas its moderating effects on earnings management itself are limited.

Based on the research results in table 7, the following equation is obtained:

$$\widehat{EM} = \beta_0 + 0.0012(CG \times IA) - 0.0007(CG \times FD) + \varepsilon \quad (8)$$

The moderation equation indicates that corporate governance has only a limited moderating role in explaining earnings management behavior. The interaction between corporate governance and information asymmetry shows a positive but statistically insignificant coefficient (β = 0.0012, p = 0.187), indicating that governance quality does not materially alter the relationship between information asymmetry and earnings management. Likewise, the interaction between corporate governance and financial distress is negative (β = −0.0007, p = 0.067), suggesting that stronger governance slightly weakens the effect of financial distress on earnings management. Nevertheless, this relationship is only marginally significant, implying that corporate governance exerts a considerably stronger moderating influence on market valuation than on managerial reporting behavior.

4.9. Discussion

This study set out to examine how information asymmetry, financial distress, and earnings management shape firm value, and whether corporate governance conditions these relationships in an emerging market context. The findings provide several important insights that extend prior literature by clarifying when and how the market evaluates discretionary reporting behavior, rather than assuming a uniform valuation response.

4.9.1. Information Asymmetry, Earnings Management, and Firm Value

The results indicate that information asymmetry is negatively associated with firm value, supporting the view that opaque information environments reduce investor confidence and increase perceived risk. This finding is consistent with theoretical arguments suggesting that higher information frictions weaken the credibility of financial disclosures and impair market valuation (Hann et al., 2020; Kim, 2025; Salem et al., 2021). Prior evidence shows that even high-status firms experience adverse stock market reactions following the disclosure of accounting irregularities, although these effects are mitigated when firms proactively self-report and are supported by strong financial performance (Kim, 2025). However, information asymmetry does not exhibit a statistically significant direct association with earnings management, suggesting that opacity alone does not automatically induce discretionary reporting behavior.

This pattern challenges a simplistic assumption often implied in prior studies that greater information asymmetry mechanically leads to more aggressive earnings management. Instead, the findings suggest that discretionary reporting practices are shaped by broader organizational and governance contexts rather than information conditions in isolation. Instead, the findings suggest that discretionary reporting practices are shaped by broader organizational and governance contexts rather than information conditions in isolation. Evidence also shows that financially constrained firms strategically rely on discretionary accruals to signal positive future prospects to external capital providers, rather than engaging in real activities manipulation that would erode long-term firm value (Lee et al., 2023).

The negative association between information asymmetry and firm value observed in this study is broadly consistent with evidence reported in other Asian emerging economies. For example, studies conducted in Vietnam have documented that higher information asymmetry increases the cost of capital and reduces firm valuation because investors demand greater compensation for informational risk (Huynh et al., 2020). Similarly, evidence from Malaysia indicates that firms operating in less transparent information environments experience lower market confidence and wider bid–ask spreads, ultimately reducing firm value (Said et al., 2009). These findings suggest that information transparency remains a critical determinant of market valuation across Southeast Asian emerging markets.

Earnings management itself is negatively associated with firm value, indicating that the market penalizes discretionary accrual behavior when it is observed or inferred by investors. This result reinforces the view that earnings management is not neutral from a valuation perspective and that investors can discount reported earnings when reporting discretion is perceived as opportunistic or value-distorting. Recent findings further indicate that profitability can be negatively and significantly associated with firm value, suggesting that strong accounting performance does not automatically translate into favorable market valuation (Meliza et al., 2025).

The finding that earnings management negatively affects firm value is also consistent with evidence from several emerging economies outside Indonesia. In Jordan, Abu Afifa et al. (2023) reported that investors tend to discount firms engaging in aggressive discretionary accruals because such practices reduce the credibility of financial reporting. Likewise, research conducted in Vietnam by Duong et al. (2025) found that financially constrained firms are more likely to engage in earnings management; however, the market generally interprets such reporting discretion as opportunistic rather than informative. Comparable evidence has also been documented in several Latin American markets, where weak institutional enforcement and limited investor protection increase investor skepticism toward discretionary accounting practices, leading to lower firm valuations.

4.9.2. Financial Distress and Direct Valuation Effects

Contrary to some expectations, financial distress does not exert a statistically significant direct effect on firm value in the baseline model (Duong et al., 2025). This finding suggests that financial distress, as captured by accounting-based indicators, does not uniformly translate into lower market valuation once other firm characteristics are taken into account. One possible interpretation is that investors differentiate between temporary financial pressure and structural solvency risk, particularly in environments where firms operate under heterogeneous governance and reporting practices.

Similarly, financial distress does not strongly predict earnings management behavior, indicating that distressed firms do not systematically engage in discretionary reporting as a dominant response. Together, these findings imply that financial distress alone is insufficient to explain either reporting behavior or valuation outcomes without considering the institutional mechanisms that shape managerial discretion.

4.9.3. Moderating Role of Corporate Governance

The most important contribution of this study lies in its examination of the moderating role of corporate governance. The results show that corporate governance significantly conditions the relationship between earnings management and firm value. While earnings management is negatively associated with firm value on average, this negative association is substantially attenuated in firms with stronger governance structures. Studies on governance structures further document that board characteristics and ownership composition influence firms' risk-taking behavior, highlighting the strategic role of governance mechanisms in shaping managerial decisions (T. Van Nguyen et al., 2025).

This finding extends previous studies from emerging markets that primarily viewed corporate governance as a monitoring mechanism designed to constrain managerial opportunism. Consistent with evidence reported by Ararat et al. (2021) across emerging economies and Pham et al. (2019) in Australia, the present study suggests that governance performs an additional interpretive role by enhancing the credibility of discretionary reporting. Consequently, investors appear to evaluate earnings management not solely based on accounting outcomes but also on the governance environment in which those reporting decisions are made.

This finding suggests that the market does not evaluate earnings management in a vacuum. Instead, investors appear to assess discretionary reporting behavior through the lens of governance quality. In firms with stronger governance, earnings management may be interpreted as a flexible reporting response to complex operating conditions rather than as opportunistic manipulation. In contrast, similar reporting behavior in weakly governed firms is more likely to be discounted by the market.

Importantly, corporate governance does not strongly moderate the effects of information asymmetry or financial distress on earnings management itself. This indicates that governance plays a more critical role at the valuation stage rather than at the reporting decision stage. In other words, governance shapes how the market interprets earnings management, rather than simply suppressing managerial discretion.

4.9.4. Earnings Management in Market Valuation

These findings contribute to a more nuanced understanding of earnings management. Rather than viewing earnings management solely as a value-destroying practice, the results suggest that its valuation consequences depend on the institutional context in which it occurs. Earnings management appears to function as a conditional signal, with its interpretation mediated by corporate governance quality.

This perspective helps reconcile mixed findings in the literature regarding the consequences of earnings management. It also aligns with theoretical arguments that emphasize governance as a credibility-enhancing mechanism that allows investors to distinguish between informative discretion and opportunistic manipulation (Bansal, 2024).

4.9.5. Implications for Theory, Practice, and Policy

From a theoretical standpoint, this study advances the literature by explicitly modeling corporate governance as a conditioning mechanism rather than as a direct determinant of firm value. The findings highlight the importance of moving beyond direct-effect frameworks and incorporating interaction structures to capture better the institutional complexity of financial reporting and valuation processes.

From a practical perspective, the results suggest that strengthening governance mechanisms can mitigate the adverse valuation effects associated with discretionary reporting. For managers, this implies that reporting flexibility is more likely to be tolerated when supported by credible governance structures. For investors, the findings underscore the importance of evaluating earnings quality jointly with governance indicators rather than in isolation.

At the policy level, the findings suggest that regulators, particularly the Indonesian Financial Services Authority (OJK), should strengthen corporate governance oversight by enhancing governance disclosure requirements, improving board and audit committee effectiveness, and incorporating governance quality into supervisory assessments to improve financial reporting credibility. For international institutional investors, the results highlight the importance of integrating corporate governance indicators into investment screening and valuation models rather than relying solely on accounting performance, as stronger governance can mitigate the adverse market perception of earnings management. These recommendations are also relevant for other emerging economies with concentrated ownership structures and relatively weak investor protection, where governance reforms can enhance market transparency, strengthen investor confidence, and promote more efficient capital market development.

5. Conclusion

This study examines how information asymmetry, financial distress, and earnings management are associated with firm value, with particular attention to the conditioning role of corporate governance. Using a path-based analytical framework applied to publicly listed firms in Indonesia, the findings offer a more nuanced understanding of how the market evaluates discretionary reporting behavior across different governance contexts. The results indicate that information asymmetry and earnings management are negatively associated with firm value, while financial distress does not exert a uniform direct effect. More importantly, the study shows that the valuation consequences of earnings management are not homogeneous. Corporate governance plays a critical role in shaping how investors interpret discretionary accrual behavior. Stronger governance structures significantly attenuate the negative association between earnings management and firm value, suggesting that governance enhances the credibility of reported earnings and moderates market skepticism toward managerial discretion. Rather than positioning earnings management as inherently value-destroying, this study highlights its context-dependent nature. Discretionary reporting appears to function as a market-evaluated signal whose implications depend on the institutional framework in which it occurs. Corporate governance emerges not merely as a monitoring mechanism that constrains behavior, but as an interpretive lens through which investors assess the reliability and intent of financial reporting.

These findings contribute to the literature by emphasizing the importance of modeling governance as a conditioning mechanism rather than as a direct determinant of firm value. By integrating moderation and mediation structures into a unified empirical framework, the study advances prior research that has focused mainly on isolated direct effects. The results underscore the need for future research to account for institutional and governance heterogeneity when examining the economic consequences of financial reporting practices. From a practical perspective, the findings suggest that firms seeking to preserve market credibility should view governance quality as an integral complement to reporting discretion. For regulators and policymakers, the results support approaches that strengthen governance transparency and effectiveness, enabling markets to better distinguish between informative reporting flexibility and opportunistic earnings manipulation.

Overall, this study reinforces the view that firm value is shaped not only by financial outcomes and reporting choices, but also by the institutional structures that frame how the market interprets those choices.

Acknowledgements

The authors gratefully acknowledge the institutional support provided by Universitas Pembangunan Nasional Jakarta (UPNVJ), notably the Institute for Research and Community Service (LPPM), the Faculty of Economics and Business, and the Department of Accounting.

Funding

This research received financial support from UPNVJ.

Conflicts of Interest

The authors declare no conflicts of interest

Data Availability Statement

The data supporting the findings of this study are available from the corresponding author upon reasonable request

Ethics Approval

Ethical approval was not required as the study relies solely on secondary data from publicly accessible sources and does not involve human participants.

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