THE EFFECT OF PRUDENCE, PROFIT GROWTH, CAPITAL STRUCTURE, AND MANAGERIAL ABILITY ON SUSTAINABLE EARNINGS

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Abstrak

Background: Sustainable earnings reflect earnings quality that is not only high in nominal terms but not also concistent and maintanable in the future.
Objective: Empirical findings regarding the factors influencing sustainable earnings have remained inconsistent across previous studies.
Research Methods: This research is conducted using a quantitative framework to evaluate the analysis on four independent factors on Sustainable Earnings. The research focuses on firms operating within the healthcare industry and publicly traded on the Indonesian capital market. Using purposive sampling based on predetermined criteria, 21 companies were selected as the research sample. Panel data regression was employed to analyze observations covering the 2020–2024 period, with the analysis conducted using EViews 12.
Research Results: The empirical findings indicate that Sustainable Earnings are significantly influenced by Prudence and Managerial Ability. In contrast, Profit Growth and Capital Structure were found to have no statistically significant relationship with Sustainable Earnings.
Originally/Novelty of Research: This study contribute to the literature by directly employing sustainable earnings as the dependent variable to provide a more spesific assessment of earnings sustainability.
Keywords: Sustainable earnings, Prudence, Profit Growth, Capital Struture, Managerial Ability.

Introduction

The phenomenon experienced by PT. Indofarma Tbk in the first half of 2024 experienced a net loss of IDR 101.9 billion, which showed a decrease of 15.2% compared to a loss of IDR 120.3 billion in the 2023 period. This decrease in losses was driven by a significant decline in net sales, which fell drastically by 69.8% from IDR 363.9 billion to IDR 109.7 billion. This resulted in gross profit falling from IDR 13.6 billion to IDR 1.3 billion (Source: CNBC Indonesia). Although PT. Indofarma experienced a decrease in losses, total debt increased by 13.3% from IDR 1.5 trillion in December 2023 to IDR 1.7 trillion as of June 2024, with short-term liabilities reaching IDR 1.3 trillion. Meanwhile, total assets increased from IDR 759.8 billion to IDR 821.4 billion, dominated by current assets (Source: CNBC Indonesia). A similar case was also experienced by PT. Kimia farma Tbk, in 2023 PT. Kimia Farma suffered a loss of IDR 1.82 trillion, which was the largest loss ever experienced by the company. This loss was caused by several factors, including a decrease in revenue from the pharmaceutical and distribution segment, an increase in operating costs, and the impact of restructuring and efficiencies in subsidiaries (Source: CNN Indonesia).

These cases indicate that favorable changes in reported profit do not automatically imply that the resulting earnings can be maintained in subsequent periods. Variations in sales, liabilities, assets, and operating costs may alter the quality and stability of reported performance. For this reason, sustainable earnings should be examined from more than a single profitability indicator. The present study focuses on four potential determinants.

Prudence represents a reporting approach that places greater emphasis on the timely recognition of unfavorable economic consequences than on the premature recognition of favorable ones. Such treatment can limit excessive income recognition and make reported performance less susceptible to short-term distortion. In relation to Sustainable Earnings, Prudence is relevant because it may help distinguish earnings generated by continuing operations from gains that are temporary in nature. The consistent application of this principle can consequently contribute to the credibility and continuity of reported earnings (Darmawan et al., 2024).

Profit Growth describes the movement of a firm's earnings between periods and can reflect changes in sales, operating efficiency, or other components of performance. Although increasing profit may be interpreted as evidence of improving financial conditions, the persistence of that increase is more important when assessing earnings sustainability. Growth that is repeatedly supported by the firm's normal activities may provide stronger evidence of sustainable performance than an increase arising from temporary events (Yuliana & Jelanti, 2025).

Capital Structure concerns how a company combines owners' funds with external financing to support its activities. The selected financing mix can influence financial exposure because debt creates contractual payment commitments, whereas equity does not impose the same fixed obligations. Differences in this financing arrangement may therefore be reflected in the firm's ability to preserve earnings performance. Accordingly, the relationship between leverage and Sustainable Earnings deserves empirical examination (Priskanodi et al., 2022).

The last influencing factor *sustainable earnings* that is, managerial ability (*management ablity*) which is used to measure the effectiveness and efficiency of the management team in managing the company's resources to achieve financial and operational objectives. Managers who have good competence can improve operational efficiency, reduce costs, and can manage risk well to prevent profit fluctuations, so that they can support a good profit. *sustainable* (Lukita, 2022). This research is based on the studies of Lukita, (2022), Desyana, *et al* (2024), and Mardiana, *et al* (2022). The present study integrates selected variables identified in prior research as potential determinants of sustainable earnings. As well as using *the sustainable earnings* variable as a dependent variable, which previously researchers used the profit quality variable with *a sustainable earnings* measurement tool, the researcher modified the use of the variable by directly using *the sustainable earnings* variable as a dependent variable in this study.

Previous empirical evidence has not produced a consistent conclusion concerning the factors that determine sustainable earnings, especially in Indonesian healthcare firms. The post-pandemic environment also presents challenges for companies seeking to preserve stable financial performance. Earnings sustainability is therefore relevant to investors, creditors, and other stakeholders who assess the reliability of future performance. Further empirical examination is needed to clarify the relationships between four determinants (Romadhon & Kusuma, 2020).

The contribution of this research is reflected in its direct use of Sustainable Earnings as the dependent variable rather than treating it merely as a proxy or component of earnings quality. The analysis incorporates several explanatory factors into the model simultaneously, based on observations of firms in the healthcare industry during the 2020–2024 period.

Considering the observed phenomenon, the mixed results of earlier research, and the contribution offered by this study, This research investigates the determinants of Sustainable Earnings based on observations of firms operating in the healthcare industry during 2020–2024.

Literature Review

Within the accounting context, Agency Theory explains that information mechanisms are required to limit managerial behavior that may conflict with the interests of the principal. One of these mechanisms is the application of *prudence* or the principle of prudence in financial reporting. The application of prudence results in losses being recognized more promptly, while gains are recognized more gradually, which can reduce the space for managers to manipulate profits for short-term goals. Thus, prudence serves as a supervisory tool to reduce the impact of agency conflicts and suppress information asymmetry between managers and investors. *Prudence,* which is rooted in agency theory, is regarded as contributing to greater credibility in financial reporting and protect the interests of the principal against the opportunistic behavior of agents (Azahra *et al*., 2024).

Capital Structure can also be interpreted within Agency Theory as a means of influencing managerial incentives. When a firm obtains debt financing, managers must meet predetermined interest and principal obligations. These commitments can place limits on discretionary use of corporate funds and may encourage more disciplined resource allocation. From this perspective, financing decisions can affect agency costs and may have implications for the continuity of earnings (Adityaputra & Astuti, 2025).

In accounting research, agency theory emphasizes the importance of information control mechanisms to minimize the risk of managers acting in self-interest. One of these mechanisms is the application of *prudence* or the principle of prudence in financial reporting. The prudential principle leads to faster recognition of losses and slower recognition of profits, which can reduce the space for managers to manipulate profits for short-term goals. Thus, prudence serves as a supervisory tool to reduce the impact of agency conflicts and suppress information asymmetry between managers and investors. *Prudence*, which is rooted in agency theory, is considered to be able to increase the credibility of financial statements and protect the interests of the principal against the opportunistic behavior of agents (Azahra *et al*., 2024).

Hypothesis

The implementation of Prudence can constrain managerial discretion in recognizing income and thereby reduce incentives for short-term earnings manipulation. More cautious recognition may produce financial information that better reflects recurring performance. Empirical evidence from Sandra and Lukman (2025) indicates a positive relationship between accounting conservatism and earnings quality, while Misnoni and Mayangsari (2023) report that Prudence is associated with earnings quality. These findings suggest that cautious recognition practices can strengthen confidence in reported earnings and potentially support their sustainability.

H1: *Prudence* positively influences *sustainable earnings*

Under Signal Theory, financial performance can communicate information about a company's future condition to external parties. An increase in earnings may therefore be interpreted as a favorable indication, particularly when the improvement is generated by recurring activities and can be maintained. Prior findings have linked profit growth with earnings quality and have suggested that more consistent growth tends to accompany greater earnings stability (Mardiana et al., 2022; Putri, 2022). These arguments lead to the following hypothesis:

H2: Profit growth positively influences *sustainable earnings*

Agency Theory indicates that financing decisions may shape managerial behavior because debt introduces obligations that must be fulfilled regardless of operating outcomes. The resulting pressure may encourage managers to exercise greater discipline in the use and reporting of corporate resources. Evidence reported by Anam (2023) suggests that capital structure is positively associated with earnings quality. Based on this reasoning, the following hypothesis is proposed:

H3: Capital structure positively influences *sustainable earnings*

From the agency perspective, managerial competence may reduce inefficient resource use and improve the quality of managerial decisions. Managers who are able to coordinate assets, liabilities, and operating activities efficiently may be better positioned to preserve the quality of reported performance. Earlier evidence also associates managerial capability with earnings quality, persistence, and sustainability (Romadhon & Kusuma, 2020; Permatasari & Ainiyah, 2022). Therefore, the following hypothesis is formulated:

H4: Managerial ability positively influences *sustainable earnings*

Research Methods

A quantitative research design is utilized to examine the causal associations between the variables. The quantitative approach was chosen because this study focuses on testing the relationships between variables that can be measured numerically through statistical analysis. According to Shirley, (2020), quantitative research is used to test pre-formulated hypotheses using numerical and statistically processed data to obtain objective conclusions. In this study, the population in particular consists of companies listed on the Indonesia Stock Exchange (IDX) in the Health Sector category, with data observed from 2020 to 2024.

The study employs purposive sampling, in which observations are chosen according to specific criteria established by the researcher, following Hajaroh & Raehanah, (2021). Based on these criteria, 21 firms operating in the healthcare sector were selected as the research sample. The analysis relies on secondary data collected from previously published sources, including relevant reports and other publicly available documents. The research variables in this study were measured using proxies, as shown in Table 1

Table 1 Operational Definition and Measurement of Variables

Variable	Measurements	Formula
Sustainable earnings (Y)	Quality of Income Ratio	$QIR = \frac{Cash\ flow\ from\ operation}{Net\ operating\ Income}$ Sumber: (Lukita, 2022)
Prudence (X1)	KNSV Score	$KNSV = \frac{NI + Depr. \& Amort. + CFO}{Total\ Asset}$

Variable	Measurements	Formula
		Sumber: (Nurdianti & Anggraini, 2024)
Capital Structure (X2)	Debt to Equity Ratio (DER)	$DER = \frac{Total\ Liabillities}{Total\ Equity}$ Sumber: (Desyana *et al*, 2023)
Profit Growth (X3)	Profit Growth	$PL = \frac{Laba\ bersih\ tahun\ ini - Laba\ bersih\ tahun\ lalu}{Laba\ bersih\ tahun\ lalu}$ Sumber: (Desyana *et al*, 2023)
Managerial Ability (X4)	Firm Efficiency	$FE = \frac{Sales}{CoGS + SG\&A + PPE + Depreciation\&Amortication + Inventorie}$ Sumber: (Lukita, 2022)

Results and Discussion

Table 2 Descriptive Statistical Analysis

Variabel	Mean	Median	Maximum	Minimum	Std. Dev
Sustainable earnings	0.658211	0.913589	31.60000	-55.32501	6.531842
Prudence	0.185413	0.183301	0.627716	-1.182465	0.254627
Profit growth	0.587244	0.041327	49.27823	-37.67758	7.280601
Capital structure	1.128387	0.491773	18.11243	-1.540329	2.461199
Managerial ability	0.958343	1.000000	1.000000	0.681000	0.082700

Source: Eviews 12 Processed 2026

The descriptive statistical results show that Sustainable Earnings (Y) has a mean of 0.658211 and a median of 0.913589, with values ranging from −55.32501 to 31.60000 and a standard deviation of 6.531842, indicating substantial variation in earnings sustainability across companies. Prudence (X1) has a mean of 0.185413 and a standard deviation of 0.254627, with values ranging from −1.182465 to 0.627716, reflecting moderate variation in the application of prudence in financial reporting. Profit Growth (X2) records a mean of 0.587244 and a standard deviation of 7.280601, with a range of −37.67758 to 49.27823, indicating considerable fluctuations in profit growth during the observation period. Capital Structure (X3) has a mean of 1.128387 and a standard deviation of 2.461199, with values ranging from −1.540329 to 18.11243, suggesting substantial differences in the funding structures of healthcare companies. Meanwhile, Managerial Ability (X4) has a mean of 0.958343, a median of 1.000000, and a standard deviation of 0.082700, with values between 0.681000 and 1.000000, indicating relatively stable managerial ability and limited variation among the observed companies.

Table 3 T Test Results

Variabel	Coefficient	Prob.
Caution	2.104452	0.0002
Profit growth	-0.051671	0.2844
Capital structure	0.084184	0.5927
Managerial abilities	-7.500712	0.0083

Source: Eviews 12 Processed 2026

Table 3 shows that Prudence and Managerial Ability are statistically associated with Sustainable Earnings. The coefficient for Managerial Ability is negative, indicating an inverse relationship. In contrast, Profit Growth and Capital Structure do not reach statistical significance in explaining Sustainable Earnings.

Table 4 F Test Results

	Probability Value
Prob. F-statistics	0.002277

Source: Eviews 12 Processed 2026

The simultaneous test produces a Prob. F-statistic of 0.002277, which is below the 5% significance level. The statistical evidence confirms that the proposed model has significant explanatory power for Sustainable Earnings.

Table 5 Determination Coefficient Test Results

Indicator	Value
Adjusted R-squared	0.117938

Source: Eviews 12 Processed 2026

The estimated model has an Adjusted R-squared of 0.117938. The results indicate that approximately 11.7% of the variation in Sustainable Earnings can be explained by the factors examined in the study. The remaining 88.3% is attributable to variables and influences that are not included in the present model.

Effect of Prudence on Sustainable Earnings

The t-test reports a probability of 0.0002 for Prudence, which is below 0.05. Accordingly, H1 is supported, indicating that Prudence has a statistically significant relationship with Sustainable Earnings. The result is consistent with the agency perspective because cautious financial reporting can limit information asymmetry between managers and shareholders. By reducing the possibility of excessive income recognition, Prudence may make reported performance more representative of recurring economic conditions. Greater application of Prudence can therefore be associated with more credible and sustainable earnings and may enhance stakeholder confidence in the information disclosed by the firm (Desmita & Kanti, 2025).

Effect of Profit Growth on Sustainable Earnings

The probability associated with Profit Growth (X2) is 0.5844, exceeding 0.05; therefore, the proposed hypothesis is not supported. The evidence indicates that changes in profit do not have a statistically significant relationship with Sustainable Earnings. Although Signal Theory considers rising profits a favorable indication of future prospects, the observed growth in healthcare firms may also originate from short-lived market conditions, management policies, or non-operating components. Consequently, an increase in current-period earnings alone may not adequately represent the firm's ability to generate stable earnings in subsequent periods (Rahmawati & Aprilia, 2022).

Effect of Capital Structure on Sustainable Earnings

For Capital Structure (X3), the probability value is 0.5927, which is higher than 0.05. The hypothesis is therefore not supported, indicating that the firm's financing mix does not have a statistically significant relationship with Sustainable Earnings. In the healthcare sample, the proportion of debt relative to equity does not appear sufficient to explain differences in earnings sustainability. The agency-based expectation that debt automatically strengthens managerial discipline is consequently not confirmed by these observations. Other considerations, including earnings quality, cash-flow consistency, and operational decisions, may play a more important role in determining sustainable earnings (Rahman et al., 2023).

Effect of Managerial Ability on Sustainable Earnings

Managerial Ability (X4) has a probability value of 0.0083, below 0.05, while its estimated coefficient is −7.500712. The variable is therefore statistically significant but exhibits an inverse relationship with Sustainable Earnings. This finding does not support the proposed positive hypothesis. A possible interpretation is that greater managerial capability, as captured by the study's quantitative measure, may coincide with strategic decisions that involve greater exposure to risk. Such decisions can increase earnings volatility even when managers are considered more capable. Hence, managerial competence may need to be accompanied by effective governance and risk controls so that improvements in managerial performance translate into more sustainable earnings (Romadhon & Kusuma, 2020)

Conclusion

Based on the empirical analysis, Prudence is found to have a significant relationship with Sustainable Earnings, suggesting that cautious financial reporting is relevant to earnings sustainability. Profit Growth does not show a statistically significant relationship, indicating that period-to-period increases in profit do not necessarily represent durable earnings performance. Capital Structure is likewise not significant, implying that the financing mix alone does not determine the sustainability of earnings. Managerial Ability has a significant negative relationship with Sustainable Earnings, meaning that higher managerial ability according to the selected measure is associated with lower earnings sustainability. At the same time, the independent variables collectively provide a statistically significant explanation of Sustainable Earnings.

The findings highlight the relevance of Prudence in maintaining the reliability and continuity of reported earnings. The absence of a significant effect from Profit Growth and the negative association involving Managerial Ability also indicate that higher short-term performance or managerial efficiency should not automatically be interpreted as evidence of sustainable earnings quality. Managers and investors should therefore evaluate earnings by considering their stability, quality, and underlying sources rather than relying on a single performance indicator.

This study is subject to several limitations. First, the five-year observation window may not adequately represent longer-term movements in earnings sustainability. Second, Managerial Ability is represented by a particular quantitative proxy, which may not capture every aspect of managerial competence and strategic decision-making. Third, the model is restricted to selected explanatory factors, leaving the potential influence of other determinants of Sustainable Earnings unexamined. These limitations should be considered when interpreting the findings.

Future studies could extend the observation horizon so that longer-term patterns in earnings sustainability can be examined more thoroughly. Researchers may also compare alternative measures of Managerial Ability to obtain a broader representation of managerial competence. In addition, incorporating variables such as corporate governance, audit quality, and macroeconomic conditions may provide a more comprehensive explanation of the determinants of Sustainable Earnings.

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Author's Contribution

The first author was responsible for the research design, data collection, data analysis, and preparation of the manuscript. The second author contributed through supervision, critical review, and revision of the manuscript. Both authors approved the final version of the manuscript.

Conflicts of Interest

The authors declare that there are no conflicts of interest that could have influenced the research, authorship, or publication of this manuscript.

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Declaration about Generative AI Tools

The authors declare that generative AI tools were not used in the research design, data collection, data analysis, or interpretation of the research findings. Generative AI was used only to assist with language-related aspects of manuscript preparation, including paraphrasing, improving sentence structure, and translating or refining the wording of the manuscript. The authors reviewed and verified all AI-assisted text and remain fully responsible for the content, accuracy, and integrity of the manuscript.