The Effect of Managerial Ownership, Institusional Ownership, Free Cash Flow, Growth, Liquidity, and Profitability Towards...

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Submission date: 16-Sep-2022 10:41AM (UTC+0700)
Submission ID: 1901022944
File name: e_Cash_Flow,_Growth,_Liquidity,_and_Profitability_Towards....pdf (614.02K)
Word count: 2765
Character count: 15106

ISSN: 2598-7976 e-ISSN: 2598-7968

THE EFFECT OF MANAGERIAL OWNERSHIP, INSTITUTIONAL OWNERSHIP, FREE CASH FLOW, GROWTH, LIQUIDITY, AND PROFITABILITY TOWARDS DEBT POLICY

(Empirical Studies on Manufacturing Sector Companies listed in Indonesia Stock *Exchange period 2012-2015)*

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Abstract

The purpose of this research is to obtain empirical evidence about the effect of managerial ownership, institutional ownership, free cash flow, growth, liquidity (CR) and profitability (ROA) towards debt policy. Debt policy is important to some companies as debitors in order to using debt effectively and for some creditors to choose their debtors wisely. The sample of this research was selected by using purposive sampling method and with secondary data which was analyzed by using multiple regression method.The samples are 19manufacturing companies determined based on purposive sampling and analyzed by using multiple regression method.The19 manufacturingcompanies as samples have been simultaneously registered in Indonesia Stock Exchange since 2012-2015, published financial statements at the end of December 31 and had been audited by independently auditor, used Rupiah as currency, had managerial ownership structure, had institutional ownership structure over 5%, had a positive asset growth, had a positive income. The results of this researchshowed that managerial ownership, institutional ownership, free cash flow, growth, liquidity (CR) and profitability (ROA) simultaneously have a significant effect towards debt policy. Growth partially has a significant positive effect towards debt policy, liquidity (CR) partially has a significant negative effect towards debt policy, while managerial and institutional ownership, profitability (ROA) partially does not has positive effect towards debt policy, and free cash flow partially does not have negative effect towards debt policy.

Keywords: debt policy, free cash flow, managerial and institutional ownership, growth, liquidity, profitability

INTRODUCTION

Indonesia’s economic condition in 2016 was declining, which one of it is caused by the economy weakening in Asia, caused by the increase in USD. This happens because The United States has already succeeded in overcoming their economic crisis and taking the investment fund from the society which exist in many countries through The Fed policy by increasing the interest rate to 0,75% (0,25%-0,5% before, www.federalreserve.gov). When The Fed increases their interest rate, then demand in dollar will also be increased which caused the USD currency will be stronger than other currencies.

According to Investment Coordinating Board of the Republic of Indonesia, the foreign investment from The United States till 3rd Quarter 2015 is US$853,71 million, drastically decreased in 3rd Quarter 2016 which is US$430,4 million. This makes the currencies of Rupiah to USD decrease drastically in the beginning of 2015 to 2016, from Rp12,474 to Rp13,582. The effect in increasing USD will caused in foreign debt which must be paid. According to Bank Indonesia, the Indonesia foreign debt at the end of August of 2016 is US$323,8 billion and 68,2% of it was in USD. So, the weaker Rupiah to USD currencies, the bigger Indonesia must pay their foreign debt (www.databoks.katadata.co.id).

BPS (Central Bureau of Statistics) shows that the movement of Indonesia's Gross Domestic Product illustrates the potential growth of the Indonesian economy amid the economic downturn in Asia.According to the Performance Report of the Ministry of Industrymanufacturing industry is always the biggest contributor to GDP (www.kemenperin.go.id). This will lead to intense competition between manufacturing companies. Competition in the manufacturing industry for companies to be more competitive in order to grow and demanded to have a competitive advantage than other companies in order to continue to grow, so the

The Sixth International Conference on Entrepreneurship and Business Management (ICEBM 2017)
Hanoi, Vietnam – November 16-17, 2017
ISSN: 2598-7976 e-ISSN: 2598-7968

company will need large funds for quality materials and machinery to create and develop new products. One that can be used to fulfill their funding is debt.

According to Utami (2012), debt financing has several benefits for the company side (1) obtaining tax benefits earned through interest expense which can be deducted as taxable income deductions, (2) no voting rights to creditors so there is no shifting control of the company and (3) control over management will be greater through the control of opportunistic behavior where with the debt there will be a commitment to pay the principal and interest thereon. But the debt has limitations, from the side of the company that is the obligation to return principal and interest at maturity. The high use of debt has an impact on companies such as bankruptcy risk caused by not being able to manage debt well, that's why the company should make their own debt policy. Debt policy is a policy which purpose to determine the amount of debt a firm has so that it remains stable and could be highly utilize.

In this research, debt policy is measured using leverage ratio that is Debt to Total Asset ratio (DTA), that is by comparing total debt of company with total asset. Debt to Total Asset ratio is a solvent measurement that indicates the percentage of total assets provided by creditors (Weygandt et al., 2015). Due to the importance of debt policy, this research examines the factors that may affect the company's debt policy, namely managerial ownership, institutional ownership, free cash flow, growth, liquidity and profitability.

METHODS AND RESULTS

Debt Policy

Debt policy is a policy taken by the management in order to obtain sources of financing from third parties to finance the company's operational activities, this is closely related to the capital structure selected by the company and the capital structure itself is a balance between foreign capital or debt with own capital (Setiana and Sibagariang, 2013). In this research, Debt to Total Asset Ratio (DTA) is used to measure the level of corporate debt policy. According to Hery (2016), if the ratio of debt to assets (DTA) is high then this will certainly reduce the company's ability to obtain additional loans from creditors because it is feared that the company is unable to pay off its debts with total assets. A small ratio indicates that at least the company's assets are financed by debt.

Managerial Ownership

Managerial ownership is the percentage of share ownership by management that actively participates in corporate decision making (directors and commissioners) (Setiana and Sibagariang, 2013). This managerial ownership can be measured by comparing the shares held by the management to the total outstanding shares. In accordance with agency theory related to funding, from the shareholder side, it is likely to prefer funding by using debt because the issuance of new shares will reduce their ownership percentage which impacts the decrease of control on management from the reduction of voting rights and the dividend obtained will become smaller. If management as the owner of the company will feel the impact of the issuance of these new shares so it will tend to choose funding with debt. In addition, management is the party that runs the company's operations that cause have strong policy and authority in decision making especially in funding and allocation of fund. Thus, management will tend to use debt to finance its operating activities in the form of assets. Thus, the higher managerial ownership in a company then the policy to use debt will tend to be higher, then the hypothesis is formulated as follows:

Ha_1: Managerial ownership has a positive effect towards debt policy

Institutional Ownership

According to Wahidahwati (2002) in David et al. (2015), institutional ownership is the proportion of shares held by institutions at the end of the year as measured by percentage. According to Sari (2015), the institutions are insurance companies, banks, investment companies and other institutions. Institutional shareholders tend to prefer funding by companies using debt. If funding is done with the issuance of new shares, then the percentage of share ownership of the shareholders of the company will decrease, which will result in a decrease in control over management as the reduced voting rights and dividend will decrease. Thus, higher institutional ownership will allow companies to adopt a policy of increasing debt, then the hypothesis is formulated as follows:

Ha_2: Institutional ownership has a positive effect towards debt policy.

Free Cash Flow

Free cash flow is the amount of discretionary cash flow available to firms that can be used for growth oriented, debt payments and payments to shareholders in dividend form (White et al, 2003 in Setiana and Sibagariang, 2013). According to Weygandt et al. (2015) free cash flow can be calculated by subtracting all

ISSN: 2598-7976 e-ISSN: 2598-7968

cash proceeds from operating activities by capital expenditure and dividend at optimum level. The high frequency of cash flow illustrates that the company has the capability to manage its operations so that there is a surplus of cash, while the low cash flow indicates that the company needs additional funds to manage and expand its operational activities. This is the same with pecking order theory, companies prefer to use internal funds first and if not sufficient then it will use debt as the main alternative in external funding. Thus, the lower the company's free cash flow makes the company implement a higher debt policy, then the hypothesis is formulated as follows:
Ha_3: Free cash flow has a negative effect towards debt policy.

Growth
Growth measures the extent to which the company has grown over time seen from the total assets available, the more assets that can be guaranteed it will make the creditors more confident to lend the funds to the company because companies that have high growth indicate that with their resources can generate good growth and can increase the value of the company to generate profits or profits to return its debt. The high growth in corporate assets shows that companies use larger funds to run their operations. Thus, the higher the growth of the company (growth) to make the company apply the policy to use the higher debt until the burden loaded from the debt (interest expense) does not exceed the return generated from the procurement of assets, then the hypothesis is formulated as follows:
Ha_4: Growthhas a positive effect towards debt policy.

Liquidity
According to Narita (2012) liquidity is an aspect that shows the company's ability to meet the obligations that must be met immediately and thus a company that has a high level of liquidity means the company is able to immediately return its debts and meet cash for unexpected needs. In this research, liquidity is measured by using current ratio formula (CR) that is current asset compared to current liabilities. The higher the current ratio the higher the current assets owned by the company to return its short-term debt. A high current ratio will result in the creditor's confidence in lending the funds, making it easier for the company to obtain external debt financing. Therefore, liquidity with higher current ratio proxies makes firms implement debt policy to use higher debt, then the hypothesis is formulated as follows:
Ha_5: Liquidity which is proxied by current ratio (CR) has a positive effect towards debt policy.

Profitability
According to Weygandt et al. (2015), profitability is the ability of the company in generating profit within a certain period. In this research, profitability is measured by using Return on Assets (ROA), that is by comparing net income after tax (Net Income) with total assets owned by the company. Return on Assets (ROA) describes the company's ability to generate profits from assets owned. High ROA illustrates that firms tend to have the ability to manage assets in operational activities so as to generate high profits and potentially to grow. Companies that have the potential to grow tend to use large funds as well primarily in managing their operational activities. In addition, high debt usage will provide tax shield benefits through interest expense on the company's net income. This is in accordance with the trade-off theory which states that the company will use the debt within certain limits when interest expense from issuing debt does not exceed the additional return on the procurement of assets to generate profit. Thus, profitability with higher return on assets proxies makes firms implement a higher debt policy, then the hypothesis is formulated as follows:
Ha_6: Profitability which is proxied by return on asset (ROA) has a positive effect towards debt policy.

Testing of the hypothesis is made by using a multivariate linear regression analysis. Tests were performed in this research by using the descriptive statistics, normality test, multicolonierity, heteroscedasticity test, autocorrelation test, test the coefficient of determination, a statistical test F and t statistical test.This research has met normality test and all the classical assumption test consisting of multicolonierity test, autocorrelation test, and heteroscedasticity test. Here is the result of t statistical test:

ISSN: 2598-7976 e-ISSN: 2598-7968

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.474	.073		6.450	.000
	KM	-.094	.223	-.042	-.420	.676
	KI	-.019	.091	-.021	-.206	.838
	FCF	1.067E-013	.000	.131	1.533	.130
	GRW	.200	.097	.164	2.061	.043
	CR	-.043	.005	-.703	-8.852	.000
	ROA	.124	.128	.078	.968	.336

a. Dependent Variable: DTA

Results of this research explained that the Managerial ownershipobtained t value of -0.420 with a significance of 0.676 does not have a positive effecttoward the debt policy. Based on these results, we can conclude that Ha_1 rejected. Institutional ownership variables obtained t value of -0.206 with a significance of 0.838. Based on these results, we can conclude that Ha_2 rejected. It is clear that the institutional ownership does not have a positive effecttoward the debt policy.

Free Cash Flow variables obtained t value of 1.553 with a significance of 0.130. Based on these results, we can conclude that Ha_3 rejected. It explains that the free cash flow does not have a negativeeffecttoward the debt policy. Growth variables obtained t value of 2.061 with a significance of 0.043. Based on these results, we can conclude that Ha_4 accepted. It is clear that the growth is proxied by Total Assets has a significant positive effect towards debt policy. Liquidity variables obtained t value of -8.852 with a significance of 0.000. Based on these results, we can conclude that Ha_5accepted. It is clear that the liquidity has a negative effect towards debt policy. Profitability variables obtained t value of 0.968 with a significance of 0.336. Based on these results, we can conclude that Ha_6rejected. It is clearthat the profitability doesn't has effect towards debt policy.

Conclusion

The results of this research showed that managerial ownership, institutional ownership, free cash flow, growth, liquidity (CR) and profitability (ROA) simultaneously have a significant effect towards debt policy. Growth partially has a significant positive effect towards debt policy, liquidity (CR) partially has a significant negative effect towards debt policy, while managerial and institutional ownership, profitability (ROA) partially does not has positive effect towards debt policy, and free cash flow partially does not have negative effect towards debt policy.

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ISSN: 2598-7976 e-ISSN: 2598-7968

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