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Managerial Ownership, Leverage, Dividend Policy, Free Cash Flow, Firm Value: Evidence in Indonesia Stock Exchange

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ABSTRACT

Limited liability company agency issues in Indonesia make for an exciting study topic from both the corporate law and corporate finance perspectives, giving rise to an agency issue, or conflict of interest. Determining the impact of managerial ownership, leverage, and dividend policy on free cash flow and firm value in the Manufacturing Industry listed on the Indonesia Stock Exchange from 2014 to 2020 is the goal of the study. 33 sample companies and 198 data samples total are used in this purposive sampling study. The data is balanced panel data that was analyzed using a stepwise regression approach. The results showed that managerial ownership had a significant negative effect on firm value, leverage did not affect firm value, dividend policy had a significant positive effect on firm value, and free cash flow had a significant positive effect on firm value. managerial ownership does not affect free cash flow, leverage has a significant positive effect on free cash flow, and dividend policy has a significant negative effect on free cash flow. This study implies that managers tend to be opportunistic so institutional ownership interference in the manufacturing industry in Indonesia is still high. High dividend payments will give a positive signal that will have an impact on increasing stock prices.

Introduction

The primary objective of the business is to enhance the value of the company, which is reflected in the success of its shareholders, one of whom may be observed in the rise in the price of the company's shares. It is crucial for a business to maximize firm value because doing so also means

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maximizing shareholder wealth. The firm's wealth or value is maximized, following the firm's theory of business, by enhancing shareholder welfare and prosperity. The market will have more faith in the company's future potential thanks to the high firm value than in only the company's current performance (Brigham & Ehrhardt, 2019).

The traditional view, maximizing shareholder wealth is the ultimate goal of a company. In terms of stakeholders, not only shareholders but also linking with other parties such as employees, suppliers, customers, communities, banks, managers, etc. (Garad et al., 2021). According to agency theory, shareholders of modern corporations can maximize their increase in corporate value by delegating company management responsibilities to professionals who are skilled in their respective fields, such as the board of directors/managers and the board of commissioners, in exchange for a service or reward in the form of a work contract (Van Horne, 2020). According to Rahmawati et al. (2018), agency theory is used to explain a contractual connection between two parties. Since agency theory is used by two opposing groups, its application is still up for debate, and its organizational implications are also still debatable.

The agency problem (or difficulties with agencies) that exist are the main subject of agency theory. Empirical findings that claim agency theory is related to the issue of corporate ownership through the acquisition of shares for agents and has an effect on the percentage of agent stock ownership so that it impacts firm value only serve to support this claim. Brigham and Ehrhardt (2019), agency issues can occur in two different types of connections, namely those between the shareholder (principal) and the manager (agent) and those between the shareholder (principal) and the creditor.

The agency connection between the company's shareholders and the manager, whereby the shareholders provide the manager with decision-making authority, may result in an information imbalance (asymmetry of information). a dispute between creditors and shareholders in which the shareholder's income is based on the firm's profit while the creditor receives a fixed sum of money from the company as interest on the debt. In this situation, shareholders are more concerned with the company's ability to earn a high return by investing in riskier ventures, while creditors are more concerned with the ability of the company to repay its loan.

Bebchuk et al. (2017) made the case that agency problems can arise because agents have objectives that deviate from the central tenet of agency theory, according to which agents act rationally while being rested, risk-averse, and always putting forth less effort (moral hazard), as well as because of adverse selection. Kostova et al. (2018) identified two types of agency problems: (1) monitoring issues that arise when the principal cannot demonstrate whether the agent has acted appropriately; and (2) the issue of risk sharing, particularly in the context of outcome control, which occurs when the principal and agent have different risk attitudes.

Agency problems between the principal and the agent also arise because of excess cash flow. Bebchuk et al. (2017) argue that the agency problem which is emphasized in agency conflict is also an issue that is still widely discussed, has received a lot of attention, and is still being debated in the financial literature, especially the relationship between principal and agent, so that agency conflict is an important thing in this theory.

It is possible to reduce agency issues, particularly agency conflicts. According to Rahmawati et

al. (2018), and Rinaldo and Puspita (2020), the agency problem—which is centered on agency conflicts—can be minimized or reduced if it is connected to the capital structure (leverage), dividend policy, also known as the dividend puzzle, and ownership structure.

In Indonesia, only in PT. Badan Usaha Milik Negara (BUMN) (including PT BUMN Tbk), there is no affiliation relationship between the state as the controlling shareholder and the board of directors and commissioners, so in Indonesia, agency problems only occur in PT BUMN and PT BUMN Tbk. Because only in BUMN there is a clear separation of management ownership. Meanwhile, in PT that comes from family companies (even those that have become listed companies) what happens is not the agency problem but the minority shareholders' appropriation. This form of limited liability company that goes public or non-going public in Indonesia is an interesting study material from both the corporate law and corporate finance sides, leading to the existence of an agency problem, which is a conflict of interest.

Based on the phenomena described above and the research gap, this study aims to re-examine the effect of managerial ownership, leverage, dividend policy on firm value, and free cash flow, to expand and develop the results of previous research, with the object of observation. The manufacturing industry is listed on the Indonesia Stock Exchange (IDX).

Literature review

Agency theory

The basis of the agency theory that has been developed to date comes from a research entitled Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure (Siebels et al., 2012). This research was conducted by Pepper & Gore, (2015). However, this study generally does not only discuss agency relationships. This study integrates elements from agency theory, ownership rights theory, and financial theory to develop corporate ownership theories.

Agency theory concerns the contractual relationship between members of the company. Garad et al., (2022) states that an agency relationship occurs when one or more people (principal) employ another person (agent) to provide a service and then delegate authority in decision making. What is called a principal is a shareholder or investor and what is meant by an agent is management that manages the company. The essence of the agency relationship is the separation of functions between share ownership and control on the part of management.

The value of the company

Setiadharma & Machali (2017) argued that firm value is the value of an asset owned by the company in the company's financial statements. Firm value is the investor's perception of the company's success rate associated with its share price. The higher the stock price, the better the level of confidence in the firm value. The main objective of the company is to maximize firm value. Maximizing value is broader and more general than maximizing profit (Van Horne, 2020). A high firm value is the desire of company owners because a high value indicates the prosperity of shareholders is also high. The wealth of shareholders and the company is represented by the market price of the shares which is a reflection of investment decisions, financing decisions, and asset management.

Managerial ownership

Iwasaki and Mizobata (2020) Managerial ownership are the separation of ownership between outsider ownership and insider ownership options. If a company has many shareholders, it is obvious that this large group of individuals cannot actively participate in the day-to-day management of the company. They, therefore, elect a board of commissioners, which oversees the management of the company. This structure means that the owner is different from the manager of the company. This will provide stability for companies that are not owned by companies where the owner is concurrently the manager.

Leverage

According to Yapa Abeywardhana (2017), the Capital structure is still an issue discussed in the financial literature. According to Van Horne (2020), Financial Leverage is the use of sources of funds that have fixed expenses, with the hope that it will provide additional profits that are greater than the fixed expenses, so that shareholder profits increase. A strong reason for using fixed expenses is to increase the income available to shareholders. Leverage is also a means to encourage an increase in profits or return on yield/value without adding to investment. Companies with higher leverage ratios are trying to convey more information as an instrument to reduce monitoring costs for investors. They provide more detailed information in annual reports to meet these needs compared to companies with lower leverage. Shahar et al. (2015) have Theories on capital structure such as pecking order theory, Trade-off Theory, and Signaling Theory.

Dividend policy

Morley (2013), the company's policy to distribute profits to shareholders means two things: 1) Funds distributed to shareholders. This is demonstrated by payments to shareholders; 2) Funds to finance company development needs. This is reflected in the balance sheet of the financial statements in the retained earnings account. Shareholders are not entitled to increase the dividend rate as recommended by the board of directors (BOD) in a board of commissioners meeting, but the board of commissioners can make a decision to reduce the dividend rate because dividend decisions are related to the timing of cash payments of shareholders, decisions on dividend policy are part of the It is very important for the company because it can affect the capital structure and stock prices in the future (Dewi et al., 2019).

Muriungi and Mwangi's (2020) Dividend policy theory is divided into three groups of theories, namely: 1) The first theory Gordon and Lithner's theory which supports the idea of paying very high dividends; 2) The second theory Miller & Modigliani theory which supports the idea that dividend policy is irrelevant; 3) The third theory Brennan's theory which supports the idea that investors prefer low dividends. Dividend explanation models are classified into two, namely: the irrelevance of dividend proposition and the relevance of dividend proposition, among others; bird in the hand theory, tax differentiation theory, clientele effect, dividend signaling theory, and agency theory.

Free cash flow (FCF)

Brigham & Ehrhardt (2011) states that free cash flow is excess cash/company leftovers that are not used for company operations or investments. Shareholders want the excess funds to be distributed to prosper their welfare, while the manager wants the excess funds to be used for investments in projects that provide benefits to the company because with these profits the manager indirectly gets more profits from the investment.

Free cash flow implies that market pressure will encourage managers to distribute free cash flow to shareholders or risk losing control of the company. According to Bararuallo and Aba (2019), free cash flow is excess cash needed to fund all projects that have a positive net present value after dividing dividends. Free cash flow reflects the company's freedom to make additional investments, pay off debts, buy treasury stocks or add liquidity so that the flow of high free cash indicates high company performance. If free cash flow is high, shareholder value will increase. Thus, financing through debt is an alternative to reducing agency costs. When agency problems can be resolved, the company's performance can run well, which affects investors' assessment of the company.

Methodology

The type of research used in this research is quantitative research based on the philosophy/positivism approach used to research a particular population or sample. This research was conducted in the manufacturing industry which is listed on the Indonesia Stock Exchange (BEI). The research period was six years, namely the 2014-2020 period. The research sample used in this study used a purposive sampling technique with population criteria as follows: a). Companies that have complete financial statements with no negative equity balance. Negative equity balances have a different meaning when included in the ratio analysis; b). Companies that do not have negative profit (loss). This requirement is set to avoid bias in cash flow; c). Manufacturing companies that pay dividends consecutively during the analysis period, namely 2014 - 2020, with the assumption that the company will benefit in the analysis period. This requirement is a reflection of the company's past performance. From the population criteria, the number of samples in this study was 33 in the period (2014-2020) so the total observation was 198 samples (balanced panel data).

Research data

The type of data used in this research is secondary data. Sources of data used in the study include the Indonesian Capital Market Directory (ICMD) published in 2014–2020, Annual Reports for all companies sampled in the 2014–2020 research, literature studies, or literature studies. Based on the dimension of time and time sequence, this study is a cross-section and time series called panel data (pooled data), because, in addition to taking samples of events at a certain time, they also take samples based on time sequences. The analysis uses a stepwise regression model of balanced panel data, which uses program e-views 10.

Measures

a. Managerial Ownership (OM)

Managerial ownership is the ownership of ordinary shares by the Director and Commissioner (Lumapow, 2018) the calculation formula is as follows:

$$Managerial\ Ownership = \frac{\text{D\&C SHRS}_{it}}{\text{TOTSHRS}_{it}}$$

b. Leverage (LEV)

Van Horne (2020) measures leverage as follows:

$$Leverage = \frac{Total\ Debt}{Total\ Equity}$$

c. Dividend Policy (DPR)

Van Horne (2020) Measured the Dividend Payout Ratio as follows:

$$Dividend\ Payout\ Ratio\ (DPR) = \frac{Dividends\ per\ share}{earnings\ per\ share}$$

d. Dependent Variable (Firm Value)

Brigham and Ehrhardt (2019) formulate the PBV as follows:

$$\text{PBV} = \frac{\text{Share Market Price per Sheet}}{\text{Book Value of Share Capital per Sheet}}$$

e. Variable Dependent or Intervening Variable (*Free Cash Flow (FCF))*

To measure *free cash flow* refers to (Sakir & Fadli, 2014).

$$\text{FCF} = \frac{(EBIT^{*}(1-tax)-depreciation-change\ in\ working\ capital-expenditur)}{(total\ assets)}$$

Results

To get the best estimation results, an estimation test was carried out with 3 estimation models, namely the common effect test, the fixed effect test, and the random effect test, and then the estimation model was selected using the Chow test, Lagrange test, and Housman test.

Best estimation model test model 1

To test panel data regression estimates, it can be done through 3 estimation models, namely the Common Effect (Pooled Least Square), Fixed Effect (FE), and Random Effect (RE). The following is the calculation result based on the three estimation models.

Table 1.

Panel model 1 data regression estimation test results

Variable	Common Effect		Fixed Effect		Random Effect	
	Coefficient	P value	Coefficient	P Value	Coefficient	P Value
C			0.112	0.480	0.145	0.187
MO	-0.198	0.006	-0.128	0.050	-0.165	0.011
LEV	-0.020	0.216	-0.039	0.037	-0.013	0.323
DPR	0.079	0.000	0.030	0.136	0.055	0.004
FCF	0.249	0.000	0.026	0.706	0.150	0.009
Adjusted R-Square		0.293		0.606		0.338

Dependent variable: firm value

From the results above, then the best model is selected to perform a balanced panel data regression test using the chow test (common effect or mixed effect), Lagrange Multiplier (LM) test (common effect or random effect), and Housman test (fixed effect or random effect).

Based on the results of panel data regression testing, it can be done through 3 estimation models, namely Common Effect (Pooled Least Square), Fixed Effect (FE), and Random Effect (RE), the best model for hypothesis testing is Random Effect (FE). Therefore, for further analysis, model 1 uses the random effect (RE).

Regression Equations (Equation 1) = The results of the panel data regression equation Model 1 (Radom Effect) are as follows: NP = 0.145-0.165MO-0.013LEV + 0.056DPR + 0.150FCF

Best estimation model test model 2

To test panel data regression estimation, it can be done through 3 estimation models, namely Common Effect (Pooled Least Square), Fixed Effect (FE), and Random Effect (RE). The following is the result of calculating the coefficient and probability values based on the three estimation models.

Table 2.

Panel data model 2 regression estimation test results

Variable	Common Effect		Fixed Effect		Random Effect	
	Coefficient	Probability Value	Coefficient	Probability Value	Coefficient	Probability Value
			0.582	0.007	0.486	0
MO	0.060	0.451	-0.028	0.754	-0.065	0.419
LEV	0.059	0.000	0.059	0.001	0.053	0.001
DPR	0.040	0.078	-0.039	0.049	0.014	0.522
Adjusted R-Square		-0.078		0.201		0.290

Dependent variable: *free cash flow*

From the results above, then the best model is selected to perform a balanced panel data regression test using the chow test (common effect or fixed effect), and Lagrange Multiplier (LM) test (common effect or random effect), Housman test (fixed effect or random effect). Based on the results of panel data regression testing, it can be done through 3 estimation models, namely the Common Effect (Pooled Least Square), Fixed Effect (FE), and Random Effect (RE), so the best model for testing the next hypothesis is the Fixed Effect (FE). Therefore, for testing the hypothesis model 2 using a fixed effect (FE).

Regression equation model 2 (Equation 2) = FCF= 0.582-0.028MO+0,059 LEV- 0.039 DPR

Classic assumption test

Model 1 and model 2 do not violate classical assumptions (multi collinearity and heteroscedasticity).

Hypothesis testing model 1

a. MO has a significant effect on NP. This is evidenced by the probability value of MO is smaller than the significance level (α) 5% (0.011 <0.05). It can be concluded that the hypothesis is accepted/supported (rejects H0).

b. LEV has no significant effect on NP. This is evidenced by the probability value of LEV greater than the significance level (α) of 5% (0.323> 0.05). It can be concluded that the hypothesis is rejected / not supported (accepting H0).

c. DPR has a significant effect on NP. This is evidenced by the probability value of DPR which is smaller than the significance level (α) of 5% (0.004 <0.05). It can be concluded that the hypothesis is accepted/supported (rejects H0).

d. FCF has a significant effect on NP. This is evidenced by the probability value being smaller than the significance level (α) of 5% (0.009 <0.05). It can be concluded that the hypothesis is accepted/supported (rejects H0). The results showed that the coefficient of determination R2 = 33.86%. This figure can be interpreted that the level of NP is caused or influenced by the merits of MO, LEV, DPR, FCF by 33.86%.

Hypothesis test model 2

a. MO has no significant effect on FCF. This is evidenced by the probability value greater than the significance level (α) of 5% (0.754> 0.05). It can be concluded that the hypothesis is rejected / not supported (accepting H0).

b. LEV has a significant positive effect on FCF. This is evidenced by the probability value being smaller than the significance level (α) of 5% (0.001 <0.05). It can be concluded that the hypothesis is accepted/supported (rejects H0).

c. The DPR has a significant effect on the FCF. This is evidenced by the probability value being smaller than the significance level (α) (0.049 <0.05). It can be concluded that the hypothesis is accepted/supported (accepting H0). The results showed that the coefficient of determination R2 = 20.17%. This figure means that the level of FCF is caused or influenced by the merits of MO, LEV, DPR by 20.17%.

Discussion

The greater the managerial ownership, the lower the company's value (Rizqia et al., 2013; Ahmed et al., 2019; Sindhu, 2014). This may imply that the higher the proportion of managerial ownership, the lower the firm value is reflected in the share price and the prosperity of the shareholders. Higher managerial ownership will give managers a strong position/position in managing the company and have full authority in decision-making. The higher the level of managerial ownership, the manager tends to behave opportunistically, namely more concerned with personal interests.

Opportunistic actions taken by managerial shareholders can reduce the company's share price, which is reflected in a decrease in firm value and will have an impact on the welfare of shareholders. With the opportunistic actions of managerial shareholders, other shareholders will feel aggrieved which results in decreased investor confidence in the company, so that the demand for company shares will decrease and the share price will automatically decrease. In the assessment of the

buyback of shares that have been sold, investors view the proportion of managers' shareholders as important information. Managerial ownership and firm value have a non-monotonic relationship. The non-monotonic relationship arises because of the incentives that managers have and they try to align interests with outsider ownership by increasing their share ownership if the firm value increases. This statement contradicts the results of research (Zamzamir et al., 2021) which states on the contrary that the higher the managerial ownership, the smaller the firm value.

Paterson (2016) stated that agency problems can be reduced if the manager has share ownership in the company because there will be a spread of decision-making and risk. Managers generally tend to use excess profits for consumption and negative behavior. With the share ownership by the manager, the manager will benefit directly from the decisions he makes but will also bear the risk directly if the decision is wrong. Bebchuk et al. (2017), agency problems do not affect share ownership.

Tangke (2021), managers tend to use high debt not to maximize firm value, but for the manager's gain. This will increase the interest expense on debt due to the increased risk of company bankruptcy so that the agency cost of debt will increase so that the amount of debt does not affect the value of the company. The size of the company's debt will also not affect the value of the company, because, in the company's operational activities and investment in projects with positive values, it tends to use internal capital. An increase in corporate debt is a source of external capital for the company's operations and is not used in investment. Investment in projects with positive value.

Yazdanfar and Öhman (2015) the amount of company debt is only used as a means of controlling the manager's party so that it does not affect the firm's value. The debt policy also does not affect firm value, if it does not include income tax expense, because the tax amount is an additional burden on debt interest costs. But by including corporate income tax, the use of debt will increase the value of the company because debt interest costs are costs that reduce tax payments (tax-deductible expense).

In theory, high free cash flow indicates high company performance so that the firm value will increase. The greater the free cash flow in the company is a positive signal that can be conveyed to investors about the company's prospects in the future which illustrates the ability of future cash creation. Park and Jang (2013) the high performance of the company will increase the firm value which is manifested in the form of high returns through dividends, stock prices, or retained earnings to be invested in the future. Free cash flow in manufacturing companies listed on the IDX has a very low average so the effect of free cash flow on firm value is downward. This effect shows that if the company's free cash flow is low, it will decrease the firm's value. This is because the company's free cash flow is used for investments that have a net present value or positive return.

The large proportion of managerial ownership does not affect the size of the company's free cash flow, meaning that the alignment between managerial ownership and institutional ownership does not affect the authority of institutional ownership. Institutional ownership still has full authority in controlling/overseeing the management of the company's free cash flow, which is likely to be distributed as dividends or for company investments that can provide better prospects for shareholders; this will have an impact on dividend distribution. The research results are different from the research results (Dwiastanti, 2017).

Accounts payable can be used to control excessive use of free cash flow by managers who tend to be for personal gain so that free cash flow will increase. Also, shareholders will exercise tighter supervision/control over managers, if the company issues new debt and uses the proceeds to buy back outstanding ordinary shares, management is required to pay cash to cover the debt, so that the debt can reduce the amount of cash flow that is owed. it is up to management to be mocked; this condition will increase free cash flow. The source of funding from retained earnings will increase the company's free cash flow because the company does not bear the risk and does not have the burden to pay installments and interest on the debt (Gusmiarni & Soeparyono, 2020).

Companies with excess free cash flow will have better performance than other companies because they can take advantage of various opportunities that other companies cannot. Managers prefer that these funds be reinvested in projects that can generate profits so that the size of the free cash flow is not affected by dividend payment policies, although on the other hand, shareholders expect the remaining funds to be distributed as dividends, The research results are different from the research results (Fatmawati & Garad, 2023; Sindhu, 2014; Sakir & Fadli, 2014). For some investors, high dividend payments are indicated as the company's inability to manage its free cash flow. Investors like this will think negatively of the company.

The increase in dividends is a positive signal for the company's future growth because the increase in dividends is interpreted as a profit that will be obtained in the future as a result obtained from investment decisions that companies with positive net present value will minimize problems in the flow, free cash, because dividend payments to shareholders affect the size of the company's free cash flow.

Conclusion

The higher level of managerial ownership provides a strong position and full authority in managing the company and making decisions without pressure from external disciplines (outside shareholders). But the interference of institutional ownership in Indonesian manufacturing companies is still high. This is reinforced by the phenomenon of companies in Indonesia, where companies evolved from family companies to limited liability companies, but company management is still dominated by families themselves so serious agency conflicts rarely occur. This condition also causes managers to act opportunistically, namely prioritizing personal interests rather than company interests.

Debt that is used by the company, is not for the benefit of the company but tends to be used by managers who behave opportunistically, namely concerned with personal interests. The high use of debt will create the risk of bankruptcy so that the agency cost of debt will be higher or the risk is transferred to creditors.

The bird-in-the-hand theory states that investors prefer dividend payments, where the risk is smaller than dividends that are not distributed or with capital gains. The number of dividends paid to shareholders will increase investor confidence in the company and give a positive signal to investors; this will cause the company's stock price to increase;

High free cash flow illustrates the growth of cash creation in the future. High company performance indicates high firm value. When a company generates high free cash flow and the

company's growth is high, investors will respond positively. Companies that have high free cash flow will be used by managers for investments that generate positive returns, to increase firm value in the future.

Accounts payable can be used to control excessive use of free cash flow by managers. Accounts payable can reduce the amount of cash flow that is in management which is used for personal gain. With debt, management will work more efficiently to avoid financial failure so that it will reduce agency costs, this condition will increase the company's free cash flow.

The smaller the income used for company operations, the smaller the company's free cash flow. Small free cash flow is reinvested in projects that can generate profits. Although on the other hand, shareholders expect the remaining funds to be distributed as dividends, for some investors, high dividend payments are indicated as the company's inability to manage its free cash flow.

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