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# RELATIONSHIP DEBT RATIO AND MANAGERIAL OWNERSHIP : FREE CASH FLOW HYPOTHESIS

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## ABSTRACT

*The purpose of research is to determine the impact of managerial ownership on the debt ratio a total of 619 research data analyzed with ANOVA the results showed there were no significant differences or did not support the hypothesis of Jensen (1986)*

**Key words:** Debt Ratio, Managerial Ownership, Manufacturing Sector.

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## 1. INTRODUCTION

Jensen and Meckling (1976) explain that managers as shareholders will act opportunistically so as to make suboptimal investments. Jensen (1986) which argues that managers use free cash flows to invest in projects (overinvestment) with negative net present value (NPV) even when these investments are not at the interests of shareholders. The overinvestment manager's actions are investing with a high level of risk or acting in the interests of shareholders so as to hurt debtholders. To reduce the action of free cash flow (FCF) is to use debt, not equity, with the aim of reducing free cash flow within the company, this action is hypothesized to be more disciplining of managers.

Research Lang et al (1996) explain the high debt ratio resulting in reduced FCF in the company. Supporting research such as Khan et al. (2012), Fatma (2011). The research objective is to find out more about the impact of the use of debt on managerial opportunistic behavior. The analysis used is ANOVA with the aim to determine whether there is a difference in debt ratio in companies with managerial ownership of more than 50% and less than 50%. Next, the Paper is divided into 3 parts, first discussing literature review, followed by research methods and finally findings and results

## 2. LITERATURE REVIEW

Jensen hypothesis (1986) states that companies with managerial ownership will carry out opportunistic actions. La Rocca et al (2008) explain (1) When profitable investment projects and growth opportunities are lacking, managers prefer to use the free cash flow (available cash flow that is in excess of the resources that are necessary to handle the firm's investments at a positive net present value) for opportunistic purposes (2) building empire (3). These authors define managerial entrenchment as a set of self-defense mechanisms that management creates by deciding on firm development strategies so as to emphasize their own competencies and skills, rather than choosing strategies that are in the firm's interest So the hypothesis is there is a difference in debt ratio in companies with managerial ownership of more and less than 50%.

## 3. DATA

The data in this study are 619 manufacturing companies listed on the Indonesia Stock Exchange from 2009 to 2018. Debt ratio used proxy debt equation ratio and managerial ownership used proxy managerial ownership/total equity

## 4. RESULT AND FINDINGS

Table 1 explained in time series, there was an increase in the average DER but the proportion of managerial ownership did not change. Data in the sample can be interpreted as changes in DER not due to changes in the percentage of managerial ownership.

**Table 1** Statistics Descriptive of DER

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Mean	0.3	1.8	1.2	1.2	0.5	1.2	1.2	1.6	2.8	1.7
Standard Error	0.9	1.1	0.3	0.2	0.6	0.2	0.2	0.6	1.2	0.4
Median	0.6	0.8	0.8	0.7	0.8	0.9	0.8	0.9	0.9	1.0
Standard Deviation	5.0	6.7	1.7	1.7	4.6	1.8	1.9	5.8	11.3	3.8
Sample Variance	25.0	45.2	2.8	2.9	21.3	3.4	3.5	33.9	126.8	14.1
Kurtosis	24.7	25.9	16.6	13.1	44.7	8.9	4.9	72.1	41.8	45.5
Skewness	-4.6	4.3	3.4	3.1	-6.2	2.1	0.9	8.2	6.4	6.3
Range	32.4	52.1	11.3	11.5	40.8	13.7	12.9	57.2	87.1	34.0
Maximum	7.1	38.8	9.4	9.6	9.0	10.1	7.7	52.1	83.1	31.7
Minimum	-25.3	-13.3	-1.9	-1.9	-31.8	-3.5	-5.3	-5.1	-4.0	-2.3
Sum	10.7	68.5	43.2	56.6	27.5	78.6	83.8	133.5	262.1	165.4
Count	31.0	39.0	37.0	47.0	57.0	65.0	71.0	82.0	92.0	98.0

**Table 2** Descriptive statistics of Managerial ownership

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Mean	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Standard Error	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Median	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Standard Deviation	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.2	0.2	0.2
Sample Variance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Kurtosis	7.2	8.4	9.4	15.7	16.5	10.9	13.5	8.7	6.4	3.9
Skewness	2.7	2.8	2.9	3.9	3.7	2.9	3.4	2.8	2.6	2.1
Range	0.6	0.6	0.7	0.8	0.7	0.7	0.8	0.8	0.8	0.8
Maximum	0.6	0.6	0.7	0.8	0.7	0.7	0.8	0.8	0.8	0.8
Minimum	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sum	2.7	3.0	2.9	2.9	3.2	4.3	5.1	7.5	9.7	11.2
Count	31.0	39.0	37.0	47.0	57.0	65.0	71.0	82.0	92.0	98.0

Based on panel data, it can be seen that DER variation is greater than managerial ownership. The average shows that debt is 1.5 times equity, companies tend to use debt versus equity (table 3). Manufacturing companies have more varied uses of DER due to different intra-sector growth opportunities, thus requiring different funding

**Table 3** Statistics Descriptive in Panel Data

	<b>DER</b>	<b>Managerial Ownership</b>
Mean	1.502229	0.084728
Standard Error	0.230434	0.006366
Median	0.82	0.013333
Mode	0.55	0.095833
Standard Deviation	5.733143	0.158392
Sample Variance	32.86893	0.025088
Kurtosis	113.9093	8.133353
Skewness	8.799918	2.79655
Range	114.86	0.839557
Maximum	83.08	0.839557
Minimum	-31.78	6.7E-08
Sum	929.88	52.44671
Count	619	619

Hypothesis testing (table 4) provides evidence of insignificant differences in companies with managerial ownership of more or less than 50%. This means that the debt ratio used is no different, so there is no agency problem caused by managerial opportunistic behavior. Managers as shareholders will not act in suboptimal investments

**Table 4** Hypothesis test

#### ANOVA

<i>Sources</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P value</i>	<i>F crit</i>	<i>RMSSE</i>	<i>Omega Sq</i>
Between Groups	0.95	1.00	0.95	0.03	0.86	3.86	0.02	0.00
Within Groups	20312.04	617.00	32.92					
Total	20313.00	618.00	32.87					

## 5. CONCLUSION

The purpose of research is to determine the impact of managerial ownership on the debt ratio a total of 619 research data analyzed with ANOVA the results showed there were no significant differences or did not support the hypothesis of Jensen (1986).

The overinvestment manager's actions are investing with a high level of risk or acting in the interests of shareholders so as to hurt debtholders. To reduce the action of free cash flow (FCF) is to use debt, not equity, with the aim of reducing free cash flow within the company, this action is hypothesized to be more disciplining of managers.

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