# The Determinant of the Debt Policy of the Firm

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Abstract: This study aims to examine and analyze the effect of independent variables in the form of, institutional ownership, free cash flow, and leverage on the dependent variable in the form of debt policy. The population in this study are insurance companies listed on the Indonesia Stock Exchange for the period 2015 to 2017. Based on the purposive sampling technique, a sample of 35 companies was obtained. The data analysis technique used is descriptive statistics and hypothesis testing in the form of multiple linear regression analysis. The test results show that the free cash flow variable does not have a negative and insignificant effect on debt policy. Institutional ownership variables do not have a positive and insignificant effect on debt policy. Leverage variables have a significant negative effect on debt policy. Free cash flow, institutional ownership and leverage are able to influence debt policy together by 29.5%.

## 1 INTRODUCTION

YA firm is established to increase its values so it can give the stockholders a welfare. Wahyudi and Parwestri (2006) in (Nuraina, 2010) stated that in long term objective is to optimize its value. The higher the value, the more welfare the owner. The value reflects the stock market price. One of the determinant is the firm's ownership structure. Some researchers believed that the structure will be able to affect the running of the firm which will affect its performance in purpose of the goal, it is the value maximization. This is caused by their control. The stock market is expected to react positively if the firm is managed by qualified competent management or it owned by good credible image stockholders. The control that owned by the owner will affect its performance. Free Cash Flow describes the financial flexibility level of the firm. Jensen (1986) in J(Lucyanda et al., 2012) stated that a manager should have incentive to enlarge the firm more than its optimum size, so they keep doing their investment in spite of their negative net present value. If the firm has free cash flow, a better firm should divide it in form of dividen to prevent the waste of funds on not profitable project. According to Mamduh and Hanafi (2013) in (Geovana, 2015) that a firm which implements fixed cost in high proportion must implement high operating leverage. In other word, Degree of Operating Leverage (DOL) of the company is high, if it has high DOL, thus high sale level will generate high revenue, on the other side if the sale decreased significantly, the firm will experience loss.

## 2 RESEARCH METHOD

### 2.1 Samples Population and Selection

The population for this research is taken from all 2015-2017 Indonesia Exchange Stock registered insurance firm. The selection is determined by implementing purposive sampling technique. The purpose is to obtain representative samples. The process is as following:

The company has annual financial report which ispublished during researching period, and also it has outlier data.

Based on that criteria, they obtained 35 samples which consist of 10 firms within 2015, 13 companies within 2016, and 12 firms within2017.

### 2.2 Data Normality Test

The result of this test with One-Sample Kolmogorov-Smirnov Test showed "Asymp. Sig. (2-tailed)" is 0,056. It results more than $\alpha$ is 0,05, so sample data distribute normally.



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## 2.3 Multi Collinearity Test

Each of Tolerance and Variance Inflation Factor (VIF) variables shows all independent variable have Tolerance more than 0,1 while VIF less than 10 Thus, there is no multi collinearity for this regression model.

## 2.4 Autocorrelation Test

The result of this test is 2,228 for D-W. Determined $\alpha$ is 5% and all sample is 35 in D-W table, then obtaining du is 1,6528 and dl is 1,2833. Based on Decision Taking table whether there is autocorrelation or not, D-W or d is between du and 4-du is 1,6528 $\leq$ 2,228 $\leq$ 2,3472. Thus, there is no autocorrelation for this regression model.

### 2.4.1 Heteroscedasticity Test

The Glejser test shows there is no significant independent variable (lesser than 0,05) which affects dependent variable is absolute residual (abs_res). This can be seen from its each significance (Sig) variable is more than $\alpha$ is 0,05. Thus, there is no heteroscedasticity for this regression model.

### 2.4.2 Multiple Linear Regression Analysis

Table 1: Multiple Linear Regression Analysis.

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. | Collinearity Statistics | |
|---|---|---|---|---|---|---|---|
| | B | Std. Error | Beta | | | Tolerance | VIF |
| Constant | -1,309 | ,341 | | -3,838 | ,001 | | |
| FCF | -,038 | ,039 | -,086 | -,971 | ,339 | ,970 | 1,031 |
| INST | ,007 | ,046 | ,014 | ,161 | ,873 | ,955 | 1,048 |
| LEV | 5,298 | ,535 | ,875 | 9,903 | ,000 | ,981 | 1,019 |

Data processed Based on the result, it obtained this regression equation as shown below:

$$DER = -1,309–0,038FCF + 0,007INST + 5,298LEV + \varepsilon \quad (1)$$

The determination coefficient test result shows 0,74, it means that free variables such as FCF, INST, and LEF affect debt policy variable up to 74% while the rest is 26% that affected by other factors which is not studied in this research.

## 2.5 F Test (Uji Goodness of Fit Test)

The result of goodness of fit model reveals free cash flow influence, institutional policy, and leverage simultaneously toward debt policy. Counted F is 33,182 while the significance is 0,000 so it is lesser than 0,05.Therefore, this model is recommended to predict free cash flow influence, institutional policy, and leverage simultaneously affect debt policy (DER) on insurance company listed in Bursa Efek Indonesia during period 2015- 2017.

## 2.6 T-test (Partial Test)

Based on the test, it obtained the constant is negative 1,309 which is significant due to the significance is 0,001 lesser than 0,05, FCF affects negative 0,038 insignificant against company value which is 0,339 more than 0,05. INST affects positive 0,007 insignificant against company value which is 0,873 more than 0.05. LEV affects positive 5.298 significant toward company value which is 0,000 lesser than 0,05.

# 3 DISCUSSION

## 3.1 Free Cash Flow Effect toward Debt Policy

First Hypotesis states that the indication of negative effect between fee cash flow and debt policy. This hypotesis is unsupported by the research result. The free cash flow (FCF) test obtained negative and insignificant effect toward debt policy. The coefficient is negative 0,038 with significant is 0,339 more than 0,05. Thus, free cash flow hypothesis with negative and significant effect is unsupported statistically.

However, the result of this research is accordance with Faisal (2004). The result shows that firm with high free cash flow will be capable to pay off high debt. So sufficient free cash flow is expected to affect the debt policy. Provided free cash flow reflects the ability of the firm to pay its debt. The firm pays the debt by using free cash flow so if a firm expects high debt, it should provide sufficient free cash flow for debt payment. The more free cash flow provided, the

more a firm is able to pay it, so a firm is expected to use high debt.

What made the acceptance of the first hypothesis in this research is its free cash flow probability which is shown that the firm is less survived, which means that the firm is less active in applying free cash flow maximally, or it is less aggressive in searching for profitable projects so the debt is used minimally.

### 3.2 Institutional Ownership Effect toward Debt Policy

The second hypothesis states that the ownership institutional has negative effect toward debt policy. It is supported by the research result. The institutional policy (INST) test indicated insignificant positive effect toward debt policy with coefficient positive 0,007 and significant 0,873 more than 0,05. Thus, significant negative institutional ownership is unsupported statistically. This result is reconfirmed by (KARTINAH, 2006) that despite positive institutional ownership toward debt policy, it is still insignificant. This research result is research by Jensen and Meckling (1976) in (Nabela, 2012) states that the ownership is more higher, causes stronger external control of the firm, so it can diminish agency costs. The higher the ownership, the lower the operational debt. It is caused by supervision of other institutions on firm performance such as bank and insurance company. If the firm spends big amount debt for failure possibility high risk project, the stockholders will sell out their stocks.

### 3.3 Leverage Effect toward Debt Policy

Third hypothesis states that leverage negative effects toward debt policy. This hypothesis is unsupported by the research result. Leverage (LEV) test is significant positive effect proof toward debt policy. The coefficient is positive 9,903 with significance is 0,000 lesser than 0,05. Thus, hypothesis on significant negative effect leverage is unsupported statistically.

The research result is opposite to the third hypothesis that a company with low operating leverage is able to enlarge financial leverage. Due to both interaction can affect net profit, so if it is in low operating leverage, it will increase the debt, on the other hand if it is in high level, debt is unnecessary. It relates to pecking order theory that in company internal finance is a priority if the operational profit can cover its operational activity.

Factor that the third hypothesis is not supported is shown by high operating leverage that will describe high sensitivity of operational profit against sale fluctuation. The higher operating leverage, the more profit the more sensitive profit against the fluctuation, so in purpose of gaining high profit, the company will expand the sale in all way. This causes they will spend external source of funds instead of debt policy as their investment finance source.

## 4 CONCLUSIONS, RESEARCH LIMITATION, SUGGESTION

### 4.1 Conclusion

Cash flow, institutional ownership and leverage are able to affect debt policy up to 74%. It is reflected from adjusted R2 up to 0,740 while the rest is 26% affected by other factors which are not studied in this research.

Free cash flow, institutional ownership and leverage have significant effect toward debt policysimultaneously. It is shown that counted equals to 33,182 with significance 0,000 lesser than $\alpha$ equals to 0,05.

Free cash flow (FCF) has no negative effect and no significance toward debt policy on insurance company in BEI (Indonesia Stock Exchange) during period 2015–2017. It is shown that counted t equals to –0,971 with significance 0,339 more than 0,05.

Institutional Ownership (INST) has no positive effect and no significance toward debt policy on insurance company in BEI (Indonesia Stock Exchange) during period 2015–2017. It is shown by counted t equals to 0,161 with 0,873 more than 0,05.

Leverage (LEV) has positive significance toward debt policy on insurance company in BEI during period 2015- 2017. It is shown that counted t equals to 9,903 with significance 0,000 lesser than 0,05.

Based on the analysed result, the most dominant effect variable toward debt policy is leverage compared to the other two variables. Due to leverage has counted t equals to positive 9,903 at most. Thus, leverage is the most affecting factor on debt policy.

### 4.2 Limitations of Research

This research has limitations such as : three years relatively short observation period only by researcher during 2015-2017, so it less reflects long term condition. They implemented three independent variables only, which actually there are still many variables can affect debt policy.

### 4.3 Suggestion

An investor needs to notice the amount of debt policy and some affecting factors such as free cash flow, institutional ownership and leverage before making decision for investing. A manager should consider some factors which are affecting debt policy in determining the amount of fund, both from the debt and own money. Hopefully, the funding is able to cost operational activity and company investment, also creating an optimum debt policy. To following researchers: hopefully, there will be more variables which possibly affect the debt policy since in this research, independent variable has only explained the dependent one up to 74%.

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