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The Effect Analysis of Management Ownership Structure, Debt Policy and Risk on Financial Performance of Indonesian Manufacturing Companies

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ABSTRACT

The main objective of this study was to examine the effect of ownership structure management, debt policy and the risks to the value of public manufacturing companies in Indonesia.. Unlike the agency problems in capital markets have developed, agency problem in Indonesia is the difference between the interests of the minority owners of the majority owner. The hypothesis in this study were: (1) ownership structure, significant effect on debt policy, (2) ownership structure and debt policies have a significant effect on the financial performance of the company. This study wanted to test the agency theory, Jensen and Meckling (1976), Pecking Order Theory, Myers (1984), The trade off models and Signaling Theory, Copeland (1992). The population in this study is an open manufacturing company listed on the Indonesia Stock Exchange. A total of 157 companies were taken as samples by using purposive sampling. Data were analyzed using the Structural Equation Modelling. These studies suggest that the ownership structure of management, significant effect on debt policy. Ownership structure and debt policies have a significant effect on the financial performance of the company. Results of this study do not support the agency theory, Jensen and Meckling (1976) but the results of this study support the Pecking Order Theory, Myers (1984), The trade off models and Signaling theory, Bhattacarya (1979).

Keywords*: management ownership structure, debt policy, financial performance.*

INTRODUCTION

Manager relations with shareholders in *agency theory are* described as the relationship between *agent* and *principal* (Schroeder et al. 2011). Manager as *agent* and shareholder as *principal.* Managers must make the best business decisions to increase shareholder wealth. The business decision taken by managers is to maximize the company's resources (utilities). However, shareholders cannot oversee all decisions and activities carried out by managers. A threat to shareholders if the manager will act in his own interests, not in the interests of shareholders. This is the basic problem in *agency theory,* which is a conflict of interest.

Shareholders and managers are each interested in maximizing their objectives. A conflict of interest occurs if the manager's decision will only maximize his interests and not in line with the interests of shareholders. Behavior of managers in situations of conflict of interest is interesting to study. The decisions and activities of managers who own company shares will certainly be different from managers who are purely as managers. A manager who owns company shares means that the manager is also a shareholder. Managers who own company shares will certainly align their interests with those of shareholders. While managers who do not own company shares, there is a possibility that they are only concerned with their own interests. Ownership of company shares by managers is called the management ownership structure.

Research on the relationship between management ownership and managerial business decisions has been carried out by researchers. But the researchers found different

results. For example, research on the relationship between management ownership and *debt ratio* shows different results among several researchers. Some researchers found a positive relationship between management ownership with the *debt ratio* company's. (Kim and Sorensen 2016, Agrawal and Mendelker 2017, Mehran 2018). While other researchers found that share ownership by managers has a significant influence and isrelated *negatively* to *debt ratio* (Moh'd 2018).

In addition, research that links management ownership with the company's financial performance (the company's financial performance is the result of manager's operational decisions), also shows different results among researchers. Founder a significant and positive relationship between management ownership and corporate financial performance. While other researchers found a weak relationship between management ownership and corporate financial performance (Lasfer and Faccio 2017). Based on the premise that managers at the same time shareholders will be do and make informed business decisions in contrast to the manager who is not the holder of the stock as well as the results of different studies among researchers about the ownership relationship management with business decisions, it is interesting to study whether there is truly a difference in business decision making between companies with management ownership and companies managed by managers who are not both shareholders.

Based on the background of the problems outlined above, this study aims to determine whether there are differences in business decision making between companies with management ownership and companies without management ownership. To focus more on the direction of this research, business decisions taken by managers are limited to financial decisions that are proxied by debt policy (capital structure), operational decisions that are proxied with risk, overall business decisions that are proxied by the company's financial performance. In addition, this research will also provide a strong empirical basis for research on the relationship of management ownership with managers' business decisions. It is illogical if the framework of the relationship between management ownership and managerial business decisions is built if it turns out there is no significant difference between companies with ownership and companies without management ownership.

The development of capital market research has motivated writers to conduct financial research. Several studies of capital structure on the company's financial performance have been carried out by researchers and the results are contradictory. Jensen and Meckling (1976) argue that agency conflicts occur because of the separation of ownership and control. Agency conflict causes a decline in the company's financial performance. Decline in the company's financial performance will affect the wealth of shareholders so that shareholders will take action to control management behavior. In short there are two views that are constantly debated by financial experts in the world. The first view is known as the traditional view which states that the capital structure affects the company's financial performance. The traditional view is represented by two theories namely *Trade off Theory* and *Pecking Order Theory*, Myers (1984). The second view was expressed by Modigliani and Miller who stated that capital structure does not affect the company's financial performance. Myers and Majluf (1984), stated that companies tend to use *internal equity* first, and if they require *external financing*, the company will issue *debt* before using *external equity*.

From several studies conducted on companies in Indonesia found that companies in Indonesia tend to follow the *pecking order theory*. Sartono (2011) has found that in general corporate managers in Indonesia tend to follow the funding hierarchy (*pecking order theory*). The company's capital structure is also predicted to be influenced by external factors and company internal factors. The ownership structure is important in agency theory because most of the agency conflict arguments are caused by the separation of ownership and management. Agency conflict does not occur in companies with one hundred percent ownership by management (Jensen and Meckling, 1976). The structure of share ownership is predicted to be influential in determining capital structure. The more concentrated share ownership of companies tends to reduce debt. The more concentrated the ownership of shares, the effective supervision of management will occur. Management will be more

careful in lending, because the amount of debt that is too high will pose a risk of *financial distress* so that the company's financial performance will decline. The amount of debt that exceeds the optimal point will make the tax savings from the use of debt lower than the current financial performance of *financial distress* and *agency costs (trade off model).* The more concentrated shareholding of the company is also predicted to improve the company's financial performance.

CONCEPTUAL FRAMEWORK AND HYPOTHESIS MODEL

Theoretically, corporate financing is faced with a variety of considerations. One theory that underlies corporate funding decisions is the *pecking order theory*, Myers (1984) which suggests that there is a tendency for companies to determine the choice of funding sources on the basis of a risk hierarchy (*pecking order theory*). *Pecking order theory* is one theory that bases on information asymmetry. Information asymmetry will affect the company's capital structure by limiting access to external funding sources. Myers and Majluf (1984) show that with information asymmetry, investors will usually interpret it as bad news if the company funds its investment by issuing equity. Thus, companies will prefer to fund their investments based on a risk sequence. Barcley and Smith (2015) suggest that *pecking orders* tend to choose *internal funds, riskless debt, risky debt* and *equity*. Myers and Majluf (1984), and Myers (1984) refer to this problem as a pecking order hypothesis which states that companies tend to use *internal equity* first, and if they require *external finance*, the company will issue *debt* before using *external equity*.

The ownership structure theoretically has a relationship with debt policy. The more concentrated the ownership of shares, the supervision by the owner of management will be more effective. Management will be more careful in obtaining loans, because the increasing amount of debt will cause *financial distress*. The occurrence of *financial distress* will result in a company's financial performance will decline thereby reducing the prosperity of the owner.

Interest rates represent the cost of capital for the company. High interest rates mean the cost of using funds is higher so companies are reluctant to make loans and subsequently debt policies will decrease. The increasingly passionate capital market situation will reduce the interest of companies to make loans because companies are more interested in financing through the capital market so that debt policy will decline. High market growth shows good market opportunities that will encourage companies to make loans so that debt policy will increase. Increased profitability will increase retained earnings so that it will reduce the interest of companies to make loans and debt policy will decrease. Increased dividend payments will reduce retained earnings so that internal resources will decrease and the company would be interested in doing borrowing so that the debt policy will increase. The size of the company shows the activities of companies owned by the company. The greater the size of the company means the greater the assets that can be used as collateral to obtain debt so that debt policy will increase. The relative market share shows the company's competitiveness is higher than its main competitors so that it will encourage companies to make loans and debt policy will increase. Institutional ownership will encourage owners to make loans to management so that management is encouraged to improve their performance, then the company's financial performance will improve. Management ownership will encourage management to improve company performance, because they also own the company. The company's improved performance will improve the company's financial performance. High interest rates will reduce investor interest in investing funds in the capital market so that trading activities will decline and the company's financial performance will decline. Market growth shows the company's performance improved so that investors will respond positively and the company's financial performance will improve. High profitability indicates a good company prospect so that investors will respond positively to these signals and the company's financial performance will improve. *Singnally theory*, Copeland (1992) suggests that high profitability shows good company prospects so that investors will respond positively and the company's financial performance will improve. Increasing dividend payments indicate the company's prospects are getting better so

investors will be interested in buying shares and the company's financial performance will improve. The large size of the company shows that the company has developed so that investors will respond positively and the company's financial performance will increase. The relative market share shows the company's competitiveness is higher than its main competitors. Investors will respond positively so that the company's financial performance will improve. The higher debt policy will cause *financial distress* so that the company's financial performance decreases. *Balancing Theory*, Adedeji (2018) states that there is a balance between benefits and sacrifice in relation to debt.

Research Hypothesis

H1 = Institutional ownership negatively influences debt policy
H2 = Management ownership negatively influences debt policy
H3 = Interest rates negatively affect debt policy
H4 = Capital market conditions negatively affect debt policy
H5 = Market growth has a positive effect on debt policy
H6 = Profitability has a negative effect on debt policy
H7 = Dividend payment has a positive effect on debt policy
H8 = Firm size has a positive effect on debt policy
H9 = Market share is relatively positive effect on debt policy
H10 = Institutional ownership has a positive effect on corporate financial performance
H11 = Management ownership has a positive effect on the company's financial performance
H12 = Interest temperature has a negative effect on the company's financial performance
H13 = The state of the capital market has a positive effect on the company's financial performance
H14 = Growth in asar has a positive effect on the company's financial performance
H15 = Profitability has a positive effect on the company's financial performance
H16 = Dividend payment has a positive effect on the company's financial performance
H17 = The size of the company has a positive effect on the company's financial . performance
H18 = Market share is relatively positive effect on the company's financial performance
H19 = Debt policies negatively affect the company's financial performance

RESEARCH METHODS

Population and Samples The population in this study are companies listed on the IDX. Sampling is done by purposive sampling, which is a sample that has the following criteria:

1. The company was listed on the Indonesia Stock Exchange in 2015 - 2018.
2. Financial statement data is available for 2015 - 2018 reports.
3. The company publishes financial statements which has been audited using the fiscal year ending December 31.

Research Variables

1. Management Ownership Structure Management ownership structure is the proportion of institutional and management ownership in company stock ownership. Management ownership is a situation where the manager owns the company's shares or in other words the manager as well as the company's shareholders. In the financial statements, this situation is indicated by the large percentage of company share ownership by managers. Because this is important information for users of financial statements, this information will be disclosed in the notes to the financial statements. Management ownership

becomes interesting if it is related to *agency theory*. In the framework of *agency theory*, the relationship between managers and shareholders is described as the relationship between *agent* and *principal* (Schroeder et al. 2011). *Agent* is mandated by the *principal* to conduct business in the interests of the *principal*. Manager as *agent* and shareholder as *principal*. Business decisions taken by managers are decisions to maximize the company's resources (utilities). A threat to shareholders if the manager acts in his own interests, not in the interests of shareholders. In this context each party has their own interests. This is the basic problem in *agency theory,* which is a conflict of interest. Shareholders and managers are each interested in maximizing their objectives. Each party has a risk associated with its function, the manager has the risk of not being appointed again as a manager if it fails to carry out its functions, while shareholders have the risk of losing their capital if they choose the wrong manager. This condition is a consequence of the separation of the management function from the ownership function.
The situation mentioned above will certainly be different, if the conditions are the manager as well as the shareholder or shareholder as well as the manager or also called the condition of the company with management ownership. Decisions and activities in companies with management ownership will certainly be different from companies without management ownership. In companies with management ownership, managers who are at the same time shareholders will certainly align their interests with their interests as shareholders. While in a company without management ownership, managers who are not shareholders are probably only concerned with their own interests.

a. Institutional
ownership Institutional ownership is the proportion of share ownership by the institution in this case the founding institution of the company, not the institution of public shareholders measured by the percentage of the number of shares owned by internal institutional investors. This measurement refers to the research of Friend and Hasbrouk (2018).

b. Management
Ownership Management ownership is the largest shareholding by company management as measured by the percentage of the number of shares owned by management.

2. Debt policy (Capital Structure) Capital structure is a comparison of the financial performance of debt with the financial performance of its own capital which is reflected in the company's financial statements at the end of the year. This variable is expressed in the ratio of total debt to the sum of total debt and equity in the year-end balance sheet. This measurement refers to research by Friend and Lang (2018), Homaifar (2014).

3. Risk Is a grouping of variables that cannot be controlled by the company. Variables included in external factors are interest rates, capital market conditions, and market growth.

a. Interest rates
The operational understanding of the variable interest rates is the interest rates on investment loans and the interest rates of working capital loans for public banks on average per year charged to companies for the use of working capital funds in the form of short-term debt and investment funds in the form of term debt long at the end of the year.

b. The capital market situation
Capital market conditions are the magnitude of the financial performance of trading transactions on the IDX at the end of the year as a reflection of the development of the IDX. The capital market condition variable is measured by the financial performance of stock trading on the Indonesia Stock Exchange at the end of the year.

c. Market Growth

The perception of business opportunities available in the market that must be seized by the company. This market growth is measured from the financial performance ratio of the difference in the volume of industrial sales in year t with the volume of industry sales in year t-1 divided by the volume of industrial sales in year t-1.

Internal factors are a set of variables that can be controlled by the company. The variables included in the internal factors are profitability, dividend payments, company size and relative market share.

a. Profitability
   The company's ability to generate profits or profits for one year expressed in the ratio of operating income to sales from the end of the year income statement data.
b. Dividend payments Dividend
   payments represent the amount of profit distributed to shareholders at the end of the year which will also reflect the amount of profit to be invested in retained earnings at the end of the year. This variable is expressed in the ratio of dividends per share to earnings per share at the end of the year.
c. Company the size
   Size of the company in this study is a reflection of the size of the company that appears in the financial performance of the total assets of the company on the balance sheet at the end of the year, as measured by total assets.
d. Relative market share
   Perception of a company's strengths and weaknesses compared to its main competitors in the market. The measurement of this variable uses the company's sales volume divided by the sales volume of the main competitors.

4. Corporate Financial Performance

Corporate financial performance is defined as investor perceptions of the level of success of the company in managing resources in year t which is reflected in stock prices in year t + 1. Variable measurement of the company's financial performance is the ratio of increase / decrease in stock prices year t + 1 with the financial performance of books per share in the year-end balance sheet t. This measurement is in accordance with the measurements used in the research of Miller (1961).

Company Financial Performance or company performance is the result of the company's operational activities. Operational activities in the financial statements are shown by the achievement of net profit. Profit is the difference between *revenue* and *expenses*. So managers in managing the company will try to maximize *revenue* and reduce *expenses*. Activity to maximize *revenue* is also called an increase in profitability, while reducing *expenses* is also called an increase in efficiency. The company's performance will be better if the company's shares are owned by managers. Managers feel they have more company. The manager is no longer a paid professional but also a company owner. Good company performance will have an impact on dividends to be received by shareholders, because dividends are always based on current year's net income and net income is a measure of company performance. Managers who own company shares will enjoy this dividend distribution.

Mudambi's research shows that share ownership by managers influences company performance. In fact, this research succeeded in proving the direction of the relationship that is not always the same (*non-monotonic*). The direction of the relationship will be different for each range of ownership percentage (Mudambi 2015). Whereas research by Kumar and Coles shows that there is a relationship between management ownership and company performance (Kumar 2014, Coles 2012).

From the explanation and some empirical research above, it can be concluded that the performance of a company without management ownership will be different from companies with management ownership.

Research Data

The data used in this study are secondary data consisting of:

1. Financial statements December 31, 2015, December 31, 2016, December 31, 2017, December 31, 2018.
2. End of month stock prices in 2015 to in 2018 and the price at share the end of 2015 to 2018.
3. Average end-of-month working capital loan interest rates and average end-of-month investment loan interest rates from Government Commercial Banks for 2015 to 2018.

DISCUSSION

The results of partial tests indicate that the variable institutional ownership has a negative and significant effect on debt policy. Increasing institutional ownership is expected to strengthen control over management. If the monitoring costs are high, the company will use a third party, namely creditors to help supervise. The management ownership variable does not have a significant effect on debt policy. The findings of this study also do not support *agency theory*, Jensen and Meckling (1976) who explain the existence of a clear separation between the ownership function and the management function. Management has no control in determining the debt because many are controlled by the majority owner. Interest rate variables have a negative effect on debt policy. The higher interest rates will reduce the interest of companies to make loans so that debt policy will decrease. The results of this study support the research results who found that interest rates have a negative effect on debt policy.

The capital market situation does not significantly influence debt policy. The more excited the capital market did not reduce the interest of companies to lend to banks. This phenomenon is interesting to study. Many large companies in Indonesia still depend on financing from the banking sector. Market growth has a positive effect on debt policy. The findings of this study support the results study which found that market growth influences debt policy. The higher the market growth, the greater the company's business opportunities.

Profitability has a negative effect on debt policy. The findings of this study support the results study which found that profitability had a negative effect on debt policy. Increased profitability will increase retained earnings. The availability of increasing internal funds will reduce the interest of companies to finance through debt so that debt policy decreases.

The variable dividend payment has a positive and significant effect on debt policy. The results of this study support the *pecking order theory*, where in financing, the company bases on the order of retained earnings, then debt and finally the issuance of new shares.

Company size has a positive effect on debt policy. Large companies have *assets* in large numbers that can be used as a guarantee to obtain financing from debt so that debt policy will increase.

The relative market share has no significant effect on debt policy. The findings of this study do not support the results of study which found that market share variables had a relatively positive effect on debt policy. The variable of institutional ownership has a negative and significant influence on the company's financial performance. The findings of this study are consistent with the findings study which found that institutional ownership negatively influences the company's financial performance.

The management ownership variable does not have a significant effect on the company's financial performance. Company management has no control over the company. Management is more controlled by the majority owner so that management is only an extension of the majority owner. The findings of this study are consistent with the findings of which found that management ownership had no significant effect on the company's financial performance.

Interest rate variables have a negative and significant effect on a company's financial performance. If interest rates increase, investors are more interested in investing their funds in the banking sector and reduce investor interest in investing their funds in the capital market. If the stock demand decreases, the share price will decrease so that the company's financial performance will decrease.

The capital market situation has a positive and significant impact on the company's financial performance. The findings of this study indicate that investors in Indonesia, namely foreign

investors and domestic investors in general will consider the capital market development factor in buying shares.

Market growth variables have a positive and significant influence on the company's financial performance. The findings of this study indicate that increasing market growth will affect *earnings* company. *earnings* Increasing companyshow good prospects for the company in the future. Good prospects will be responded positively by investors. The positive response from these investors will increase share prices and will further improve the company's financial performance.

The profitability variable has a positive and significant influence on the company's financial performance. The findings of this study support the *signaling theory*, Copeland (1992) which states that companies that have *earnings* increasingare a signal that the company has good prospects in the future. Dividend payment variable has a positive and significant effect on the company's financial performance. This finding supports the results of study which found that dividend payments had a positive effect on *returns* stock.

The size of the company has a significant positive effect on the company's financial performance. The findings of this study are consistent with research findings. The findings of this study indicate that investors consider the size of the company in buying shares. Company size is used as a benchmark that the company has good performance. The relative market share has a significant positive effect on the company's financial performance. The findings of this study indicate that in making stock purchases many investors consider relative market share. Debt policy has a negative and significant influence on a company's financial performance. The results of this study support the capital structure theory of *the trade off model* which states that the increasing amount of debt will reduce the company's financial performance.

CONCLUSIONS AND SUGGESTIONS

This research proves that there are differences in debt policy and corporate financial performance between companies without management ownership compared to companies with management ownership. The average score of the company's debt policy variables with management ownership compared to companies without management ownership strengthens the evidence that a manager and shareholder are more careful in taking on a debt policy. The financial performance of companies without management ownership compared to companies with management ownership has proven to be different, even the average financial performance of companies with management ownership is better than the average financial performance of companies without management ownership. While the hypothesis about differences in corporate financial performance between companies without management ownership compared with companies with management ownership is not proven. The average performance of companies without management ownership compared to companies with management ownership is the same even though the average performance of companies managed by managers and shareholders is better.

The results of this study can be a reference material for other research related to management ownership. This research supports and can be used as a basis for research on the relationship or influence between management ownership on debt policy and corporate financial performance. In addition, for financial statement users, especially investors and creditors, this research can be used as a reference to see that between companies managed by managers who are both owners and those who are not different in terms of prudent funding decisions and improve the company's financial performance. So the results of this study can be used as a basis for providing stock options for managers.

This research has not provided information on how far the ownership of public companies in Indonesia can be reduced so that agency conflicts can be more creative. Ownership of public companies observed in this study also has not observed ownership by foreign owners. Future research needs to include ownership by foreign investors so we can observe how the implementation of *good corporate governance* in public companies.

Analysis of *good corporate governance* in this study is also only based on data which is secondary data.

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