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ANALYSIS OF THE EFFECT OF FREE CASH FLOW AND MANAGERIAL OWNERSHIP ON THE COMPANY VALUES: EMPIRICAL STUDY IN MANUFACTURING COMPANIES LISTED AT THE INDONESIAN STOCK EXCHANGE

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ABSTRACT
The company is a place to carry out the activities of the production process of goods or services. The ultimate goal for the company is to maximize shareholder prosperity through the share price enhancement. Managers entrusted by the owner of the company to manage the company are always required to be able to play an important role in operations, marketing, and the formation of the overall corporate strategy. In carrying out their duties, managers are expected to provide good performance in order to achieve the company's goals. The cash position available to shareholders will be reflected in the free cash flow owned by the company. This study aims to examine the effect of free cash flow on the company value and to examine the effect of managerial ownership on company value. Locus / object of this research are Manufacturing Companies listed at the Indonesian Stock Exchange for the period 2012-2016. Based on research obtained the variable of Free Cash Flow (FCF) not proven had negative and significant effect on company value. Managerial ownership variable also not proven had a positive and significant effect on the company value.

KEY WORDS
Size, LEV, FCF, Managerial ownership.

The establishment of a company needs to have a clear purpose. There are several things that stated about the purpose of the establishment of a company. The company's first goal is to achieve maximum benefit or maximum profit. The second goal of the company is to prosper the owner of the company or the shareholders. Whereas the third company goal is to maximize the value of the company which is reflected in its share price. Shareholders and company assets are represented by share prices which reflect investment decisions, financing, and asset management. The higher the stock/share price, the higher the company's value. High company value is the desire of company owners or shareholders, because with high company value shows the prosperity of shareholders that also high.

The ultimate goal for the company is to maximize shareholder prosperity through the share prices enhancement. But the management or manager of the company often has other objectives that conflict with the main objectives of the company, so that often cause conflicts of interest that occur between managers and shareholders. To eliminate conflicts of interest and maintain the company's business continuity, then the company always strives to increase dividend payments from year to year so that the welfare of shareholders also increases. Dividends are profits provided by the stock/share issuing company on profits generated by the company. *Free cash flow* is company cash that can be distributed to creditors or shareholders that have not been used as working capital or investment in fixed assets. Management usually prefers to reinvest the free cash flow funds in projects that can generate profits, because this alternative will increase the incentives that management will receive.

While the shareholders really hope that the free cash flow funds can be distributed as dividends, so that it will increase the prosperity of the shareholders.

Jensen (1986) in Uyara and Tuasikal (2003) explains that if a company has free cash flow, usually the manager of that company will be pressured by shareholders to distribute the part of the dividend. Ross et. al (2000) in Uyara and Tuasikal (2003) states that free cash flow is a company's cash that can be distributed to creditors by shareholders that are not used for working capital by investation in fixed assets. Shiever and Vishny (in Siallagan & Machfoedz, 2006) state that the ownership of large shares in terms of economic value has an incentive to monitor. According to Jensen and Meckling (1976), when share ownership by management is low, then there is a tendency for managers' opportunistic behavior to increase as well.. Research by Wahyudi and Pawestri (2006) found that managerial ownership has an influence on the company value. The relationship between managerial ownership and the company value is a non-monotonic relationship that arises because of incentives owned by managers and they try to align the interests with outsider ownership by increasing their share ownership if the value of the company increases.

Meanwhile the results of research from Tendi Haruman (2008) concluded that managerial ownership variable has an influence with the direction of negative relationships. This can be interpreted that the higher the proportion of managerial ownership, the lower the market value. These results are consistent with research by Lemons and Lins (2001), Lins (2002) and Siallagan and Machfoedz (2006).

This decrease in market value was due to opportunistic actions taken by managerial shareholders.

Manufacturing company is a company chosen by the author as the object of research to see the effect of free cash flow and managerial ownership on the firm/company value. with the consideration that the data are sufficiently available. Another fundamental reason in relation to reinvesting company equity and the presence of free cash flow is because companies in Indonesia have characteristics that are not different from companies in Asia in general, where companies owned by someone are always run and controlled by the family. Even though the company grew and became a public company, family control still remained significant. The pattern of business ownership like this encourages the practice of irregularities that will bring down the value of the company (Herdinata,2008).

Through the description in the background above, there are still differences in inconsistencies with the results of previous studies, so in this study the author wants to conduct in-depth testing concerning: “Analysis of the Effect of Free Cash Flow and Managerial Ownership on Company Value in Manufacturing Companies Listed at the Indonesian Stock Exchange/ Bursa Efek Indonesia (BEI).

Based on the background description described above, then the formulation of the issues raised in this study is: Does free cash flow has an effect on the value of the company and whether managerial ownership has an effect on the value of the company.

The purpose of this study was to examine the effect of free cash flow on the firm/company value and examine the effect of managerial ownership on the firm/company value.

LITERATURE REVIEW

Jensen (1986) defines free cash flow as cash flow which is the remainder from the funding of all projects that generate a positive net present value (NPV) discountenanced at the rate of relevant capital costs. This free cash flow which became the driven of differences in interests between shareholders and managers. When free cash flow is available, the manager will waste the free cash flow, resulting in inefficiencies in the company or will invest freecash flow with a small return (Smith & Kim, 1994).

Based on agency theory, differences in interests between managers and shareholders result in conflict that is commonly called *agency conflict*. This potential conflict of interest causes the importance of a mechanism implemented to protect the interests of shareholders (Jensen & Meckling, 1976).

Managerial ownership is a form of stock ownership by company management that measured by the percentage of the number of shares owned by management (Sujono and Soebiantoro, 2007).

According to Itturiga and Sannz (2000) the managerial ownership structure can be explained from two points of view, namely the Agency Approach and the Asymetric Information Approach.

Gunarsih (2004) states that the form of company ownership is one of the mechanism that can be used so that managers carry out activities in accordance with the interests of company owners.

Shleifer and Vishny (in Siallagan Machfoedz, 2006) stated that ownership of large shares in terms of economic value has an incentive to monitor. According to Jensen and Meckling (1976), when share ownership by management is low, there is a tendency for managers' opportunistic behavior that will increase as well.

Basically, the value of a company is measured from several aspects, one of which is the market price of a company's stock, because the market price of a company's stock reflects the investor's assessment of the overall equity owned (Wahyudi and Pawestri, 2006).

Company value can reflect the value of assets owned by the company such as securities. Stock/share is one of the securities issued by the company, the high and low of shares is much influenced by the condition of the issuer. One of the factors that influence stock prices is the ability of companies to pay dividends (Martono & Agus Harjito, 2005: 3). Company value can be seen from the company's ability to pay dividends. The amount of this dividend can affect stock prices. If the dividend paid is high, then the stock price tends to be high. Conversely, if the dividend paid is small, then the share price is also low.

According to Indriyo (2002), that aspects as a guideline for increasing / maximizing company value are as follows:

- Avoid high risks. If the company is carrying out long-term operations, it must avoid a high level of risk. Projects that have high profit potential but contain high risks need to be avoided.
- Pay dividends. Dividends are the distribution of profits to shareholders by a company. Dividends must be in accordance with the needs of the company and the needs of shareholders. When the company is experiencing growth, dividends are less likely, so that the company can cultivate the funds needed at the time of growth. However, if the company is already well established where at that time the revenue received is already large enough, while the need for fund cultivation is not so large, then the dividend paid can be enlarged. By paying dividends fairly, then the company can help attract investors to look for dividends and this can help preserve the value of the company.
- Seeking the Growth. If the company can develop sales, this can result in business safety in competition in the market. Then companies that will try to maximize the value of the company, must continually strive for growth in sales and income.
- Maintaining High Market Prices. The development of stock prices in the market is the main concern of financial managers to provide prosperity to shareholders or company owners. Managers must always try in that direction to encourage people to be willing to invest their money in the company. With the right investment selection, then the company will reflect the direction as a wise investment for the community. This will help enhance the value of the company.

Agency theory states that as an agent of shareholders, managers do not always act in the interests of shareholders. Agency theory is a consequence from the separation of the control function from the ownership function.

The first type of agency problems which are commonly happened in developed countries, where found the large companies that are managed by professional managers and their owners are investors with relatively small ownership.

The principal is the owner of the company (shareholders) and the agent is the management team in the context of the company. The management team is given the authority to make decisions related to the company's operations and strategies in the hope that the decisions made will maximize the value of the company.

The second type of agency problem is highlight conflicts of interest between majority shareholders and minority shareholders. The majority shareholder who is usually also the manager of the company or at least appoints the manager of his/her choice, can make decisions that only benefit the majority shareholder.

The third type of agency problem is highlight conflicts between shareholders and lenders. The conflict was caused by differences in risk between the two parties (Choi, 1992 in Sugiarto 2009). Shareholders can enforce policies that allow welfare transfers from lenders to shareholders.

Free cash flow is the excess cash funds after being used to fund all projects that provide positive net present value and discountenanced at the rate of relevant capital costs (Jensen, 1986). Jensen basing on agency theory states that companies that have excess cash funds, will have a tendency to spend it on unprofitable investments. This is because managers in companies with excess cash funds tend to use them in order to enlarge the size of the company and the advantages in the form of benefits for managers themselves.

This has an impact on the use of free cash flow that does not provide benefits for shareholders.

Jensen states that the tendency of managers' actions to use free cash flow in over investment activities is based on the following thinking (Kallapur, 1993):

- *Cash retention,* namely gives the manager an authority that the manager will lose if the company often issues shares to the market in order to finance its investment;
- Increasing company size will encourage prestige and salaries for managers;
- The tendency of companies to give rewards to middle-level managers in the form of promotion rather than bonus money, hence there will be a bias in the company's growth.

The more free cash flow that is owned and meanwhile the opportunity for growth is relatively small, this will encourage an increase in the problem of free cash flow (Michaely & Robert, 2006).

According to agency theory, the separation between ownership and management of the company can lead to agency conflict. Agency conflict is caused by principals and agents having their own conflicting interests because agents and principals are trying to maximize their respective utility.

Differences in information held by the manager and owner (information asymmetry) are often more beneficial for the manager because the manager knows more about the daily activities of the company in detail. When there is a difference in information between manager and owner or information asymmetry,

then decisions made by managers can affect stock prices because the information asymmetry between better-informed investors and less-informed investors causes transaction costs and reduces expected liquidity in the market for company shares (Komalasari, (2000) in Siti, (2004))).

There are two types of information asymmetry (Rahmawati et al, 2007), namely:

Adverse Selection. Adverse selection is a type of information asymmetry where one or more parties who carry out or will carry out a business transaction, or potential business transactions have more information over other parties. *Adverse selection* occurs because some people such as company managers and other insiders are more aware of the present conditions and future prospects of a company than outside investors.

Moral Hazard. Moral hazard is a type of information asymmetry where one or more parties who carry out a business transaction or potential business transaction can observe their actions in the settlement of their transactions while the other parties do not.

Moral hazard can occur because of the separation of ownership from control which is characteristic of most large companies.

Solihan and Taswan (in Jogi and Josua, 2007) found a significant and positive relationship between managerial ownership and the firm/company value. While research conducted by Laster and Faccio (1999) found a weak relationship between management ownership and the firm/company value. Sialllagan and Machfoedz (2006) also concluded that managerial ownership has a negative effect on the firm/company value usually measured by Tobin's Q.

Jensen and Meckling (1976) found that the greater shareholding by management would reduce the tendency of management to optimize the use of resources resulting in an increase in the firm/company value. In contrast to Jensen and Meckling (1976), Stulz (1988) in Chen et al (2003) developed a model that shows that at a high level of managerial ownership, managers tend to be entrenched in their positions which results in a negative relationship between the two variables between managerial ownership and firm value.

METHODS OF RESEARCH

In this study the authors take the object of research on Manufacturing Companies listed at the Indonesian Stock Exchange in the period of 2012-2016. These are companies that are not include insurance companies and are not engaged in banking and construction, which publish financial reports in a row from 2012 to 2016. The data used are sourced from the Indonesian Capital Market Directory (ICMD) from 2012 to 2016 as well as books or literature that are closely related to the title of this study.

The statistical test in this study was carried out using the Eviews 4.0 program to determine the effect of the independent variables namely free cash flow and managerial ownership, then testing the research hypothesis on the variables by conducting t test.

$$Q_{it} = a + \beta 1\ FCF_{it} + \beta 2\ MGT\ OWN_{it} + \beta 3\ SIZE_{it} + \beta 4\ LEV_{it} + \varepsilon_{it}$$

Where: Q - company value; a - Constant Number; β1…β4: Regression Coefficient; I - Individual company; t - Year of…; FCF - Free Cash Flow; MGT OWN - Managerial Ownership; SIZE - Company Size; LEV – Leverage; ε – Error.

RESULTS AND DISCUSSION

The results of data management in the form of information to determine whether free cash flow has a significant negative effect on the firm/company value and whether managerial ownership has a significant positive effect on the firm/company value.

The total population in this study amounted to 142 manufacturing companies listed at the Indonesian stock exchange in 2012-2016. Based on the determined criteria obtained a sample of 62 manufacturing companies taken by purposive sampling method. The following is the sample selection process in this study.

Table 1 – Sample Selection Process

Information	Number of Samples
1. Manufacturing Companies listed at the Indonesian Stock Exchange.	142
2. Companies that have incomplete financial statements during the research year.	30
3. Companies that have experienced losses during the study period	-
4. Companies that do not have complete data related to the variables used in the study.	50
Number of Final Samples	62

Source: Data Processed.

Table 1 above shows that from the 142 manufacturing companies listed on the Indonesian Stock Exchange in 2012-2016, only 62 companies were used as the sample in the study according to specified criteria.

The main descriptive statistics discussed are the mean, standard deviation, maximum value and minimum value of the studied variables. Descriptive statistics of the research variables can be seen in the following table.

From Table 2, it can be conveyed several things related to variable characteristics, among others, Q using observation of 62 companies have a minimum value of 2,007 and a maximum value of 2,011 with a mean value of 2,008. This shows an increase in the value of the company with a standard deviation of 1,414.

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For the FCF variable has a minimum value of 8,146 and a maximum value of 9,46 with a mean value of 1,20, indicating an increase in the value of the company at a high level of free cash flow with a standard deviation of 2,24. With this large standard deviation, it shows that the data is more varied.

Table 2 – Descriptive Analysis

Variable	Min	Max	Mean	Std. Deviation
Q	2,007	2,011	2,008	1,414
Ln_FCF	8,146	9,460	1,200	2,240
Mgt Own	22,300	32,904	29,933	1,904
Size	0,000	1,985	0,013	0,146
LEV	25,414	32,664	28,359	1,548

Data source: Secondary data processed.

Mgt Own variable has a minimum value of 22,300 and a maximum value of 32,904 with a mean value of 29,933 and a standard deviation of 1,904. Furthermore, the variable size has a minimum value of 0,000 and a maximum value of 1,985 with an average value of 0,013, indicating that the company has sufficient assets to make subsequent investments with a standard deviation of 0,146.

Whereas the LEV variable has a minimum value of 25,414 and a maximum value of 32,664 with an average value of 28,359 with a standard deviation of 1,548.

The results of hypothesis testing can be seen in table 3 below:

Table 3 – Testing Results

Variable	Common Model	Fixed Effect Model	Random Effect Model
Q	2.008 (8.958)	-	2.009 (5.563)
Ln_FCF	1.53 (0.413)*	3.21 (0.538)*	4.60 (0.877)*
Mgt Own	-0.042 (- 0.936)*	-0.077 (-1.225)*	-0.008 (-1.073)*
Size	0.907 (1.645)*	1.098 (1.603)*	0.062 (0.500)*
LEV	0.066 (1.247)*	0.175 (1.890)**	0.001 (0.204)*
R^2	0.017	0.081	-0.180
Adjusted R Squared	0.004	-0.267	-0.195
F	1.317*	2.648***	-
DW	2.332	2.339	1.986

*Source: Data Processed. Notes: * is a significant level at the 10% level; ** is a significant level at the 5% level; *** is a significant level at the level of 1%.*

The results of hypothesis testing can be seen in table 4.3 with the comparison of the use of each model, as follows:

In the common model the results show that, free cash flow has a positive coefficient value of 1,53 with a t-statistic value of 0,413 and a probability level of 0,679.

Managerial ownership has a negative coefficient of -0,042 with a t-statistic value of -0,936 and a probability level of 0,349. Testing of variable size with the common model can show the results of a coefficient of 0,907 by having a t-statistic value of 1,645 and a probability level of 0,100.

Testing for LEV variable has a coefficient value of 0,066 with a t-statistic value of 1,247 and a probability level of 0,213. Testing of each variable with the fixed effects model shows the results that, the free cash flow variable has a coefficient of 3,21 with a t-statistic value of 0,538 and a probability level of 0,591.

Managerial ownership variable has a coefficient value of -0,077 and a t-statistic value of -1,225 with a probability level of 0,221. While the size variable has a coefficient value of 1,098 with a t-statistic value of 1,603 and a probability level of 0,110. And for the LEV variable has a coefficient value of 0,175 with a t-statistic value of 1,890 and a probability level of 0,059.

Testing the variable with the random effect model shows the result that, the free cash flow variable has a coefficient of 4,60 with a t-statistical value of 0,877 and has a probability level of 0,380. Managerial ownership variable has a coefficient value of -0,008 with a t-statistic value of -1,073 and has a probability level of 0,283. While the size variable has a coefficient value of 0,062 with a t-statistic value of -0,5000 and a probability level of 0,617. And for the LEV variable has a coefficient value of 0,001 with a t-statistic value of 0,204 and a probability level of 0,838.

If seen from table 4.3, the greatest value of R^2 is in the fixed effect model when compared with the results of R^2 in the common model and random effect model. A value of 0,081 indicates that the better the independent variable explains the dependent variable.

DISCUSSION OF RESULTS

$H_{1:}$ *Free cash flow has a negative and significant effect on the firm/company value.*

The regression test results in table 3 show that the FCF variable t-value amounted to 0,538 with a probability of 0,591. Because the value of the t-test probability is greater than the level of 0,05 or 5% , then H_1 is rejected. Thus Free cash flow (b_1) has a positive and not significant effect on the value of the company. This shows that with every increase in free cash flow, and then the company's value will also increase. Based on the results of this study it can be said that the availability of large free cash flow illustrates a good company growth situation.

The results of this study are contradictory or not in accordance with the results of previous studies conducted by Jensen (1986) where companies with large free cash flows will tend to enlarge the company by taking on projects with negative NPV, so this will reduce shareholder wealth and will also decrease the value of the company.

$H_{2:}$ *Managerial ownership has a positive and significant effect on the firm/company value.*

The regression test results in table 4.3 show that the t-value of managerial ownership variables amounted to -1,225 with a probability of 0,221. Because the value of the t-test probability is greater than the level of 0.05 or 5%, then H_2 is rejected Thus managerial ownership (b_2) has a negative and not significant effect on the firm/company value.

This shows that the presence of high managerial ownership will cause a decrease in the value of the company.

The results of this study are not in accordance with the results of previous studies conducted by Jensen and Meckling (1976) who found that the greater share ownership by management would reduce the tendency of management to optimize the use of resources thereby increasing company value.

The results of previous statistical tests have shown the coefficient results of the size variable is positive at 1,098 and not significant at the level of 0,05%. This shows that size is said could affect the value of the company. The greater the size of the company, then higher the value of the company (Davies et al., 2005). The large size of the company illustrates that the company has large assets and has a good growth rate so that it can reflect high company value.

The test results for the LEV variable showed a positive coefficient of 0,175 and significant at the level of 0,05%. This shows that LEV is said could affect the value of the company. Companies with good prospects tend to use more debt as an alternative to meeting the needs of dividend payments in the short term if the company does not have internal funds to meet these funds. So if the company uses debt as an alternative need for dividend payments, then the value of the company will increase (Baskin, 1989) and (Adedeji, 1998) in Haruman, 2008.

CONCLUSION AND SUGGESTIONS

This study examines the effect of free cash flow and managerial ownership on the firm/company value.

In this study, the sample used was manufacturing companies listed at the Indonesian Stock Exchange for the period of 2012 to 2016 with a total sample of 62 companies.

From the discussions in the previous chapters, the following conclusions can be drawn:

- The Free Cash Flow (FCF) variable not proven had negative and significant effect on the firm/company value. With the large free cash flow will increase the value of the company. The availability of large free cash flow illustrates a good company growth situation. Companies with excessive free cash flow will have better performance than other companies because they can take advantage from various opportunities that may not be obtained by other companies. Companies with high free cash flow can be expected to survive more in a bad situation. So that it can reflect an increase in the value of the company for shareholders or investors;
- Managerial ownership variable not proven had a positive and significant effect on the firm/company value. The ownership of a high number of shares by the management causes a decrease in the value of the company. Managers who have a large number of shares will tend to entrench (secure) their position. As a result, the decision taken is non-value maximizing, causing the company's value to decline.

Suggestions:

- For investors who will conduct an invesment need to look at free cash flow the company;
- Because free cash flow describes how much cash is available to be distributed to investors;
- For companies, it is necessary to increase managerial ownership so that company managers can work optimally and not take actions that harm the company for their own interests;
- For investors who will conduct stock transactions at the Indonesian Stock Exchange, especially in manufacturing companies can pay more attention to the growth conditions of a company;
- For further research to further develop the independent variable considering the many other variables that play a role in influencing dividend policy by multiplying the sample and increasing the period of research in order to provide more valid results.

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