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Determinants of Debt Policy in Indonesia's Manufacturing Companies

Natasha Claudia Darmawan[1] Liana Susanto[1*]

[1]*Faculty of Economics and Business, Universitas Tarumanagara, West Jakarta - 11470, Indonesia*
[*]*Corresponding author. Email: lianas@fe.untar.ac.id*

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ABSTRACT
For manufacturing companies in Indonesia, the goal of this study is to gather empirical evidence to see if institutional ownership has a negative impact on corporate debt policy, if free cash flow has a negative impact on corporate debt policy, if asset structure has a positive impact on corporate debt policy, and if profitability has a negative impact on corporate debt policy. This study collects data using a purposive sample strategy and processes it using EViews 12 SV. Institutional ownership has no impact on corporate debt policy, free cash flow has a negative impact on corporate debt policy, asset structure has a negative impact on corporate debt policy, and profitability has a negative impact on corporate debt policy, according to research conducted on 73 companies between 2017 and 2020.

Keywords: *Debt policy, institutional ownership, free cash flow, asset structure, profitability*

1. INTRODUCTION

As time goes by, business competition that occurs between companies tends to be more stringent, be it large companies or small companies. These companies are trying to grow their business in the midst of highly unstable economic conditions to make the company's business stand out in the global market. Moreover, there are many obstacles experienced by companies that cannot be predicted. One of them is the Covid-19 pandemic which has had a huge impact on the company. The pandemic is not indiscriminate, all companies are affected by the pandemic. Along with that, the dynamics of the business world will certainly create new obstacles, one of which is funding. The decisions taken by the company's executives are very important decisions that will determine the survival of the company in the future. Corporate funding is considered to be one of the most important. The tremendous amount of competition is forcing these companies to develop a firm value in the market in order to stay afloat. Every company must be able to take advantage of the resources owned by the company, one of which is to ensure that the company can meet the needs of the funds used to run and develop the company. These funds must be able to fund the company's day-to-day operations. Company finances can come from a variety of places, including internal and external sources. Internal funds, as the name implies, originate from within the firm, such as profits, share capital, and retained earnings, whereas external funds, such as long-term and short-term loans, come from outside the organization.

Of course, mere funds are not enough to determine the viability of a company in the global market. Various benchmarks are used to analyze the company's presence in the market. One of them is debt policy. Debt policy is a metric for evaluating how much a firm owes on its assets. Debt is one of the criteria that determines a company's long-term viability, with higher debt posing a greater risk. Company managers' judgments are not just based on their own judgment; there are shareholders that invest in the company. These shareholders have an interest in profiting from dividends, so the company must minimize risk by reducing its debt. As a company grows, it becomes increasingly difficult to be managed, therefore, the company must spread its wings and appoint other professionals to run the company.

Internal funding, on the other hand, is not always sufficient to fund the company's activities. On the other hand, if a company's own money is insufficient to fund its operating activities, debt may be required. Generally, company managers will take advantage of debt to prevent the company from stopping operations. Company managers also use debt to optimize profits, so that in the future, these profits can finance the company's operational activities. In addition, the ownership structure also has an influence on the company in terms of its performance. Shareholders who have control will try to find out how to make the company's performance better and result in greater company value. The ownership structure is often classified into two categories: managerial ownership (share ownership held by company management) and institutional ownership (share ownership held by the general public). Institutional ownership refers to the ownership of company shares by institutions that are either within or external to the company. According to Pasaribu and Sulasmiyati [1], institutional ownership plays a role in overseeing company management because institutional ownership is believed to be able to monitor decisions made by company management better than individual or community ownership. One example is the use of large amounts of debt that require shareholder approval. Shareholders can vote on whether the use of debt will be good for the company.

A large amount of debt also has an impact on free cash flow, which will decrease as debt levels rise, suppressing the usage of debt as well as the asset structure. Yogi and Damayanthi [2] revealed that cash remaining from the firm's operational as well as financing activities that can be given to shareholders and creditors, but not used for company investment activities or as company capital, is referred to as positive free cash flow. Meanwhile, a negative free cash flow indicates that the company's operations have resulted in a cash deficit, forcing the company to rely on other sources of money to fund its investment activities. Because the investment decision surpasses the firm's optimal investment capability, it is argued that the company's investment operations do not yield maximum profitability as a result of the company manager's decision. In other words, free cash flow refers to surplus cash or cash that must be added to the company's investment operations, particularly capital expenditures. If the company's free cash flow is insufficient, it will turn to another source of capital, one of which is debt.

In practice, asset structure aids in establishing a company's ability to repay its loans. If a firm seeks to borrow money, the value of fixed assets is thought to represent a guarantee. Companies may readily use debt as a source of external funding thanks to the asset structure, which provides assurances if they want to utilize debt. A large asset structure will also boost borrowing capacity, so companies can easily use debt as a source of external funding.

Profitability is a measure for determining the likelihood of a company's long-term success. The amount of income received by the company during a certain period is divided by the total assets owned by the company to determine profitability. It is claimed that the higher the profitability, the lesser the company's debt. Because the firm's profits can already finance the company's running activities, and it can even utilize it to carry out investment activities, the company can reduce its usage of debt as a source of external cash.

Many studies on debt policy have been conducted, however the outcomes of these studies differ. Because the results of prior research were inconsistent, a new study was done to look into the elements that determine debt policy. The goal of this research is to gather data on the impact of institutional ownership, free cash flow, asset structure, and profitability on debt policy. It is intended that by conducting this research, the corporation will be able to determine the elements that drive their debt policy.

2. LITERATURE STUDY

2.1. Agency Theory

This theory outlines the link between principals and agents, with shareholders as principals and firm management as agents [3]. The company's primary goal is to maximize profits and increase the company's worth, maximizing shareholder wealth. In this case, the shareholder as the principal appoints the company's management as an agent to make decisions for the benefit of the shareholders. Because of this, there is a separation of functions between shareholders and management, where there

can be conflicts due to misalignment of information between shareholders and management, where shareholders have an interest in getting a return on capital on their investment, while management has an interest in getting rewards for their work [4].

2.2. Pecking-Order Theory

According to the pecking-order theory, corporations will prioritize sources of finances from internal funding sources to equity, based on the cost of financing, with equity coming last. First, the company will utilize internal funds, then debt, and only if that isn't enough, the company will use its equity [5]. Sources of funds used by companies based on pecking order theory tend to come from a hierarchy, where company management is more interested in internal funding sources than external funding sources with the aim of maximizing the profits achieved. Hamzah and Prasetyo, [6] said that companies tend to employ internal money rather than external sources, according to the pecking-order theory, in order to reduce the usage of debt as a source of firm funding. Managers prefer to use internal funds first to avoid conflicts that will arise because of the use of sources of funds originating from debt, only to issue shares as the last source of funding if funds from internal sources and debt are not sufficient for the company's needs.

2.3. Debt Policy

Debt policy refers to a policy that measures the amount of debt a firm uses as a source of funding to fund its operational activities [7]. Debt policy, according to Arry [8], is a management choice to reduce or increase the amount of debt used for business operations. Debt policy refers to a corporation's policy on how much or how little money comes from outside the organization through debt [9]. The percentage of a company's operational activity financed by external sources, especially debt, is referred to as debt policy. Debt policies must be monitored to minimize the risk of company bankruptcy due to excessive or uncontrollable debt. Debt is needed for the company's operating activities, but if the debt is too large, it can increase the risk of bankruptcy, so it is concluded that debt policy can make the company's value higher, but it can also cause company bankruptcy. Debt policy reflects the balance between debt and capital according to Viriya and Suryaningsih [10], the best debt policy is one that maximizes firm value while lowering capital costs. [11].

2.4. Institutional Ownership

The number of shares owned by external parties in the form of institutions, such as banks, insurance companies, governments, and other institutions, is referred to as institutional ownership [4]. Institutional ownership refers to the percentage of a company's stock that is owned by a company. Outsiders are more interested in the firm's shares if institutional ownership of shares increases [10]. This is because it is seen that the company has strong debt management, making the company's shares more intriguing. Institutional ownership is critical because shareholders can better monitor management with institutional ownership [12].

2.5. Free Cash Flow

Positive free cash flow is defined as cash left over after capital expenditures from a company's operational activities, whilst negative free cash flow is defined as cash required for operating activities after capital expenditures [4]. Because corporate management seeks to invest extra cash flow in projects that can raise company value, while shareholders wish to distribute excess cash flow to increase shareholder welfare, free cash flow can produce friction between shareholders and company management. shareholders. Conflict is more common in larger firms. This is due to the fact that managers desire more free cash flow for their personal profit, whereas shareholders want more free cash flow so that they can receive more dividends. As a result, supervision is required so that businesses can minimize conflicts to the greatest extent possible [12].

2.6. Asset Structure

The asset structure depicts how the fixed asset composition compares to the overall assets of a corporation. Assets are the company's resources that are employed to produce income and maximize the company's value now and in the future. A company's assets are often classified into two categories: fixed assets and current assets [11]. The asset structure depicts how a corporation uses the balance between fixed and current assets [13]. Companies with large assets can increase the company's borrowing capacity. If the company has difficulties in funding, the asset structure is very important because the higher the borrowing capacity, the easier it is for the company to obtain external funding, so as to save the company from financial difficulties. The asset structure gives companies access to funding from external parties [14].

2.7. Profitability

Profitability, according to Kieso, et al [15], can be used to determine the level of success or failure of a company over a given period. Viriya and Suryaningsih [10] also believe that profitability refers to a company's ability to generate profits within a specific time frame. Profitability ratios, which are ratios that assess how effective managers are at managing finances and assets in a company to achieve profitability, are used to measure profitability.

2.8. Hypothesis Developments

2.8.1. The Effect of Institutional Ownership on Debt Policy

The larger the institutional ownership, the smaller the debt, because the company's management will try to avoid the dangers of utilizing too much debt in order to maintain the company's shares appealing to investors [4]. According to agency theory, shareholders as principals will also guarantee that management uses debt sparingly in order to reduce the possibility of bankruptcy, because huge debts are a sign of a company's insolvency. Shareholders will also ensure that their interests, namely, to get large dividends, can be met, so managers must also ensure that the company uses debt to a minimum so that the interests of shareholders can be fulfilled [9]. Wahyudi, et al. [7] said that institutional share ownership can reduce agency costs, because there is effective supervision on the part of shareholders, thereby reducing the use of debt. With institutional ownership, shareholders can more easily play a role in corporate decision making, especially the use of debt that requires the approval of the major shareholders. The first hypothesis can be expressed as follows based on this reasoning:
Ha_1: Institutional ownership has a significant and negative effect on debt policy.

2.8.2. The Effect of Free Cash Flow on Debt Policy

The bigger the free cash flow, the lower the debt, according to Tahir, et al. [4]. This is because the firm's management will utilize free cash flow to pay off its debts, as a large amount of debt is a major risk for the company and can lead to bankruptcy. company. The company expects to gain from the debt reduction in terms of operations and investment. Given that a high level of debt is indicative of a company's bankruptcy, the company's management is required to be able to use free cash flow, which is a source of funds from within the firm, to pay down the company's obligations, which are external sources of funds. This is in accordance with the pecking order principle, which states that free cash flow will be utilised first, followed by debt. The second hypothesis can be stated as follows based on this logic:
Ha_2: Free cash flow has a significant and negative effect on debt policy.

2.8.3. The Effect of Asset Structure on Debt Policy

According to Onofrei et al. [14], the more fixed assets a company has, the more probable it is to use those assets as debt collateral. These assets are thought to be capable of giving assurances to the

company in order for it to get debt financing. This is in keeping with the pecking order theory, which states that before employing stock, a corporation will first utilize debt, with the asset structure serving as a guarantee to obtain finance. The third hypothesis can be stated as follows based on this logic:
Ha_3: Asset structure has a significant and positive effect on debt policy.

2.8.4. The Effect of Profitability on Debt Policy

According to Angela and Yanti [9], the higher the company's profitability, the lower the debt it owes. Because the company will use retained earnings to invest and carry out operational activities, companies with high profits tend to have little debt. Higher profitability indicates that the company's profit is higher, implying that the company can finance its running activities with internal cash rather than relying on debt. Profits will be used as an internal source of cash before debt is used as an external funding source for the company's operational activities, according to the pecking order idea. The third hypothesis can be stated as follows based on this logic:
Ha_4: Profitability has a significant and negative effect on debt policy.

3. METHODOLOGY

This study's population is made up of manufacturing companies that have been continually listed on the Indonesia Stock Exchange between 2017 and 2020. A purposive sampling strategy was utilized for sampling. The purposive sampling approach selects the sample to be used based on preset criteria [16]. The predetermined criteria are: (1) Manufacturing companies that consistently present financial statements ending on December 31, and (2) Manufacturing companies that earn consecutive profits. Based on this research, there were 73 companies that met the sample selection criteria with four research periods, namely from the 2017-2020 period so that 292 data were obtained.

EViews 12 SV software is used to collect and process all research data on manufacturing businesses listed on the Indonesia Stock Exchange for the period 2017-2020 in the form of financial reports and annual reports. Table 1 shows the Operationalization of Research Variables.

Table 1 Operationalization of Research Variables

Variable	Proxy	Scale	Reference
Debt Policy	$DAR = \frac{Total\ Debt}{Total\ Assets}$	Ratio	Tahir, et al. [4]
Institutional Ownership	$IO = \frac{Institutional\ Shares}{Outstanding\ Shares}$	Ratio	Tahir, et al. [4]
Free Cash Flow	$FCF = \frac{OCF - Capital\ Expenditure}{Total\ Assets}$	Ratio	Tahir, et al. [4]
Asset Structure	$SA = \frac{Fixed\ Assets}{Total\ Assets}$	Ratio	Tahir, et al. [4]
Profitability	$ROA = \frac{Net\ Income}{Total\ Assets}$	Ratio	Angela and Yanti [9]

Debt policy is the study's dependent variable. Debt policy is measured using the proxy Debt to Assets Ratio denoted by DAR, according to Tahir et al. [4]. DAR is a ratio that compares total debt to total assets to determine debt policy.

The first independent variable, institutional ownership (IO), is derived by comparing the number of institutional shares to the number of outstanding shares, according to Tahir, et al. [4]. The second independent variable is free cash flow, abbreviated as FCF, which may be determined by comparing operational cash flow after capital expenditures to total assets, according to Tahir, et al. [4].

The asset structure, indicated by SA, is the third independent variable, which is derived by comparing fixed assets to total assets, according to Tahir et al. [4]. The final independent variable,

profitability, is represented by ROA and can be assessed using the proxy Return on Assets, which compares net income after taxes to total assets [9].

4. FINDINGS AND DISCUSSIONS

Table 2 shows the descriptive statistics for each variable. For a total sample of 292 samples, the first variable, institutional ownership, has a mean of 0.781506, a median of 0.881065, a maximum value of 0.999541, and a minimum value of 0.000278 with a standard deviation of 0.236597. With a standard deviation of 0.102640, the second variable, free cash flow, has a mean of 0.056002, a median of 0.041815, a maximum value of 0.412188, and a minimum value of -0.256518. Asset structure is the third variable, with a mean of 0.376574, median of 0.378703, maximum of 0.781027, and minimum of 0.000951 and a standard deviation of 0.192512. With a standard deviation of 0.085757, the fourth variable, profitability, has a mean of 0.075608, a median of 0.052928, a maximum value of 0.716023, and a lowest value of 0.000282. Debt policy is the fifth variable, with a mean of 0.404534, a median of 0.410035, a maximum of 0.844782, and a minimum of 0.003453, and a standard deviation of 0.188116.

Table 2 Descriptive Statistics

	IO	**FCF**	**SA**	**ROA**	**DAR**
Mean	0.781506	0.056002	0.376574	0.075608	0.404534
Median	0.881065	0.041815	0.378703	0.052928	0.410035
Maximum	0.999541	0.412188	0.781027	0.716023	0.844782
Minimum	0.000278	-0.256518	0.000951	0.000282	0.003453
Std. Dev	0.263597	0.102640	0.192512	0.085757	0.188116
Observations	292	292	292	292	292

Normality and multicollinearity tests are two of the most used assumption tests. Table 3a shows the normality test results. The Jarque-Berra Prob value obtained from these results is 0.077830, which is greater than the 5% significance level, indicating that the residual data is normally distributed.

Table 3a. Classical Assumption-Normality Test

Jarque-Berra	5.106462
Probability	0.077830

The multicollinearity test can be seen in Table 3b. There are no symptoms of multicollinearity because the correlation matrix is less than 0.85.

Table 3b Classical Assumption-Multicollinearity Test

	IO	**FCF**	**SA**	**ROA**
IO	1.000000	0.158534	0.079412	0.171760
FCF	0.158534	1.000000	-0.136789	0.597945
SA	0.079412	-0.136789	1.000000	-0.150675
DAR	0.171760	0.597945	-0.150675	1.000000

Table 4 shows the results of multiple linear regression tests using the Random Effect Model (REM).

Table 4 Multiple Linear Regression-REM

Variable	**Coefficient**
C	0.500362
IO	-0.025794

FCF	-0.213040
SA	-0.129433
ROA	-0.198375

The multiple linear regression model in this study can be formed as follows based on the test results:

$$\mathbf{DAR} = 0.500362 - 0.025794\ \mathbf{IO} - 0.213040\ \mathbf{FCF} - 0.129433\ \mathbf{SA} - 0.198375\ \mathbf{ROA} + \varepsilon_{i,t}$$

whereas:
DAR: Debt to Assets Rasio
IO: Institutional Ownership
FCF: Free Cash Flow
SA: Asset Structure
ROA: Return on Assets
$\varepsilon_{i,t}$: Error

Table 5 shows the coefficient of determination (Adjusted R^2). The results show that the independent variables of institutional ownership, free cash flow, asset structure, and profitability can only explain 0.079030 or 7.903 percent of the variation in the dependent variable, debt policy, and the remaining 92.097 percent is influenced by factors other than the variables used in this study.

Table 5 Adjusted R^2

Adjusted R-Squared	0.079030

Table 6 shows the results of the F-test. It is clear from the results that the value of Prob. The F-statistic value is 0.000014, which is less than 0.05. As a result, the independent factors of institutional ownership, free cash flow, asset structure, and profitability, when combined, have a considerable impact on the dependent variable of debt policy.

Table 6 The Result of F-Test

Weighted Statistics	
F-statistic	7.242772
Prob(F-statistic)	0.000014

Table 7 shows the results of the t-test. The coefficient for institutional ownership is -0.025794, and the prob. t-statistic is 0.4816, which is bigger than the value of significancy, 0.05, indicating that Ha_1 is not accepted, implying that institutional ownership has no significant effect on the dependent variable of debt policy. The coefficient value for the free cash flow variable is -0.213040, and the prob. t-statistic is 0.0002, which is less than 0.05, indicating that Ha_2 is accepted, and the free cash flow variable has a negative and significant effect on the dependent variable of debt policy. The asset structure variable has a negative and significant effect on the dependent variable of debt policy, with a coefficient of -0.129433 and a prob. t-statistic of 0.0252, which is less than the value of 0.05, indicating that Ha_3 is not accepted because the asset structure variable has a negative and significant effect on the dependent variable of debt policy. The coefficient for the profitability variable is -0.198375, and the prob. t-statistic is 0.0098, which is less than 0.05, indicating that Ha_4 is acceptable, and that the independent variable profitability has a negative and significant influence on the dependent variable debt policy.

Table 7 The Results of t-Test

Variable	Coefficient	t-Statistics	Prob.
C	0.500362	11.88185	0.0000
IO	-0.025794	-0.704614	0.4816
FCF	-0.213040	-3.831190	0.0002

SA	-0.129433	-2.249557	0.0252
ROA	-0.198375	-0.599339	0.0098

Institutional ownership has no significant influence on debt policy. These findings are consistent with [7], [10]–[11], and [18], but not with [9] and [12], implying that institutional ownership has a favorable impact on debt policy. This research contradicts [4] and [9], both of which claim that institutional ownership has a detrimental impact on debt policy. The inability of institutional ownership to influence the extent of the company's debt may be due to shareholders who want management to borrow to maximize profits so that dividends paid to shareholders from operational profits can be increased.

Debt policy is influenced negatively by free cash flow. These findings are consistent with [4], which claims that free cash flow has a negative impact on debt policy, but not with [6, which claims that free cash flow has a favorable impact on debt policy. This research contradicts [12] and [18], which claim that free cash flow has no major impact on debt policy. This is due to the fact that as free cash flow increases, debt decreases. This decision was made by management to reduce the risk of the company going bankrupt, as evidenced by the amount of debt that could signal bankruptcy. Debt reduction is expected to benefit the firm not only in terms of reducing the risk of bankruptcy, but also in terms of optimizing profits and increasing corporate value, so that these funds can be used for investment activities in the future.

Debt policy is influenced negatively by asset structure. This is consistent with [4, 11, and 14], but not with [17] and [19], which claim that asset structure has a favorable impact on debt policy. This study also contradicts [4], which found that asset structure has no substantial impact on debt policy. The debt will reduce as the asset structure improves. Companies rarely use their fixed assets as debt collateral. This also means that the company's assets can be used to fund the company's operating activities rather than relying on significant loans. Because the company's borrowing capability is large, a high asset structure does not ensure that the company will use a lot of debt. There are a number of other factors that influence management's debt policy decisions.

The impact of profitability on debt policy is significant and negative. These findings support [6], [11], [13], and [18], which claim that profitability has a negative impact on debt policy, but contradict [19], which claims that profitability has a favorable impact on debt policy. This study contradicts the findings of [9–10], [17], and [21], which claim that profitability has no impact on debt policy. Companies with great profitability can pay off their debts with their operational profits, reducing the need for debt as a source of company cash. High profitability also demonstrates the company's numerous internal sources of funds, which can be used for operational purposes or even company investment. According to the pecking order idea, corporations prefer to employ internal capital before turning to debt for financing.

5. CONCLUSIONS

The insignificant effect of institutional ownership shows that although shareholders have an interest in getting the maximum profit, on the other hand, management as the party running the company remains selective in making decisions, especially decisions related to costs.

The negative and significant influence of free cash flow implies that the lower the debt, the higher the free cash flow. Free cash flow will be utilized to pay off debts so that the company's debt does not grow, and the risk of bankruptcy is reduced. Because a large amount of debt poses a significant danger to the company, management will use free cash flow to pay down debt and prevent it from growing. This is in line with the pecking order hypothesis, according to which the company will use its free cash flow to pay down debt, reducing the use of debt and increasing the use of internal sources of funds for operating activities.

The negative and significant effect of asset structure indicates that the company tends to use larger debt if its asset structure is smaller. This shows that the company's assets are sufficient to fund the company's operational activities, avoiding the need for substantial indebtedness.

Profitability has a negative and significant influence, indicating that the corporation prefers to use internal funding sources arising from profits to reduce debt. This is consistent with the pecking order

theory, which states that management prefers internal funding sources and avoids debt. Debt will be used only if the company's internal funding is insufficient to fund its operating activities. Management does not need to take on a lot of debt if the earnings is adequate to fund the company's operations.

The primary goal of this research is to identify the factors that influence manufacturing businesses' debt policies, so that they can use the information to lessen their reliance on debt. We did so by studying the financial reports of the individual companies and processing the data collected from these financial statements to determine whether debt policy is affected.

We hope that this study will give a number of contribution, considering how debt policy is one of the important aspects of how a company operates. As for academicians, we hope that this study can uncover more critical aspects of debt policy to be researched. Thus, companies can apply the recommended approach of this study into their operational activities.

The study's limitations are that it only covers four years, from 2017 to 2020; second, the sample used in this study only includes manufacturing companies listed on the Indonesia Stock Exchange, making it less representative of all existing companies; and third, this study only uses four independent variables.

Based on these constraints, it is hoped that future research can prolong the study period, increase the sample (i.e., not just manufacturing companies, but also companies in other industries like banking), and add other independent variables like liquidity and dividend policy.

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