International Journal of Multidisciplinary and Current Educational Research (IJMCER)
ISSN: 2581-7027 ||Volume|| 4 ||Issue|| 4 ||Pages 118-128 ||2022||

Free Cash Flow on Company Performance Moderated By Debt and Dividend Policy

Ivanna Glory Laismono
Master of Management Study, Widya Mandala Catholic University Surabaya

ABSTRACT: A company is expected to allocate free cash flow effectively and efficiently to increase the value of the company. This study describes the concept of maximizing free cash flow through debt and dividends as moderating variables. Company performance can be maximized by allocating free cash flow for investment and funding purposes. When the company's growth slows down with limited investment opportunities, the company allocates free cash flow through debt. Meanwhile, a company will allocate dividends to attract more investors in pleasant conditions. Free cash flow for investors will be received as interest, while shareholders will receive it as dividends. The company's performance in this study is shown in return on assets, where the company will use its assets as resources. Panel regression was employed in data analysis. The results of this study showed that cash flow had a significant negative influence on company performance, while debt moderated the negative influence of free cash flow on company performance. Furthermore, dividends moderated the positive influence of free cash flow on company performance.

KEYWORDS: debt, dividend, free cash flow, overinvestment, underinvestment.

I. INTRODUCTION

Every established company has a clear goal: maximizing profits, prospering shareholders, and maximizing company value [1]. The company value is formed from the company's performance in business operations and the decisions taken by the management. The company's performance by the management will focus on the high return on total assets (ROA). The management will maximize the use of assets to obtain maximum income to improve company performance. Numerous types of companies use assets as resources, especially manufacturing companies. Manufacturing companies have their uniqueness, such as the existence of capital expenditure. The need for capital expenditures can cause Free Cash Flow problems, which concern stakeholders.The management is given the authority to allocate free cash flow to debtholders and shareholders. The existence of the authority given to management based this study on agency theory. Agency theory in this study is seen from the management point of view as an agent and investors as principals. Management has broader access to information than investors. With this freedom of access to information, management can manage the current free cash flow to be allocated. The management must adjust the allocation of free cash flow with the company's growth. The identity of free cash flow is the net cash flow distributed to debtholders and shareholders as measured by operating cash flow expenditures after meeting the investment needs of fixed assets and working capital needs [2] and [3].

The free cash flow allocation is expected to create equality between operating cash flows and cash flows for investors. When the company growth is in optimal condition, debt is an instrument used by the company as leverage to maximize the value of the company. The benefits provided when the company is in debt are reduced agency conflicts and overinvestment problems. The company is expected to allocate debt to projects with a positive value so that the management will monitor the expenditure of funds. When the company is in debt to external parties, management will manage its assets to maximize the flow of funds. However, the company also continues to control the debt policy so that it is not too exploitative, leading to a decrease in performance [4]. Companies that experience overinvestment tend to invest their funds in less profitable projects, which will reduce the company's performance in the long term. Other studies conducted by [5] and [6], show that using debt to a certain extent can improve company performance. However, the debt needs of a company should be adjusted to the optimal level of debt. Another study by [7] showed that the problem of overinvestment is an irregular capital expenditure that impacts equity. It confirms that management discipline is important in determining debt policy by considering the high-interest costs charged to the investment value. When the management wanted to improve its performance but feared high debt interest, it would cause the company chose equity issuance. However, when equity cannot cover the investment value of a project, the company will lose investment opportunities. It causes the company to experience underinvestment [8]. The equity financing choice causes the emergence of an alternative company that is expected to distribute dividends to increase the

company's value. High dividend payouts can reduce conflict and agency costs. The management and investors will receive dividends as a return on investment. Dividend distribution is an indirect compensation given by the company to reduce agency conflict. Management will allocate the current free cash flow more effectively as a sense of belonging to the company. Management with a sense of ownership in the company will act like investors. Management and investors will have the same interests in reducing agency costs and preventing the company from moral hazard. Previous researchers have conducted various studies on this variable. The results of previous studies are also mixed. The results of a study conducted by [9] show that free cash flow (overinvestment) has a negative effect on company performance. In addition, a study conducted by [9] stated that the advantages of cash flow could be invested in one of the instruments by adding debt or dividend policy which positively influences the company's performance. However, when the debt policy and dividend distribution are carried out simultaneously, it has a negative effect on the problem of free cash flow (overinvestment) on the company's performance. Another study by [10] shows that free cash flow (overinvestment) positively affects company performance. On the other hand, dividends, debt, liquidity, tangibility, and company growth have a negative effect on company performance. Another study by [4] shows that free cash flow (overinvestment) affects performance and lower risk, overinvest additional working capital in companies reduces company performance, but underinvestment can reduce the risk for companies. Therefore, the researcher conducted another study on the Effect of Free Cash Flow on Company Performance With the Impact of Debt and Dividend Policy as Moderating Variables in manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2020. This study aims to examine and analyze the effect of Free Cash Flow on company performance, the effect of debt as moderating, which has a negative effect on Free Cash Flow on company performance, and the effect of dividends as moderating, which has a negative effect on Free Cash Flow on company performance. This study is also expected to be useful in providing information corresponding to research variables to future researchers and management, as well as confirming the agency theory and free cash flow hypotheses.

II. LITERATURE REVIEW

Agency Theory : Agency theory is motivated by the authority possessed by managers to decide debt, dividend, and investment policies that determine company performance. Agency theory is a branch of the economic game of theory that states that there is a contract between the agent and the principal to achieve the same goal with different interests [11]. Agents are interested in increasing the value of company assets to obtain personal gain. On the other hand, the principal is interested in maximizing equity to increase the firm value [9]. This difference of interest creates an agency conflict. Agency conflict between principal and agent creates information asymmetry. Information asymmetry is a condition where the agent as a business actor tends to have wider information than the principal. The information asymmetry can lead to moral hazards. The principal will prevent moral hazards by monitoring management so that the company incurs agency costs. Supervision that the principal can carry out can be in the form of direct and indirect supervision. Direct supervision is the manager will get compensation payments in the form of bonuses for the performance achieved. It can lead to a tendency for moral hazard. Direct supervision tends to cause managers to expand by investing excess funds in projects to increase the company size. The desire to be selfish with limited thinking and avoid risk causes managers not to consider the feasibility of a project which can lead to overinvestment. The manager's expectation of investing in many projects is the return in the form of bonuses directly on their performance. However, if the manager allocates to unprofitable projects, it can reduce the company's performance and indirectly affect the manager's compensation. Meanwhile, indirect supervision is more effective because the company instils in managers the idea that the company managed is theirs and compensation is given in the form of shares [11]. Managers will be more focused on considering the projects that will be accepted. Management must consider the feasibility of project management to the company growth conditions When the company growth slows, companies should use alternative debt policies to improve their performance.

The management still has to invest for the survival of a company. When management does not use its assets optimally to generate growth, the company may experience underinvestment. Thus, companies miss the opportunity to turn risks into business opportunities. Management is expected not to be too conservative but can measure the investment value of a project with the funding spent. Management must use available information to estimate the value of a project. Underinvestment is the impact of agency problems that occur due to information asymmetry. The limited information causes management to choose internal funding to fund a project. There is a perspective that the interest cost of debt can be higher than the investment value of a project. It causes management to choose equity issuance [8]. Equity issuance that causes the emergence of dividend distribution is expected by investors and can reduce agency problems.

Free Cash Flow Hypotheses : FCF is money obtained from operating activities after capital expenditures to invest and meet working capital needs [2] and [3]. FCF is free cash flow distributed to creditors and shareholders. FCF allocated to creditors is to fulfil loan repayment obligations and distribution to shareholders in the form of dividends and share buybacks. Management is expected to allocate funds to projects with a positive net present value (NPV). The allocation of these funds is expected to increase the company's value. However, if the company expands too much on unfeasible projects, which do not create value for the company, it can cause a negative impact on the company's performance.

Debt : Debt is used as an alternative to leverage the company's performance through the composition of the capital structure. Debt is funding from external parties given to the company under the company's ability to pay. Debt is given based on trust in the performance of a company. The company provides information on the company's performance in the form of historical data in the financial statements to determine the proportion of debt. The company obtains debt according to the necessary capital requirements. Creditors will tend to pay attention to a company's funds flow. Creditors will measure the capital requirement with the invested capital. If the value of the invested capital is greater than the capital requirement, the company has experienced overinvestment. Companies that experience excessive free cash flow can reduce company performance.

Company's Performance : Each company stakeholder has roles and interests which will impact the company's performance. Company performance is a measurement to see how far the company's achievement for the efforts it has made. These measures are listed in the financial statement information [12]. Meanwhile, based on the Financial Accounting Standards for Entities Without Public Accountability [13], company performance is the relationship between revenues and costs incurred by the company listed on the income statement. Profit and loss are often used as a measure of return on investment or earnings per share. The value of income and expenses incurred in the income statement is obtained from the recognition and measurement of assets and liabilities. However, the company's performance should be assessed comprehensively, not only focusing on the profits earned. As for some views on financial statements, financial statements are a communication tool used by stakeholders to provide information in the form of financial data on business processes that occur during a certain period [14].

Company Size : Company size is a basic factor that affects company performance. The smaller the company's size, the less the access cost and controllable coverage. Therefore, the costs tend to be lower. If the cost of supervision is low, the profitability obtained by a company will be higher. On the other hand, companies with a large size tend to have a long bureaucracy, so a company's supervision cost tends to be high [15]. In addition, company size can also be measured from the total assets a company owns. A higher value of a company's fixed assets indicates the larger size of a company [16]. Measurement of company size can also be measured on other sides, namely total sales, profit for the period, share value, and the number of employees [17] and [18]. This study measures company size by the natural logarithm of total assets. Company size plays a role in determining the management structure that will be applied in the organization. The problem with Free Cash Flow is the impact of management decisions.

Company Growth : The company's growth is the change in total sales compared to the previous period. The management expects the company's growth as a positive signal of the company's performance. The management is obliged to develop work programs to increase sales. In this study, the work program implied is the projects with a positive net present value. The purpose of this investment is for the company to experience company growth, change company size, increase liquidity, and increase tangible assets. If the company experiences continuous positive growth in the long term, the value of the company will also increase. This company growth is also an alternative determinant that the company can use. When the company's growth is slowing, companies prefer financing from debt. On the other hand, when the company is in a fluctuating condition and cannot predict the value of the project, the funding is from equity. Management can not ascertain the cost of debt interest on the investment value, so equity funding is an alternative.

Liquidity : Liquidity is the company's ability to repay loans in the short term. Companies can convert their assets into cash in a short time. The measurement uses liquidity to signal that management has optimally allocated company funds. Not all free cash flow from the company is allocated to the project, but it is carried out proportionally. Liquidity is an early indication of a company's health problems. Then, it will be followed by solvency problems to bankruptcy in a longer time. It causes the importance of liquidity to show the company's performance. When a company has debt, liquidity is a determining factor that creditors pay attention to.

Creditors hope that a company can convert its assets into cash quickly. In addition, investors also pay attention to liquidity. Investments in equity funded projects must be converted back into cash.

Tangibility : Tangibility relates to tangible assets owned by a company. These tangible assets can be used as collateral for a company's loan. The higher the value of a company's tangible assets, the higher the loan can be obtained. Companies can reduce agency conflicts by converting existing funds into tangible assets. If the company experiences liquidity difficulties in the short term, it can easily convert it into cash in the form of loans and make these assets as collateral. Thus, it can lead to increased corporate funding from debt. If funding from debt is high, then the obligation to pay principal and interest on the loan will also be high. The high obligation to pay principal and loan interest will affect the company's performance. In addition, companies with high tangibility tend to have a high cost of capital [10].

The relationship between debt, dividends and Free Cash Flow on company performance : Companies that experience excess free cash flow will prefer financing through debt so that it can reduce company performance. The purpose of debt financing carried out by management is to increase the size of the company. Management will invest in many projects on an exploitative basis. When management invests in exploitation, it indirectly invests in projects with negative net present value. It causes excess free cash flow. If these problems occur in the long term, it will reduce the company's performance. At that time, there was a devaluation of the value of debt and an increase in the market value of shares. When the company invests, there will be a risk transfer. When the company's risk is high, equity funding is more effective. Internal companies are also responsible to investors because interest is not charged, but returns can be in the form of dividends. Investors are willing to be subordinated after debt obligations are fulfilled. Obligations to external parties are prioritized because they are subject to interest. The company must consider that the value of the invested project must be higher than the interest expense. Management is also expected to assess the project objectively and not be too optimistic, which can lead to projection errors. The value of the project that currently becomes the object of investment must be considered because the risk transfer carried out must be a profit to increase the company's size.

Effect of Free Cash Flow on Company Performance : Various previous studies have been conducted and have different results. Huggett and Ospina (2001) find evidence that productivity growth declines when factories make large equipment purchases. It shows that if the company's free cash flow is used entirely for investment, it will be less than optimal [19]. In addition, Liu and Bredin (2010) provide results that companies in Singapore that experience overinvestment and underinvestment are the results of decisions from shareholder activities that will have a negative impact on company performance. The shareholder activity in Singapore based their study on agency theory. In Liu and Bredin (2010), it is explained that the larger the size of the company, the more company prefers to pay the cost of monitoring management activities in investing rather than having to pay dividends [20]. Other researchers, Guariglia and Yang (2016), present that only investments with projects with positive NPVs could have a positive effect. In addition, if it is allocated to projects with negative NPVs, it has a negative effect on company performance [21]. It shows that management decisions have an impact on company value. Based on the theory and previous studies, in this study, the researcher developed some hypotheses stating that Free Cash Flow has a negative effect on company performance.

H1: Free Cash Flow has a negative effect on company performance.

Effect of Free Cash Flow on Company Performance with Debt as Moderating Variable : Since Free Cash Flow affects the company's performance, several alternatives are considered to directly reduce the impact of the misuse of free cash on the company's performance. The management can divert the current free cash flow by increasing the value of debt for expansion in projects with a positive net present value and distribution of dividends for shareholders' welfare. Based on a previous study by Trong and Nguyen (2020), these alternative options can be effectively carried out if what is implemented is only increasing debt or only distributing dividends. If the two policies are carried out simultaneously, they will negatively impact [9]. A study by Lang and Litzenberger (1989) shows that decreasing overinvestment will improve company performance and dividend distribution to shareholders [22]. On the other hand, another study, Grossman and Hart (1982), shows that the allocation of free cash flow on poor company performance can increase the risk of bankruptcy because investing in projects with a negative net present value [23].

H2a: Debt moderates the negative effect of Free Cash Flow on company performance.

Effect of Free Cash Flow on Company Performance with Dividends as Moderating Variable : The majority of companies in Indonesia are dominated by family ownership. Family ownership is a form of concentrated ownership that creates a majority and a minority group. The difference between the majority and minority groups affects the dividend distribution policy in Indonesia. Setia Atmaja (2009) [25]; Pindado (2010) [25], and Setianto & Sari (2017) [26] stated that the distribution of dividends with family ownership tends to be higher than non-family ownership. The phenomenon of dividend distribution in developing countries is in line with the study by Rajverma et al. (2019) [27]. This study found that information asymmetry plays an important role in the dividend distribution. Higher dividend payouts reduce the company's cash and information asymmetry. If the company experiences a cash reduction, it will indirectly reduce its free cash flow. Dividend distribution reduces the risk of moral hazard and increases firm value [9]. In Sujoko and Soebiantoro (2007), dividend distribution policy positively affects company performance because it benefits shareholders [28]. Shareholders prefer dividend distribution to be allocated to retained earnings/increase in debt for expansion purposes. At the time of the announcement of the distribution of dividends, the market tends to catch a positive signal on the company's performance in the current period.

H2b: Dividends moderate the negative effect of Free Cash Flow on company performance

III. RESEARCH METHOD

This study is quantitative research with hypothesis testing. In hypothesis testing, certain variables are tested until they are formulated into a research equation model. The existence of testing between these variables causes this study to be causal-comparative. The sample of this study is a manufacturing company registered in Indonesia from 2016 to 2020, which is processed using the Eviews software tool. After each variable is measured, the data will be processed using the panel data method. The panel data testing steps are done by determining the regression model estimation method, choosing a panel regression model with the Chow test, Lagrange multiplier test, and Hausman test, and testing significance with the F test, T-test, and adjusted R^2. The following is the measurement of the variables used in the study.

Table 3.1.
Variable Measurement

Variable	Measurement
Company's Performance	ROA = earnings after tax (EAT)/total assets
Free cash flow	Hodrick-Prescott Filter (HP filter) method and the investment demand function. HP Filter draws the investment trend line minus the actual value. If the sample shows that it is above the investment line, the company is experiencing overinvestment. Conversely, if the sample shows that it is below the investment line, the company is experiencing underinvestment. Mathematically, the HP filter can be written in the following equation. $Investment_{i,t}^{New} = Debt\ ratio + Risk + Company\ Size + Sales\ Growth + Asset\ Turnover + Cash\ Flow + V_{i,t}$
Debt	Total liabilities/total assets
Dividends	Dividend total/ earnings after tax (EAT)
Company Size	Natural logarithm of total assets
Company Growth	(Net sales t – net sales (t-1)) / net sales (t-1)
Risk	Standard deviation of ROA
Liquidity	(Current asset-inventories)/current liabilities
Total asset	Fixed asset/total asset

IV. ANALYSES AND DISCUSSION

4.1. VARIABLE TEST RESULTS AND PANEL REGRESSION TEST : First, a descriptive analysis of each variable was conducted. This descriptive analysis will describe the minimum, maximum, average, and standard deviation values of each research variable that make up the performance equation. The following are the results of the descriptive analysis presented in Table 4.1

Table 4.1.
Description of Research Variable

Variable	N	Minimum	Maximum	Mean	Std. Dev.
Performance					
EAT/TA	555	-0.54676	0.92100	0.03702	0.10239
Independent Variable					
Free cash flow	555	-0.06227	0.39893	0.00001	0.04039
Moderator Variables					
Debt Ratio	555	0.06513	5.16774	0.53760	0.53530
Dividend	555	-7.51289	12.13000	0.19339	0.77868
Control Variables					
Company Size	555	4.18996	19.67902	13.49479	3.46189
Sales Growth	555	-0.98415	29.44320	0.09502	1.31518
Risk	555	0.00226	0.39582	0.04394	0.05733
Liquidity	555	-0.33677	17.53619	1.43673	1.70327
Tangibility	555	0.02372	0.90182	0.41038	0.19445

If depicted from existing data sampling, company performance and free cash flow development tends to decrease. Meanwhile, debt is relatively stable, and dividends have increased.

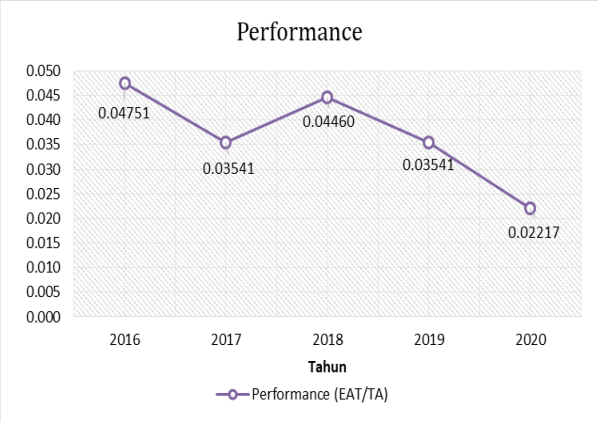


Figure 4.1 Company Performance from 2016 to 2020

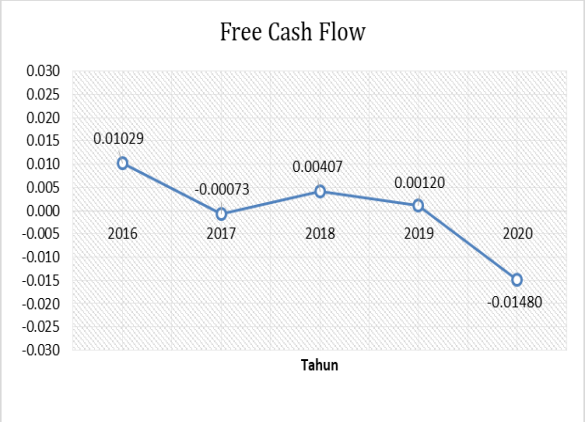


Figure 4.2 Free Cash Flow from 2016 to 2020

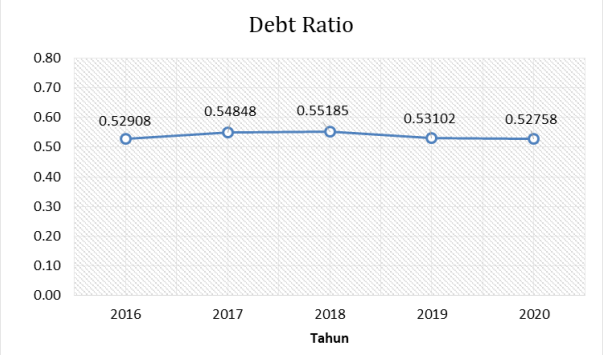


Figure 4.3 Debt Development from 2016 to 2020

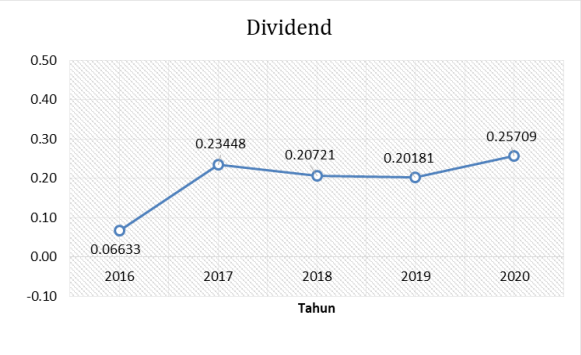
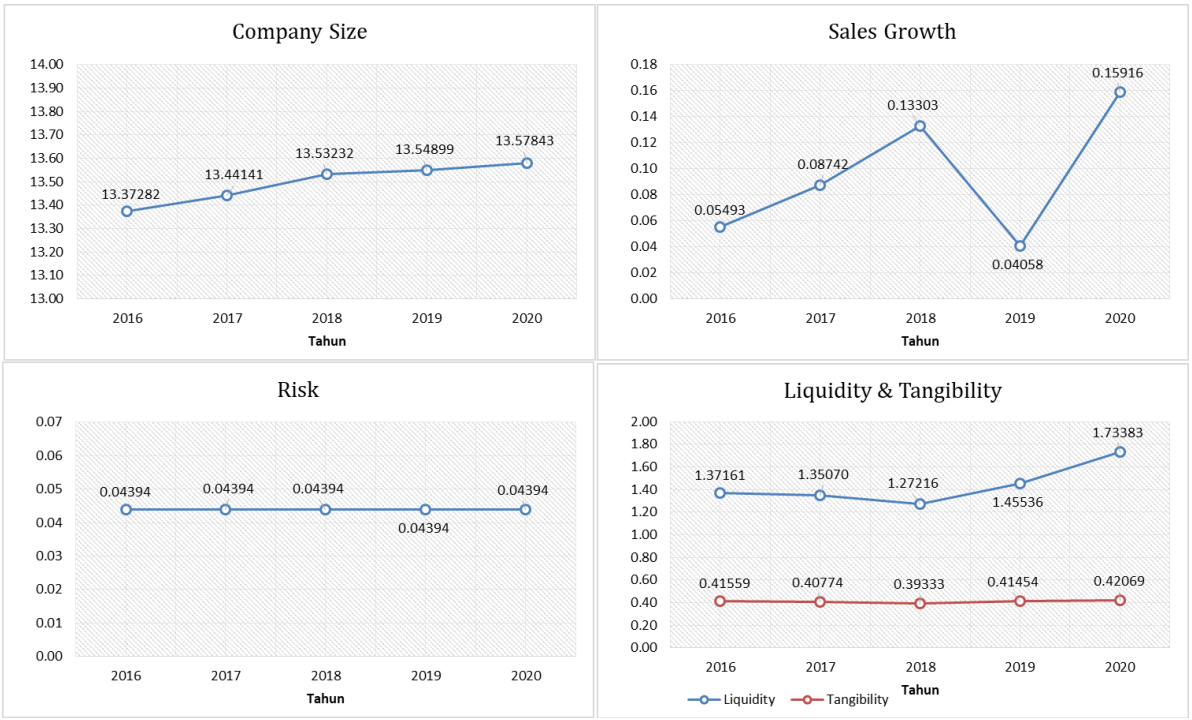


Figure 4.4 Dividend Development from 2016 to 2020

On the other hand, the control variable data shows that the company's size tends to increase. The company's growth from 2016 to 2018 increased but decreased in 2019. The company's growth increased again in 2020. Nonetheless, the development of risk and tangibility variables tends to be stable every year. Another control

variable, liquidity from 2016 to 2018, tends to decrease. From 2019 to 2020, the liquidity has increased again. The graph movements can be seen in the image below.



After all the data from the variables are described, the next free cash flow analysis is carried out. Free cash flow is the remaining cash owned by the company after investing and paying for its operational activities. A positive free cash flow value indicates the company has cash remaining after disbursements. On the other hand, a negative value indicates the company does not generate sufficient income to cover costs and investments. This study measured free cash flow using the Hodrick-Prescott Filter (HP filter) and the investment demand function methods. HP Filter is drawing an investment trend line subtracted from the actual value, which in this statistic is also called the residual. If the sample shows it is above the line (residual > 0), then the company has cash remaining after disbursements, and if the sample shows it is below the line (residual < 0), then the company does not generate sufficient income to cover costs and investments. Trong and Nguyen (2020) explained that the value of free cash flow is the residual value calculated from the investment demand function. The results of the estimation of the investment demand function with regression analysis can be formulated as follows:

Investment ^{NEW} = 0,010785 - 0,002093*Debt - 0,183109*Risk + 0,001197*Size - 0,00062*Growth + 0,048098*Turnover + 0,000065*Growth Option - 0,00000426*Cash Flow

Through this equation, the Investment^{NEW} value can then be calculated. Then the residual value is calculated, which is the difference between the real Investment value and the Investment^{NEW} result from the investment demand function.

The results of the description of the free cash flow variable in the previous section yield an average value of 0.00001, which indicates that the average value of free cash flow in manufacturing companies listed on the BEI is only 0.001 percent when compared to the total assets owned. The free cash flow trend in manufacturing companies from 2016 to 2020 tends to decline. In 2016 free cash flow was 1.03 percent of total assets, and in 2020, it fell to -1.48 percent of total assets, or there was a decreased ratio of 2.51 percent. After the free cash flow analysis has been carried out, a regression analysis of the company's performance with the EAT/TA proxy is carried out. The explanation of the analysis is presented as follows:

Regression Equation : The results of the regression analysis of company performance with EAT/TA proxies produce the following regression equation coefficients:

Performance = 0,0473 - 0,3935 Free cash flow - 0,0287 Debt + 0,0274 Dividend + 0,0033 Company Size + 0,0002 Sales Growth + 0,1640 Risk + 0,0019 Liquidity - 0,1320 Tangibility - 0,0183 Debt x Free cash flow + 0,3856 Dividend x Free cash flow

(a). The regression coefficient of the Free cash flow variable is known to be -0.3935, which explains that the influence of free cash flow on the company's performance is -0.3935. The coefficient with a negative sign indicates that the greater the free cash flow, the lower the company's performance will be.
(b). The debt variable regression coefficient is known to be -0.0287, which explains that the influence of the debt ratio on company performance is -0.0287. A negative coefficient indicates that the greater the company's debt ratio, the more the company's performance will decrease.
(c). The dividend variable regression coefficient is known to be 0.0274, which explains that the effect of dividends on company performance is 0.0274. A positive coefficient indicates that the greater the dividend the company gives, the more the company's performance will increase.
(d). The company Size variable regression coefficient is known to be 0.0033, which explains that the influence of firm size on firm performance is 0.0033. The positive coefficient indicates that the larger the company's size, the more the company's performance will increase.
(e). The sales growth variable regression coefficient is 0.0002, which explains that the effect of sales growth on company performance is 0.0002. A positive coefficient indicates that the higher the sales grow, the more the company's performance will increase.
(f). The risk variable regression coefficient is known to be 0.1640, which explains that the influence of company risk on company performance is 0.1640. The positive coefficient indicates the higher the company's risk, which is marked by high fluctuations in ROA, indicating that the company's performance will increase.
(g). The liquidity variable regression coefficient is known to be 0.0019, which explains that the effect of liquidity on company performance is 0.0019. A positive coefficient indicates that the higher the company's financial liquidity, the more the company's performance will increase.
(h). The tangibility variable regression coefficient is known to be -0.1320, which explains that the effect of tangibility on company performance is -0.1320. A negative coefficient indicates that the greater the tangible assets, the lower the company's performance.
(i). Debt x Free cash flow interaction regression coefficient is known to be -0.0183, which explains that the interaction effect of debt and free cash flow on company performance is -0.0183. A negative coefficient indicates that debt can add to the negative impact of free cash flow on company performance.
(j). The regression coefficient of Dividend x Free cash flow interaction is known to be 0.3856, which explains that the interaction effect of dividends and free cash flow on company performance is 0.3856. The positive coefficient indicates that the distribution of dividends can reduce the negative impact of free cash flow on company performance.

1. Coefficient of Determination

The coefficient of determination (R^2) shows 0.1688, which means that the diversity of information that the performance equation can explain based on the EAT/TA proxy is 19.68%. This R^2 value also means that the percentage of the influence of free cash flow, debt ratio, dividend, company size, sales growth, risk, liquidity, tangibility, and their interaction on company performance is 19.68%.

2. F Test

The results of the F test show that the calculated F value is 13.3330 and the probability value is 0.0000 (less than 5%), indicating that the performance equation with the EAT/TA proxy has a good model fit (good fit).

3. t Test

In this study, the t-test was only performed on three coefficients, following the number of hypotheses formulated in the previous chapter.

(a). **H_1: Free Cash Flow has a negative effect on company performance**

The results of the t-test of the effect of free cash flow on performance resulted in a regression coefficient value of -0.3935 (negative) and a probability value of 0.0296. Since the probability value was less than 5%, it was concluded that free cash flow negatively and significantly affected company performance. Thus, the hypothesis stating that free cash flow has a negative effect on company performance can be accepted **(H_1 is accepted).**

(b). **H_{2a}: Debt moderates the negative effect of Free Cash Flow on company performance**

The results of the t-test of the effect of free cash flow x debt on performance produce a regression coefficient value of 0.0183 (negative) and a probability value of 0.9394. Since the probability value is greater than 5%, it is concluded that the debt ratio does not significantly moderate the effect of free cash flow on company performance. The coefficient of influence is negative, which indicates that the greater

the company's debt ratio will impact the free cash flow, which will further reduce the company's performance, although it is still not significant. Thus, the hypothesis stating that debt moderates the negative effect of free cash flow on company performance cannot be accepted **(H_{2a} is rejected).**

(c). **H_{2b}: Dividends moderates the negative effect of Free Cash Flow on company performance**

The results of the t-test of the effect of free cash flow x dividends on performance yield a regression coefficient value of 0.3856 (positive) and a probability value of 0.0114. Since the probability value is less than 5%, it is concluded that dividends significantly moderate the negative effect of free cash flow on company performance. A positive coefficient indicates that the greater the dividend the company gives, the smaller the negative impact of free cash flow on performance. Thus, the hypothesis stating that dividends moderate the negative effect of free cash flow on company performance can be accepted **(H_{2b} is accepted).**

MODEL ANALYSIS OF THE EFFECT OF FREE CASH FLOW ON COMPANY PERFORMANCE AND THE IMPACT OF DEBT AND DIVIDEND POLICY MODERATION

This sub-chapter discusses the analysis of the free cash flow influence on company performance and a moderating analysis of debt and dividend policies on the effect of free cash flow on company performance, among others.

1. **Free Cash Flow has a negative effect on company performance**

   The coefficient value of the influence of free cash flow on the company's performance is -0.3935 (negative). This coefficient value shows the impact of free cash flow on the company's performance by assuming that debt and dividends are constant. The coefficient of influence is negative and significant at 5%, indicating that if the company does not use debt and does not pay dividends, then free cash flow has a negative effect on company performance. The negative impact of free cash flow is following agency problems. Agency theory shows that conflicts of interest between managers and shareholders can be detrimental to the company. Managers wish to increase personal income by increasing investment, even investing in less profitable projects, leading to free cash flow problems. The existence of free cash flow allocated to projects with a negative net present value can reduce the company's performance. To reduce the agency problem, the company must pay for monitoring and compensation following the management performance. This finding is similar to empirical research conducted by previous researchers [4] and [9].

2. **Debt moderates the negative effect of Free Cash Flow on company performance**

   The coefficient value of the influence of debt on company performance is -0.0287 (negative). This coefficient value shows the impact of policies on the company's performance by assuming that Dividends and Free cash flow are constant. The coefficient of influence is negative and significant at 5%, indicating that the greater the company's debt ratio, the more company's performance will decrease. These results support the attitude that when firms have more debt in their capital structure, they will face a higher risk of financial distress and bankruptcy risk. Therefore, the company must incur higher interest payments, which reduces profitability. The analysis results also show that the moderation of debt policy on the effect of free cash flow on company performance is negative, although still not significant. It shows that debt can add to the negative effect of free cash flow on company performance. The use of debt requires companies to meet their obligations to creditors, which can reduce discretionary funds to make inefficient investments. Debt or financial leverage can add to the detrimental effect of free cash flow on company performance.

3. **Dividends moderates the negative effect of Free Cash Flow on company performance**

   The coefficient value of the effect of dividends on company performance is 0.0274 (positive). This coefficient value shows the impact of dividend policy on company performance by assuming that debt and dividends are constant. The influence coefficient is positive and significant at 5%, indicating that the greater the dividends are given to shareholders, the more the company's performance will increase. It shows that the allocation of free cash flow on debt is low, so the dividend policy will positively affect company performance. The positive sign implies that when the company pays more dividends to shareholders. The company will be more trusted by investors so that the company can be more trusted in financing investments in profitable projects to increase profitability [27]; [29], [9]. The analysis also shows that the moderation of dividend policy on the effect of free cash flow on company performance is positive and significant, indicating that dividend payments can reduce the negative effect of free cash flow on company performance. In contrast to debt, dividend payments imply that the company seeks to satisfy shareholders and strengthen shareholder confidence. With the trust of shareholders, companies can be more flexible and have sufficient financing funds for investment. It can reduce the negative effect of free cash flow on company performance.

V. CONCLUSION

This study concludes that free cash flow has a negative effect on company performance. The management exploits to increase the size of the company, leading to investments with a negative net present value which can reduce the company's performance. The purpose of increasing the company size is, therefore, the management gets more bonuses for their performance, which can cause a moral hazard. Therefore, this study confirms the agency theory. In addition, this study also gives results that debt can strengthen the negative effect on free cash flow, which has a negative effect on company performance. When the company chooses debt as leverage, the company will have a higher risk. Companies must be able to minimize risk to optimize business profits. When the company has debt, the interest expense on the debt charged will reduce profitability. Thus, it can cause a decrease in performance. In terms of changes in internal capital, dividends can reduce the negative effect of free cash flow on company performance. The dividend distribution signals that the company's performance is in good condition. Companies that distribute dividends are the result of investor confidence. Funds obtained from investors are used as resources to improve company performance. Dividend distribution can also be used to attract investors to increase equity. In addition, dividends are incentives sent by management to the market to describe the company's performance and have been disclosed transparently.

ACKNOWLEDGMENTS

The researcher would like to thank Dr Lydia Ari Widyarini, Dr Mudjilah Rahayu, Dr Cicilia Erna Susilawati, and Dr Hendra Wijaya for their advisory so that the researcher can complete this thesis.

REFERENCES

[1] Harjito dan Martono, 2005, Manajemen Keuangan, Edisi Kedua, Cetakan Pertama, Yogyakarta, Ekonisia.
[2] Keown, A. J., J. D. Martin, dan J. W. Petty., 2007, Foundations of Finance, Edisi Keenam, New Jersey: Pearson Prentice Hall.
[3] Ross, S. A., R. W. Westerfield, and B. D. Jordan, 2008, Essentials of Corporate Finance, Edisi Keenam, New York: McGraw-Hill/Irwin.
[4] Setianto, R., H., dan A. Pratiwi, 2019, Working Capital Management in Indonesia: an Analysis on Free Cash Flowand Underinvestment Firms, Gadjah Mada International Journal of Business, Volume 21, No 1: 1-18.
[5] Faulkender, M., dan R. Wang, 2006, Corporate Financial Policy and The Value of Cash. The Journal of Finance, Volume 61 (4);1957-1990.
[6] Wang, W., 2002, Liquidityyu Management, Operating Performance and Corporate Value: Evidence From Japan and Taiwan, Journal of Multinational Financial Management, Volume 12: 159-169.
[7] Mello dan Miranda, 2010, Long Term Debt and Free Cash FlowAgency Problem, Journal of Banking and Finance, Volume 34: 324-335.
[8] Ross, S. C., dan N. S. Majluf, 1984, Corporate Financing and Investment Decisions When Firms Have Information That Investors Don't Have, Journal of Financial Economics, Volume 13 (2): 187-221.
[9] Trong, N., N., dan C., T., Nguyen, 2020, Firm Performance: The Moderation Impact of Debt and Dividend Policies on Overinvestment, Journal of Asian Business and Economic Studies.
[10] Tumba, A., N., B., dan U. Murtini, 2021, Pengaruh Dividen, Hutang, Resiko, Liquidity, Tangibility, Company Growth, Firm Size, Dan Free Cash FlowTerhadap Kinerja Perusahaan, Jurnal Riset Akuntansi dan Keuangan, Volume 17, Nomer 1.
[11] Scott, W. R., 2012. Financial Accounting Theory, 6th ed., Toronto: Pearson Canada Inc.
[12] Anggraeni, S., U., R., Iskandar, dan Rusliansyah, 2020, Analisis Kinerja Keuangan pada PT Murindo Muti Sarana di Samarinda, http://journal.feb.unmul.ac.id/index.php/akuntabel, Volume 17 (1), page 163-171.
[13] Standard Akuntansi Keuangan Entitas Tanpa Akuntabilitas Publik, 2013, Jakarta: Dewan Standar Akuntansi Keuangan Ikatan Akuntan Indonesia.
[14] Munawir, 2010, Analisa Laporan Keuangan, Edisi Keempat, Cetakan Ketiga Belas, Yogyakarta: Liberty.
[15] Tsiapa, M., 2022, Performance on Large Firms in Greece During The Unstable Period of 2011-2016: Lesson From The Weak Parts of Europe, European Journal of Management and Business Economics, Volume 31, Nomer 1, Page 94-114.
[16] Graubner, M., 2006, Task, Firm Size, and Organizational Structure in Management Consulting, Germany, Deutscher Universitats-Verlag.
[17] Fisher, G. J., 1998, Contigency Theory, Management Control System and Firm Outcomes: Past Result and Future Directions, Behavioural Research in Accounting Volume 10.
[18] Zainuddin, Y., 2003, Management Accounting and Control System: The State of The Art, Makalah Seminar Dosen Tamu Magister Sains Akuntansi Universitas Diponegoro 25 September 2003.

[19] Huggett, M. and S. Ospina (2001), Does productivity fall after the adoption of new technology? Journal of Monetary Economics, Volume 48, Page 173-195.
[20] Liu, N., dan D., Bredin, 2010, Institutional Investors, Over-Investment and Corporate Performance, University Collage Dublin.
[21] Guariglia, A., dan J., Yang, 2016, A Balancing Act: Managing Financial Constraints and Agency Costs to Minimize Investment Inefficiency in the Chinese Market, Journal of Corporate Finance, Volume 36, page 111-130.
[22] Lang, L., H., dan R., H., Litzenberger, 1989, Dividen Announcements: Cash Flow Signalling vs Free Cash Flow Hypothesis? Journal of Financial Economics, Volume 24, Page 181-191.
[23] Grossman, S., J., dan O., D., Hart, 1982, Corporate Financial Structure and Managerial Incentives, The Economics of Information and Uncertainty, University of Chicago Press.
[24] Setia-Atmaja, L., Tanewski, G. A., Skully, M. (2009). The Role of Dividends, Debt and Board Structure in the Governance of Family Controlled Firms. Journal of Business Finance & Accounting, 36 (7) & (8), 863–898.
[25] Pindado, J., Requejo, I., de la Torre, C. (2012). Do Family Firms Use Dividend Policy as a Governance Mechanism? Evidence from the Euro zone. Corporate Governance International Review, Vol. 20 (5), 413-431.
[26] Setianto, R., H., dan Sari, P., K., Perusahaan Keluarga dan Kebijakan dividen di Indonesia, Jurnal Siasat Bisnis, Volume 21, No 2: 107-118.
[27] Rajverma, A. K., Misra, A. K., Mohapatra, S., and Chandra, A., 2019, Impact of Ownership Structure and Dividen on Firm Performance and Firm Risk, Managerial Finance.
[28] Sujoko dan Soebiantoro, Ugy., (2007), Pengaruh Struktur Kepemilikan Saham, Leverage, Faktor Intern Dan Faktor Ekstern Terhadap Nilai Perusahaan, Jurnal Manajemen dan Kewirausahaan, Vol. 9 No. 1, Page 41-48.
[29] Chosiah, C., B. Purwanto, W. J. Ermawati, 2019, Dividend Policy, Investment Opportunity Set, Free Cash Flow, and Company Performance: Indonesian's Agricultural Sector, Jurnal Keuangan dan Perbankan, Volume 23 (3): 403-417.