DEBT POLICY, FREE CASH FLOW HYPOTHESIS, AND BALANCING OF AGENCY THEORY THROUGH OWNERSHIP: EVIDENCE FROM INDONESIA

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Abstract

This research argues that there is conflict of interest between managers and shareholders. The conflict also varies based on growth opportunities. This research argues that disciplinary role exist in debt policy with the use of free cash flow hypothesis. This research explores the implications of free cash flow hypothesis concerning the disciplinary role of ownership structure in corporate debt policy. Managerial ownership and internal institutional are other mechanism to reduce agency conflict also has a significant impact on debt policy (control coalition cohesiveness). The relationship between managerial ownership and debt policy is interdependence, as known as balancing of agency theory. This study uses 1264 observation of 154 listed Indonesian firms between the years 1995 until 2003. Three state least square (3SLS) model will be use for statistical and analytical purposes. This study developed several arguments. The relation between debt and free cash flow are positive, but the relation differs between low-growth firms and high-growth firms. Internal institutional shareholders discourage managerial perquisites using debt. The result of this research support the free cash flow hypothesis and balancing of agency theory through ownership and there is disciplinary role of ownership structure in debt policy.

Keywords: Balancing of Agency Theory, Ownership Structure, Leverage, Free Cash Flow, Agency Conflict

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