



The Impact of Free Cash Flow and Capital Structure on Financial Performance of Companies Listed on the Indonesia Stock Exchange

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ABSTRACT

The capital market as an effective means to accelerate the development of a country because the capital market is a vehicle that can mobilize the long-term mobilization of funds from the public to be channeled into productive sectors. Investors have no single investment motive, but incentive motives such as security, growth, income and speculation can differ from one investor to another. In addition, investors by analyzing the company's financial statements and pay attention to factors that affect financial performance so that expectations for obtaining the maximum return can be achieved.

Data used in this research were taken from the company's annual financial report obtained from www.idx.co.id. Type of data used in this research is secondary data. The samples in this research were gathered using purposive sampling with some specific criteria with the total sample of 20 companies. The analytical method used is Multiple linear regression.

The result of this research show that Free cash flow has a significant positive effect to financial performance on companies listed in Indonesia Stock Exchange, it can be interpreted that the movement of increase or decrease in free cash flow is followed by an increase or decrease in company performance. Capital structure has an insignificant negative effect to financial performance on companies listed in Indonesia Stock Exchange.

Keyword: Free cash flow, capital structure and financial performance

INTRODUCTION

The purpose of the company in general to increase the value of the company through increasing the prosperity of owners or shareholders. David (2010:5) in Gamal and Purwoko (2016), strategic management could be defined as art and knowledge in formulating, implementing, and evaluating functional traffic decisions that enabled an organization to reach its purpose. Party managers as managers of the company have different goals, especially in terms of improvement of individual achievement and compensation to be accepted. If the manager of the firm undertakes selfish actions by ignoring the interests of investors, it will cause investors to fall back on the return on the investments they have invested. It is necessary to have a protection against various parties with an interest in the company.

Manufacturing companies are companies that make efforts to convert basic inputs into products that are sold to individual customers (Wahyuni and Soepriyanto, 2009). The large number of manufacturing companies listed on the Indonesia Stock Exchange encourage intense competition between manufacturing companies. Companies compete in increasing corporate profits so that the value of the company can increase. The company's goals encourage the improvement of company performance in order to achieve the desired goals

Capital structure is a form of corporate financial proportion, that is, between owning capital sourced from long term liabilities and shareholders equity which is the source of financing for a company. The capital structure of a company consists of long term debt and shareholder equity, where stockholder equity consists of preferred stock and common equity, and common equity itself consists of common stock and retained earnings. (Husnan, 2015; 6).

According to Jensen, (1986) in Piramita (2012) if a company has a high free cash flow, the company tends to have a better performance than a company that has a low free cash flow. According to Wang (2010) suggested a significant positive relationship between free cash flow and financial performance. Wang (2010) uses return on assets (ROA) as a proxy for financial performance. ROA is a measure of company profitability, where the greater ROA the greater the company's ability to generate profits for shareholders. The ability to generate profits can be used to project the ability of the company in generating cash in the future because one source is free cash flow is profit

The users of financial statements want to find out information about the company's cash condition, to find out the company's ability to generate cash. In general, interested parties are more interested in information about the state of free cash flow on the company's cash flow statement. Free cash flow is cash flow available to be distributed to investors (both shareholders and bondholders) after the company invests in additional fixed assets, increased working capital, which is needed to maintain company growth.

LITERATURE REVIEW AND HYPOTHESIS

Free Cash Flow

Cash flow is cash flow that is actually available to be distributed to all investors (shareholders and owners of debt) after the company put the entire investment on fixed assets, new products, and working capital are required to keep operations running (Brigham and Houston, 2010:65). The value of a company's operations will depend on the entire free cash flow expected in the future, which is defined as operating profit. after taxes minus the amount of investments in working capital and fixed assets needed to maintain the business. Free cash flow will reflect the cash actually available for distribution to the investors and managers to make the company become more valuable by increasing free cash flow.

A company's free cash flow can be measured by reducing the company's operating cash flow with taxes and interest costs that become a company's obligation and also paying dividends to general and preferred shareholders and divided by net sales. Free cash flow states that at the time of companies need funds, old shareholders prefer to issue new debt than issuing new equity because the terms of interest payments compel managers to act in the interests of shareholders. In fixed debt repayments, the misuse of investor money risks the failure of debt repayments which causes bankruptcy of the company.

Capital Structure

Gitman (2012:488), the definition of capital structure is as follows: capital superstructure is the mix of long term debt and equity maintained by the firm. Enterprise capital structure

reflects the comparison between long-term debt and own capital used by the business. There are two kinds of capital tipe yaitu debt capital and own funds. Weston and Copeland (2010:221) that capital superstructure or the capitalization of the firm is the permanent financing represented by long-term debt, preferred stock and equity shareholder's. Siegel and Shim (2006:80) say capital super structure is the composition of ordinary shares, shares of preferen, and various classes like that, gains who were detained, and long-term debt retained by unity of effort to fund assets.

Capital structure is a combination of various components on the right side of the balance sheet, namely debt and equity (Asnawi and Wijaya 2005). Modigliani Miller's (MM) theory states that company value does not depend on capital structure. Brigham and Hourstan (2001) argue that the proportion of debt and equity has no impact on the success of increasing company value. In MM II theory (tax shield), the use of debt can save profitable taxes on corporate finance. According to MM, the optimal capital structure is all debt. The Trade Off Theory explains that the company will owe to a certain level where the value of the tax shield will equal the cost of financial distress.

Financial Performance

Financial performance is the presentation of information concerning the assets, liabilities, income and expense, changes in equity and cash flow. This information is followed by the note, will help users predict future cash flows (Sutrisno, 2009:53).. Fahmi (2012:2) describes the financial performance was an analysis conducted to see the extent to which a company has done with the use of the financial implementation of the rules properly. Financial performance analysis is a process of assessment were critical towards the review of data, calculate, measure, menginterpretasi, and gives the solution to the financial company at a certain period.

Performance measurement is used by companies to make improvements over their operational activities in order to compete with other companies. Financial performance analysis is a critical review process of reviewing data, calculating, measuring, interpreting, and providing solutions to the company's finances in a certain period. Financial ratio analysis is done to facilitate the analyzer to understand the company's financial condition. In general, various financial ratios that are judged can be grouped into (Husnan, 2015:80)

1. Profitability ratios

These ratios are intended to measure how far the company's ability to generate profits from sales of its assets or from the equity it has.

2. Asset management ratio

This ratio measures how effectively the company manages its assets. If investments in various assets are excessive, the total operating capital will be too high, reducing free cash flow, which will ultimately depress the value of the company (share price).

3. Liquidity ratio

Liquidity shows the company's ability to meet financial obligations that are immediately fulfilled (short-term obligations).

4. Market value ratio

This ratio measures how the capital market (capital market) values a company. It can happen that two companies make the same profit after tax but the market thinks they are not the same. Likewise, it can happen that two companies have the same book value of equity, but markets provide different market values

Hyphotesis

1. The Effect of Free cash flow on Financial Performance

To evaluate prospective companies, buyers must estimate future cash flows that are expected to be added from the acquisition after tax deduction. The cash flow remaining after deducting from the expected income is called free cash flow. Free cash flow reflects the company's flexibility in making additional investments, paying off debts, buying treasury shares or adding liquidity, so that high free cash flow indicates high corporate performance. The company's performance is usually focused on the group task, rather than the group matter subject internally (Gamal and Soemantri, 2017)

The results of this study are supported by research conducted by Hong, Shuting, and Meng (2012) with the title 'Relationship between Free Cash Flow and Financial Performance Evidence from the Listed Real Estate Companies in China'. The results of this study conclude that Free Cash Flow has a significant effect on financial performance. From the explanation above, the hypothesis proposed in this study is:

H₁ : Free Cash Flow has significant effect on financial performance on companies listed in Indonesia Stock Exchange for the 2014-2016

2. The Effect of Capital Structure on Financial Performance

The use of debt in the capital structure as an addition to funding company assets is expected to increase profits that will be obtained by the company, because the company's assets are used to generate profits. Thus the available profit for the equity holders becomes greater, but according to the theory Modigliani Miller (MM) argues that the greater the debt used in the capital structure will reduce the value of the company, this is due to the benefits obtained because the use of debt is offset by an increase in capital costs. In this case it can be said that capital structure that uses more debt can affect the company's financial performance of high financial performance. This is because companies that use high debt, in general the company has high growth, companies that have a good growth rate indicate the company's ability to pay interest on debt

The results of this study support the research conducted by Arulvel and Ajanthan, (2013) entitled "Capital Structure and Financial Performance A Study of Listed Trading Companies in Sri Lanka". The results of the study can be concluded that there is an important relationship between capital structure and financial performance. Vatauvua (2015) This study concludes that (1) Capital structure influences financial performance in 196 Romanian companies listed on the Bucharest Stock Exchange and operates in the manufacturing sector, over an eight-year period (2003-2010). From the explanation above, the hypothesis proposed in this study is:

H₂ : Debt to asset ratio has a significant effect on financial performance on companies listed in Indonesia Stock Exchange for the 2014-2016

RESEARCH METHODS

Sample

Sample of a population of 20 companies that meet the sample criteria with limitations

1. Companies listed on the Indonesia Stock Exchange for 2014 to 2016.
2. Companies active on the Indonesia Stock Exchange in 2014 to 2016 continuously in the year reported its financial information in the form of annual reports.
3. The companies that were active in 2014 to 2016 continuously distributed profits

Data Analysis Technique

According Sugiyono (2014: 191), multiple linear regression analysis aims to measure the influence of independent variables. Multiple linear regression is to show an independent relationship with two or more other independent variables.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$$

Information

Y_1 = financial performance

α = Constants

$\beta_{1,2}$ = Direction coefficient of regression

X_1 = Free cash flow

X_2 = Capital Structure

e = Error

Classical Assumption Test

Classic assumption test aims to determine whether the regression model shows a significant and representative association. The classical assumption used are (Ghozali, 2011: 105): Normality Test, Autocorrelation Test, Heterocedastity Test and Multicollinearity Test.

Hypothesis testing

is done by using multiple linear regression to test the effect of independent variables on the dependent variable using the T test and F test. T test is used to determine whether the independent variable partially has a significant influence on the dependent variable, while the F test is used to test whether an independent variable simultaneously effects significantly on the dependent variable (Sugiyono, 2014: 192).

F Test (Simultaneous Test)

To test this hypothesis F statistics are used with decision making criteria at a 5% confidence level. Means accepting an alternative hypothesis, which states that all independent variables simultaneously and significantly influence the dependent variable (Ghozali, 2013:98).

T test (Partial Test)

Statistical test t is used to show how far the influence of one independent variable individually in explaining the variation of the dependent variable (Ghozali, 2013:98). In this study the t-test was used to determine the effect of each independent variable, namely free cash flow and capital structure on financial performance (partially). To test this hypothesis t statistics are used with a confidence of 5%.

Conceptual Framework

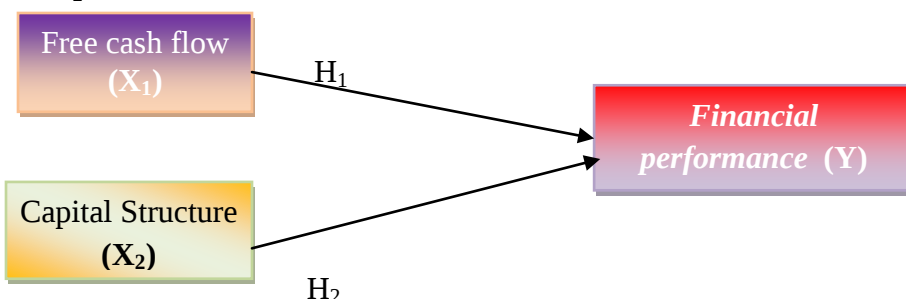


Figure 1. Conceptual Framework

ANALYSIS AND DISCUSSION

Descriptive Statistics Test

Table 1.Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Free Cash Flow	60	,00	67,12	13,4175	12,22202
Capital structure	60	,07	,84	,4633	,16861
Fiancial Performance	60	,67	35,87	10,5782	8,43805
Valid N (listwise)	60				

Normality test

Normality test aims to test whether in the regression model, residuals have a normal distribution (Ghozali, 2013). In this study using a normal probability plot will form a diagonal straight line, and residual plotting will be compared with a diagonal line. Basic decision making

- If the data spreads around the diagonal line and follows the direction of the diagonal line or the histogram graph shows a normal distribution pattern, then the regression model meets the normality assumption.
- If the data spreads far from the diagonal and / or does not follow the direction of the diagonal line or histogram graph does not show a normal distribution pattern, then the regression model does not meet the assumption of normality.

Based on the results of data processing, it is found that the free cash flow (X1) and capital structure (X2) and financial performance (Y) interests are normally distributed, as shown in Figure 1 below.

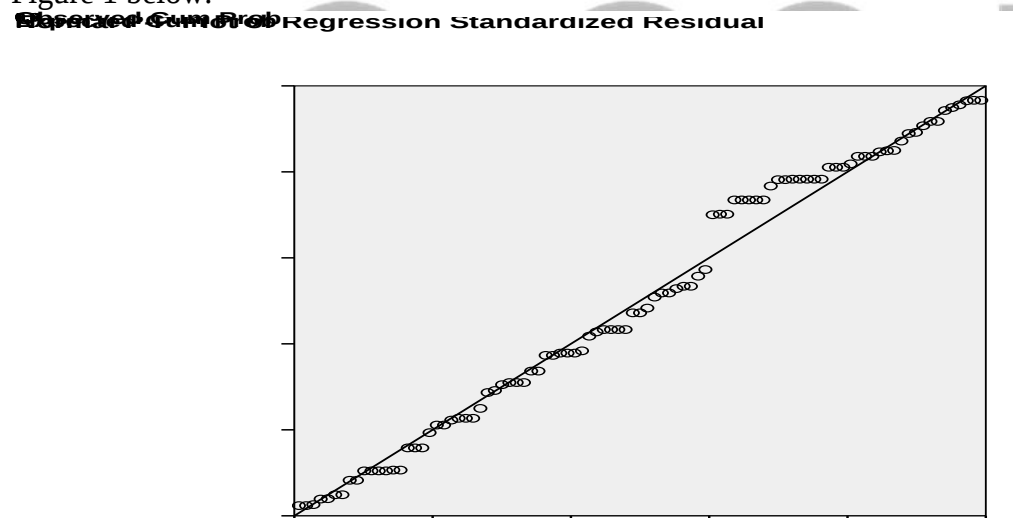


Figure 2. Normal Distribution

Based on Figure 2, the data is spread around the diagonal line and following the direction of the diagonal line shows the normal distribution pattern.

Multicollinearity Test

To detect the presence of multicollinearity can be seen from the Variance Inflation Factor (VIF). If the $VIF \geq 10$ then multicollinearity occurs and vice versa if $VIF \leq 10$ then there is no

multicollinearity. The results of this test get a value of $VIF = 1,000$ indicating that there are no symptoms of multicollinearity because the VIF value ≤ 10 .

Table 2. Variance Inflation Factor Values

No	Variable	VIF Values	Tolerance
1	X_1	1.121	0,892
2	X_2	1.121	0,892

Table 2 shows that the VIF value for the free cash flow variable is 1.121, and the capital structure is 1.121, while the tolerance for free cash flow is 0.892 and the capital structure is 0.892. Because the VIF value of the two variables is not greater than 10 and the tolerance value is no less than 0, it can be said that there is no multicollinearity in the two independent variables. Based on the terms of the classical assumptions of linear regression, a good linear regression model is free from the presence of multicollinearity. As such, the above model has been freed from the presence of multicollinearity

Heteroscedasticity Test

Heteroscedasticity test is done through scatterplot graph analysis. If a scatterplot graph has a data distribution pattern that forms a certain pattern, then it shows homoscedastic. Conversely, if the scatterplot chart pattern does not form a particular pattern or randomly, then it shows there is no heterocasticity. The random pattern in the graph as shown in the figure below shows the linear regression model does not meet heteroscedastic assumptions. So, the heteroscedastic test through scatterplot graphs shows that the multiple linear regression model meets the homoskedastic assumption.

Scatterplot Standardized Predicted Value

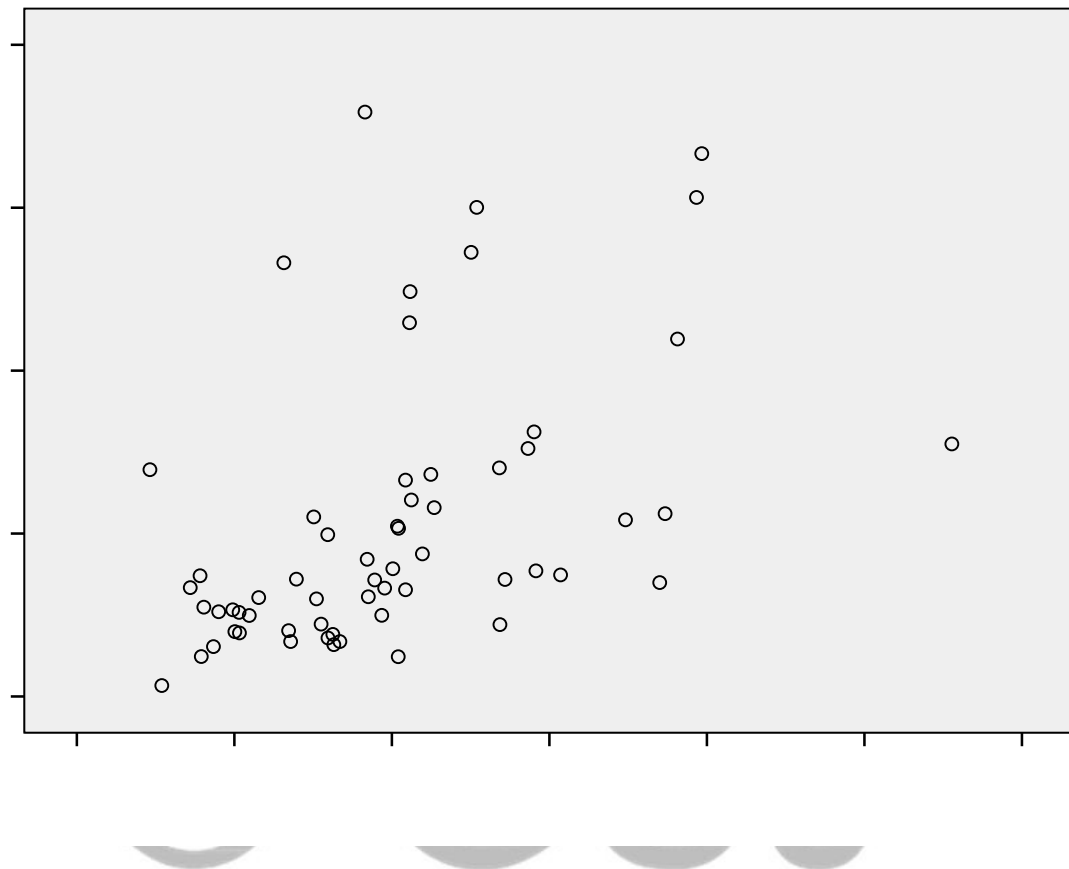


Figure 3. Heterocedasticity Test

Multiple Linear Regression

Following the regression results between the variables Free cash flow and Capital structure to finance performance using the SPSS program.

Table 3. Results of Multiple Linear Regression

Variable	Regression Coefficient	t count	Significant
Constant	10.739	3.011	
Free cash flow (X_1)	0.268	3.125	0.003
Capital structure (X_2)	-8.096	-1.304	0.197

The calculation results in this analysis use the SPSS program, the multiple linear regression equation is obtained as follows:

$$Y = 10.739 + 0.268 X_1 - 8.096 X_2$$

Based on the above equation, the values of the multiple linear regression coefficients can be described as follows

- $\alpha = 10,739$, meaning that the amount of finance performance (Y) is 10.739 assuming the variable Free cash flow (X_1) and Capital structure (X_2) is zero.

- b. $X_1 = 0.268$ means that if Free cash flow goes up by one unit then the finance performance will increase of 0.268 units assuming the variable Capital structure (X_2) is zero.
- c. $X_2 = 8.096$ means that if the capital structure goes down by one unit, the finance performance will increase by 8.096 units assuming the variable Free cash flow (X_1) is zero.

Hypothesis Testing

Testing the proposed research hypothesis, and to test both hypotheses by using the simultaneous regression significance test (F test) and the partial regression significance test (t test).

1. F Test (Testing of Regression Coefficients Simultaneously)

Table 4. Results of Processing With SPSS Program (F Test)

Model	Sum of Squares	df	F	Significant
1 <i>Regression</i>	914.029	2	7.9260	0.001*
<i>Residual</i>	3286.810	57		
<i>Total</i>	4200.839	59		

This F test is used to determine whether the regression model can be used to test between free cash flow and capital structure together against finance performance. Based on SPSS calculation results in Table 4, it is known that the Significant values of the two independent variables are free cash flow and capital structure on financial performance of 0.001 (< 0.05) so that H_0 is rejected and H_1 is accepted, which means the regression model matches the data.

2. Test t (Test of Partial Regression Coefficient)

1) The Effect of Free cash flow on Financial Performance

Based on the SPSS calculation results in Table 3, it is known that the significant value of free cash flow is 0.003 (< 0.05) so H_0 is rejected and H_1 is accepted, meaning that there is a significant effect of free cash flow on financial performance. Then it can be concluded that free cash flow has a significant effect on financial performance can be accepted.

The results of this study are supported by research conducted by Hong, Shuting, and Meng (2012) with the title "Relationship between Free Cash Flow and Financial Performance Evidence from the Listed Real Estate Companies in China". The results of this study conclude that Free Cash Flow has a significant effect on financial performance.

2) Effect of Capital Structure on Financial Performance

Based on the SPSS calculation results in Table 3, it is known that the significant value of capital structure is 0.197 (> 0.05) so H_0 is accepted and H_1 is rejected, meaning that there is a insignificant effect of capital structure on financial performance. Then it can be concluded that capital structure has a insignificant effect on financial performance can be accepted.

The results of this study support the research conducted by Setiana (2012), with the title "Analysis of the influence of capital structure on performance on automotive companies listed on the Indonesia Stock Exchange in 2008-2010". The problem in this study is the difficulty in determining the optimal capital structure. Because capital structure decisions must affect the activities of the company and affect the profits obtained. The results of this study can be concluded that shows that simultaneous DAR, DER, and LDER significantly influence the performance of automotive companies listed on the Indonesia Stock Exchange in 2008-2010.

CONCLUSIONS and SUGGESTIONS

Conclusions

Based on the discussion, the following conclusions can be made:

1. Free cash flow has a significant positive effect to financial performance on companies listed in Indonesia Stock Exchange, it can be interpreted that the movement of increase or decrease in free cash flow is followed by an increase or decrease in company performance
2. Capital structure has an insignificant negative effect to financial performance on companies listed in Indonesia Stock Exchange. This shows that companies that use capital structure in the form of debt in running their businesses can improve the company's financial performance.

Suggestions

As the final part of this research, the suggestion that can be delivered is for investors who analyze shares based on company fundamentals, they need to pay attention to companies that have high free cash flow and should be associated with the company's operating expense ratio. If investors want to know the performance of the company, they should look at the operating expense ratio. Future studies to further develop research by looking for other variables.

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