The Effect of Capital Structure and Managerial Ownership on Financial Performance with Agency Cost as Intervening Variables

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ABSTRACT
This study applies a comparative causal method with a quantitative approach with regard to descriptive statistics on analysis with the object of research in the form of manufacturing sub sector miscellaneous industry listed on Indonesia Stock Exchange during the period 2016 - 2018. This study aims to prove the existence or whether or not the effect of Debt to Equity Ratio (DER) and Managerial Ownership (KM) on Return on Equity (ROE) through Agency Cost as an intervening variable.

Data collection techniques applied in this study is to use the library research method in connection with the application of secondary data. The research population is 51 manufacturing sub-sector miscellaneous industry. While the research sample was 35 listed manufacturing sub sector miscellaneous industry obtained by applying the purposive sampling method.

Data analysis techniques applied in this study were multiple regression analysis, path analysis, coefficient of determination (R2) and hypothesis testing using the IBM SPSS Statistics version 16. The data analysis was performed after all the classic assumption test criteria were met through the application of the normality test, autocorrelation, heteroscedasticity and multicollinearity.

Based on the test results using a significance level of 5%, it can be concluded that: (1) DER has a negative and significant effect on ROE with a regression coefficient of 0.639 and significant amounted to 0.000. (2) KM has a positive and not significant effect on ROE with a regression coefficient of 0.068 and significant of 0.558 (3) DER has a negative effect on ROE with agency cost as an intervening variable with a path coefficient of path analysis 0.1005 . (4) KM has a positive effect on ROE with agency cost as an intervening variable with a path coefficient of path analysis 0.0839.

Keywords: Financial Performance, Capital Structure, Managerial Ownership, Agency Cost.

I. INTRODUCTION

This study aims to examine the effect of capital structure and managerial ownership on financial performance with agency cost as an intervening variable. Financial performance is a result that shows the overall financial health of the sector over a certain period of time. It shows that how well an entity utilizes its resources to maximize shareholder wealth and profitability (Naz and Naqvi, 2016).

Measurement of financial performance in this study using Return on Equity (ROE). This is because ROE is able to show the rate of return on total equity, which is a measure of the company's financial performance as well as shareholders. For shareholders who invest their funds in the company as additional equity, this ROE is also a measure of how much they will get in return for the capital invested (Niresh, 2012).

ROE is an important measure of corporate financial performance that measures returns to shareholders (Jones et al. 2009). ROE can be a measure of the efficiency of the use of own capital which is operationalized in the company. The greater the ROE, the greater the company's ability to generate profits for shareholders, this shows that the company's financial performance is good.

The decline in financial performance in the manufacturing industry is a phenomenon of this research. According to Faisal (2014) In 2014

Indonesia was ranked 14th in the world as the country with the largest manufacturing industry, then Indonesia experienced a decline in 2015 to rank 21st.

According to the Central Statistics Agency (BPS), in the first quarter of 2015 the manufacturing industries that experienced a decline include: the textile and clothing industry experienced a decline of 6.14% followed by a decline of 3.83% by the wood, wood, and cork industries, woven goods from bamboo, rattan and the like, as well as the paper and paper goods industry, printing and reproduction of recording media decreased by 0.11%. The textile and apparel industry continued the slowdown in performance, after the previous quarter also experienced a decline of 6.8% (Ministry of Industry, 2015).

The decline in manufacturing financial performance can be seen from the decline in the ROE value as shown in the table below:
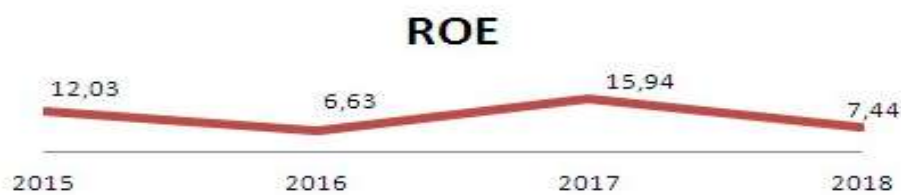
Figure 1. Decreasing ROE in the Manufacturing Industry in 2015-2018

Figure 1.1 shows the decline in the value of ROE in the manufacturing industry during the period from 2015 to 2018. According to Mirza (2011) the factors that caused the decline in performance in the manufacturing industry in 2015 were the declining purchasing power of the people and the global economic slowdown. The decline in manufacturing financial performance was also caused by several factors, one of which was the low implementation of corporate governance (Kemenperin, 2015).

The manufacturing industry is an industry that in its activities relies on capital from investors, therefore manufacturing companies must be able to maintain financial stability. Given the magnitude of the impact that arises when financial difficulties occur in the manufacturing industry, it is necessary to conduct an analysis in such a way that financial difficulties and the possibility of bankruptcy can be detected early. This situation requires sufficient funds for manufacturing companies to survive and compete.

Success in the selection and use of capital is a key element of a company's financial strategy (Velnampy and Niresh, 2012). This triggers the company to try to take an optimal policy of capital structure practices. The preparation of a less effective capital structure will result in losses to the company such as the case experienced by PT. Tunggal Yudi Sawmill Polywood in 2016. PT. Tunggal Yudi Sawmill Polywood went bankrupt due to its inability to fulfill its obligations due to the use of liabilities as a source of company funding. The company, which operates in the plywood industry, was declared bankrupt by the Surabaya Commercial Court in 2016 for not being able to pay its trade debts which had reached Rp140 billion. Bankruptcy of PT. Tunggal Yudi Sawmill Polywood not only leaves a sizeable debt to creditors, but also causes losses to the company's shareholders (Detik.com, 2016).

The case shows that the preparation of the capital structure is less effective, resulting in bankruptcy due to the company's inability to fulfill its debt obligations as a source of company funding. The issue of funding is an important issue that must be taken into account. According to Hilmi (2010), the problem of funding refers to capital, both at the time of establishment, when the company is running normally, or when the company is expanding its business. The main task of company management is to determine the optimal target capital structure in which there is a proportion of funding by company debt. Managers must be careful in making funding decisions for companies related to determining the capital structure, because these decisions can affect the company's performance and ultimately affect the achievement of the goal of maximizing shareholder welfare.

According to Gitman (2009) the company's capital structure reflects the comparison between the amount of liabilities and equity capital used by the company. Capital structure is the composition or composition of capital derived from liabilities and equity as capital that is a claim for the owner of the company. In this study, the capital structure is used as a comparison between liabilities and total equity (Rustam, 2014).

The use of borrowed capital (liability) in the company's capital structure in terms of financial management, is the application of a leverage policy, where the company finances its operational activities with borrowed capital and bears a fixed

burden on the grounds of limited own capital. This policy relates to one of the objectives in selecting various alternative methods of spending, namely to increase the income for the owners of the company's capital.

According to Myers (1977) in the relationship between the capital structure and the company's financial performance there is an optimal level of leverage (debt ratio). The use of liabilities will increase the company's financial performance to a certain leverage limit (optimal), but after passing the optimal point, the use of leverage will cause greater bankruptcy costs so that it can reduce the company's financial performance. Liabilities will increase productivity so that sales increase, this causes profits to increase, and consequently performance increases.

Brigham and Houston (2001) argue that financial leverage is an alternative that can be used to increase profits. The use of liabilities in investment as an addition to funding the company's assets is expected to increase the profits to be obtained by the company, because the company's assets are used to generate profits. Thus the profit available to equity holders is greater (Brigham and Houston 2001). However, the greater the use of leverage, the greater the interest expense (Brigham and Gapenski, 1997). If the interest expense is very large while operating profit is not large enough, financial difficulties will arise which will cause performance to decline. Debt interest expense is also a tax deduction that can increase firm value (Brigham and Gapenski, 1997). Thus debt can improve financial performance. Meanwhile, if the company uses equity, there is no tax savings because the equity burden does not reduce taxes (Le and Phan, 2017).

The results of previous studies are inconsistent and it is suspected that there are other factors that affect financial performance other than capital structure. In this case the capital structure is not the main determining factor affecting the company's financial performance. This result is due to different capital structure policy making in companies (Budiarso, 2014).

Furthermore, the decline in the financial performance of the manufacturing industry is one of the reasons for the low implementation of corporate governance (Ministry of Industry, 2015). Shleifer and Vishny (1997) argue that the implementation of corporate governance is very important as a control to maximize the welfare of shareholders and the implementation of good corporate governance is very important in improving financial performance. In addition, corporate governance mechanisms are also needed to align the interests between managers and shareholders because of different interests or desires (Walsh and Seward, 1990). In this study, corporate governance is proxied by managerial ownership.

According to Jensen and Meckling (1976) the greater the share ownership, the manager will try his best to increase company profits. This is because by having share ownership, the manager has a share of the profits earned. Management ownership of company shares will encourage them to work effectively and efficiently in increasing company profits. Thus, managers are motivated to improve financial performance.

Several previous studies have had inconsistent results. This difference is thought to be caused by the presence of other variables that affect financial performance. Financial performance can not be separated from the amount of agency costs incurred in selecting the capital structure. The selection of an effective capital structure is the key to success in achieving good corporate financial performance (Fachrudin, 2011). The use of debt in the capital structure can prevent non-essential company expenses and encourage managers to operate the company more efficiently. This causes agency costs to decrease and subsequently the company's financial performance is expected to increase (Cao, 2006). This is evidenced by the research of Khidmat and Rehman (2014) in Pakistan which proves that agency costs have a negative effect on financial performance. This is in line with the research of Herliana et al (2016) in Indonesia which proves the negative influence of agency costs on financial performance.

Agency costs are the provision of appropriate incentives to managers as well as supervision costs to prevent moral hazard. Agency cost also means the use of cash flow for bonuses or unnecessary expenses made by managers for free cash flow (free cash flow). According to Rahmawati (2012) agency costs are costs that must be incurred to optimize each company's decision making and also the effect of the separation between the owner and the agent.

Jensen and Meckling (1976) were the first to link agency costs with debt in the capital structure. Debt is believed to be able to increase productivity so that sales increase. Thus the ratio of discretionary expense to net sales which is a proxy for agency costs is reduced. This opinion is supported by research by Rakesh and Lakshmi (2013) in India which proves the negative effect of capital structure on agency costs. Similar results were also obtained by Handoko (2014) in Indonesia

who concluded that the negative effect of capital structure on agency costs.

The increase in share ownership by managers is expected to make managers act in accordance with the wishes of the principal. By owning company shares, management will indirectly feel the impact of the policies that he runs, therefore managers will ensure the company runs well. According to Jensen and Meckeling (1976), increasing share ownership by management is one way to reduce agency costs. If management is also a shareholder (owner manager) agency problems will be smaller, because in this condition the owner manager is not too burdened with the obligation to regulate profits (moral hazard) because profit or loss will have a relatively equal impact between the management (agents).) and shareholders (principals). This is in line with research by Rashid (2016) in Bangladesh which proves that there is an inverse effect of managerial ownership on agency costs. This result is also strengthened by the research of Susilawati (2007) in Indonesia which concludes the opposite effect of managerial ownership on agency costs.

The difference between this research and previous research is that there are intervening variables. In this study, an intervening variable, namely agency cost, was added, because based on previous research it was inconsistent and this variable was used as a support for supervising agents so as to improve financial performance. Then it is suspected that agency costs in this study can mediate between capital structure and managerial ownership on financial performance.

II.   LITERATURE REVIEW

Agency Theory

Agency theory is a theory that companies use to base their business practices. Jensen and Meckling (1986) state that the agency relationship is a contract that occurs between the manager (agent) and the owner of the company (principal). The powers and responsibilities of both the agent and the principal are regulated in a work contract by mutual agreement. Both parties in the agency theory want the maximum profit. They also try to avoid possible risks. The existence of different interests between the two parties can lead to agency conflicts.

Financial Performance

According to Malik and Nadeem (2014) financial performance is a measurement of the company's financial position in a certain period to find out how efficient the company is in using resources to gain profits. The company's financial performance is proxied by using ROE (Return on Equity). ROE is the company's profitability ratio measured by comparing net profit after tax with the company's total equity, to measure the company's ability to generate net income using own capital.

Capital Structure

Capital structure refers to the company's source of funding (Subramanyam and Wild, 2010). Capital structure is a combination of various components on the right side of the balance sheet, namely debt and equity (Asnawi and Wijaya, 2005). According to Gitman (2009) the company's capital structure is a comparison between the amount of debt and equity capital used by the company. In agency theory, it is suggested to increase debt in the company's capital structure to overcome agency conflicts. In this study the capital structure using the Debt to Equity Ratio (DER) proxy which is one type of leverage ratio or debt to equity ratio is calculated by taking the total debt obligations and dividing by equity.

Managerial Ownership

Managerial ownership is share ownership by the company's management (Loderer and Martin, 1997). The managerial ownership structure is the percentage of the number of shares owned by the company from the total number of shares outstanding on the IDX (Boediono, 2005). Jensen and Meckling (1976) state that the greater the share ownership by management, the less management tends to optimize the use of resources while reducing agency costs due to differences in interests. With ownership for management, it will increase management's motivation to work better in improving financial performance. The larger the company's shareholding, the higher the productivity of managers in maximizing financial performance.

Agency Cost

According to Meckling (1976) agency costs are the provision of appropriate incentives to managers and supervision costs to prevent moral hazard. Agency cost also means the use of cash flow for bonuses or unnecessary expenses made by managers for free cash flow. The SGA represents costs associated with the management and product sales functions, including managerial salaries, rental fees, insurance costs, utility costs, inventory costs and advertising costs. These costs generally reflect managerial discretionary expenses and can be a good proxy for agency costs (Singh and Davidson, 2003). All costs in the SGA Expense to Sales Ratio are determined by management, so

there is a possibility that these expenses are determined solely for management's personal gain, not for performance improvement. Therefore, the greater the SGA Expense to Sales Ratio, the greater the company's Agency Cost.

**Research Method**
Research Time and Location
In conducting this research, the research locations chosen by the researchers are issuers listed in various industrial sub-sector manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2016-2018 period.

Research Design
Based on the method, this study applies a quantitative method using a descriptive and verification analysis approach.
Based on the theoretical relationship pattern between variables above, its representation on the path diagram can be described as follows:
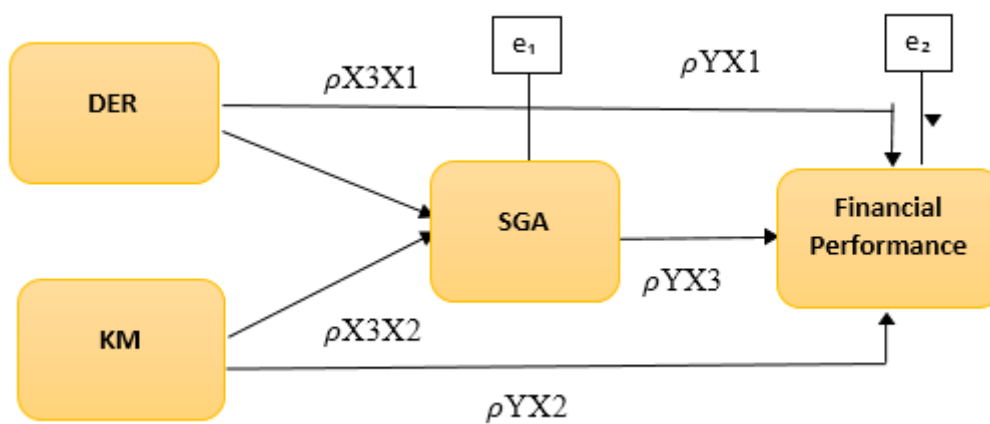
Figure 1. Concept Model

Population and Research Sample
The population in this study has a total of 51 (fifty one) manufacturing companies in various industrial sub-sectors listed on the Indonesia Stock Exchange in the 2016-2018 period.
There are a number of companies that can be included in the research sample as shown in the table, as follows:

Table 1. Results of Sample Selection

Sample Selection Criteria	Total
Companies that are included in the category of various industrial sub-sector manufacturing companies listed on the IDX in the 2016-2018 period	51
Provide periodic financial reports to the Indonesia Stock Exchange during the research period.	7
There is completeness of complete financial report data published so that it can be used in research	9
Total	35

Data Collection Technique
In this study the data used is in the form of secondary data. Secondary data is data obtained from existing sources. In connection with the use of secondary data as a type of research data, the data collection technique applied in this research is to use the Library Research method.

Data Analysis Techniques
The data analysis technique in this study used the regression analysis method which was expanded by the application of the path analysis method in connection with testing the influence of the intervening variable.

Research Result
Model Test
Structural Equation Model I

Below is a table of SPSS 16 output results from multiple regression analysis on the structural equation model 1:

Table 2. Results of Multiple Regression Analysis Structural Model 1

Coefficientsᵃ

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.090	.018		5.018	.000
	DER	.022	.008	.388	2.580	.015
	KM	-.277	.129	-.324	-2.156	.039

a. Dependent Variable: SGA

Meanwhile, the magnitude of the influence of DER (X1) and KM (X2) in explaining the SGA variable (X3) in the structural equation model 1 can be reflected in the coefficient of determination (R2) as shown in the following table:

Table 3. Test Results of R2 Structural Equation Model 1

Model Summary

Mode l	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.537ᵃ	.288	.243	.0636057

a. Predictors: (Constant), KM, DER

From the table above, it can be seen that R2 shows that the contribution of DER and KM to SGA is 28.8% while the rest (71.2%) is influenced by variables not examined in this study. Where from this R2 can also be calculated e1 namely:

$$e_1 = \sqrt{1 - R^2} = \sqrt{1 - 0,288} = 0,8438$$

The figure above will be used in making path analysis and mathematical equations for structural model 1. From the data in this sub-chapter, it can be concluded that the empirical effect for structural model 1 between the independent variables DER and KM on the dependent variable (intervening) SGA is as follows:

SGA = 0,090 + 0,022 DER - 0,277 KM + 0,8438

Structural Equation Model 2
Below is a table of SPSS 16 output results from multiple regression analysis on the structural equation model 2:

Table 4. Results of Structural Model Multiple Regression Analysis 2

Coefficientsᵃ

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.204	.039		5.237	.000
	DER	-.082	.015	-.639	-5.405	.000
	KM	.132	.223	.068	.593	.558
	SGA	-.588	.287	-.259	-2.049	.049

a. Dependent Variable: ROE

Meanwhile, the magnitude of the influence of the variables DER (X1), KM (X2), SGA (X3) in explaining ROE (Y) in the structural equation model 2 is reflected in the value of the coefficient of determination (R2) which in this study is shown in the following table:

Table 5. Test Results of R2 Structural Equation Model 2

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.804ª	.647	.613	.1032081

a. Predictors: (Constant), SGA, KM, DER

From the table above, it can be seen that R2 shows that the contribution of DER and KM to SGA is 64.7% while the rest (35.3%) is influenced by variables not examined in this study. Where from this R2 can also be calculated e1 namely:

$$e_2 = \sqrt{1 - R^2} = \sqrt{1 - 0,647} = 0,5941$$

The figures above will be used in making path analysis and mathematical equations for structural model 2. From the data in this sub-chapter, it can be concluded that the empirical effect for structural model 2 between the independent variables DER and KM on the dependent variable ROE is as follows:

ROE = 0,204 − 0,082 DER + 0,132 KM - 0,588 SGA + 0,5941e

Hypothesis Testing
a. Hypothesis 1
It is known that tcount = -5.405 with a probability value of t sig. of 0.000 and t table (0.025.31) = 2.03951. It is known that the probability value of t sig. of 0.000 is less than the level of significant (0.05), so the decision is to accept H1 which means DER has a negative and significant effect on ROE.

b. Hypothesis 2
It is known that tcount = 0,593 with probability value t sig. of 0.558 and t table (0.025.31) = 2.03951. It is known that the probability value of t sig. of 0.558 is less than the level of significant (0.05), so the decision is to accept H2, which means that DER has a negative and significant effect on ROE.

c. Hypothesis 3
It is known that the direct effect of DER on ROE (ρYX1) is 0.639 with a negative direction and the indirect effect of DER on ROE through the SGA intervening variable is 0.10049. It can be concluded that H3 namely Capital Structure (DER) has an effect on Financial Performance (ROE). through the Intervening Agency Cost (SGA) variable is rejected, which means Agency Cost is not able to mediate the effect of Debt Equity Ratio (DER) on Return of Equity (ROE).

d. Hypothesis 4

It is known that the direct influence of KM on ROE (ρYX2) is 0.068 and the indirect effect of KM on ROE through SGA is 0.0839). It can be concluded that H4 namely Managerial Ownership (KM) has an effect on Financial Performance (ROE) through the intervening Agency Cost variable. (SGA) is accepted, which means that Agency Cost is able to mediate the effect of Managerial Ownership (KM) on Return of Equity (ROE).

III. DISCUSSION
1. Capital Structure has a Negative Effect on Financial Performance
This study proves that there is a negative effect of capital structure on financial performance. This negative effect explains that the greater the use of debt, the greater the interest expense. If the interest expense is very large while operating profit is not large enough, financial difficulties will arise which will cause performance to decline.

2. Managerial Ownership has a Positive Effect on Financial Performance
This study proves that managerial ownership has a positive and insignificant effect on financial performance, this means that managerial ownership is a factor that can improve financial performance. This shows that the large or small level of managerial ownership in a company will affect a greater rate of return to shareholders.

3. Capital Structure Indirectly Affects Agency Costs on Financial Performance
This study proves that agency costs cannot mediate the effect of capital structure on financial performance in manufacturing companies in the sub-sector of various industries because each industry has a different character and this mediation mechanism is not proven due to the small influence of agency costs on financial performance.

4. Managerial Ownership Indirectly Affects Agency Costs on Financial Performance
This study proves that agency costs can mediate the effect of managerial ownership on financial performance in various industrial sub-

sector manufacturing companies. This study proves that managerial ownership is one of the mechanisms that help control agency problems. Increasing the proportion of shares owned by managers will reduce the tendency of managers to take actions that are oriented towards personal interests (opportunistic behavior).

IV. CONCLUSIONS AND RECOMMENDATIONS

Conclusion
Based on the results of data analysis and discussion that has been described, the following conclusions can be drawn:
1. Based on data processing, it is obtained that the capital structure variable has a negative and significant effect on financial performance.
2. Based on data processing, it is obtained that managerial ownership has a positive and insignificant effect on financial performance.
3. Based on data processing, it is obtained that the capital structure variable on financial performance with agency cost as an intervening variable, it can be seen that the agency cost variable is not a variable that mediates the relationship between capital structure and financial performance.
4. Based on the processing of the data obtained, the results of testing the managerial ownership variable on financial performance with agency cost as an intervening variable, it can be seen that the agency cost variable is a variable that mediates the relationship between managerial ownership and financial performance.

Suggestion
Based on the results of the research in the previous chapter, the researcher intends to provide a number of suggestions that are expected to be useful for future research in order to obtain better results, as follows:
1. It is recommended to be able to add other variables that can affect financial performance, or by changing the ratios that will be used as a proxy for the company's fundamental aspects.
2. It is recommended to be able to expand or replace research objects from various sectoral indices with industries that have a uniform character listed on the IDX and increase the research period so that it will be better able to explain the influence of each research variable on financial performance.

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