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Determinants of Firm Value: Perspectives of Free Cash Flow, Investment Opportunities, Managerial Ownership, and Opportunistic Behavior

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A B S T R A C T

This study analyses the effects of free cash flow, investment opportunities, managerial ownership, and opportunistic managerial behaviour on firm value with firm size as a control variable. The research sample comprises 35 manufacturing companies listed on the Indonesia Stock Exchange for 2018-2022. Data were analysed using panel data regression with a random effects model. The results show that free cash flow has no significant effect on firm value, while investment opportunities have a positive and significant impact. Managerial ownership negatively and significantly affects firm value, indicating potential agency conflicts. Opportunistic managerial behaviour also negatively and substantially affects firm value, reflecting management actions prioritising personal interests. Firm size has no significant effect on firm value. This study provides insights into the optimal management of factors such as investment opportunities, ownership structure, and managerial conduct, which are crucial to enhancing firm value and shareholder interests.

1. INTRODUCTION

1.1. Research Background

The increasingly fierce business competition today encourages every company to increase profits and the firm's value in the public eye so that the company's goals can be achieved. From a financial management standpoint, the corporation's primary objective is to optimize the firm's value. Firm value represents the per-share value that would be obtained if the company's assets were sold based on the share price or the present value of future free cash flows, discounted at the weighted average cost of capital. Free cash flow refers to the surplus cash generated by a firm that is available to be given to creditors or shareholders. This surplus cash is no longer required for day-to-day operations or for investing in long-term assets. [1]. Firm value can be increased, among others, through increasing shareholder welfare.

The welfare of a company's shareholders can reflect the firm's value and show how well the company is performing. Firm value is important for investors because it indicates how the market values the company. This goal can be achieved by carefully and accurately carrying out the financial management function, considering that every economic decision will affect other choices and the firm's value [2] [3]. The Investment Opportunity Set (IOS) is an investment decision in the form of a combination of assets owned and future investment options, which affects the firm's value and is related to the ability to exploit opportunities to take advantage.

In reality, not all companies experience an increase in firm value. This also happens to manufacturing companies, even though manufacturing companies are one of the sectors expected to have bright prospects in the future. According to the Central Statistics Agency (BPS), the growth of large and medium manufacturing industries in the third quarter of 2019 was lower than the same period the previous year. In addition, there were 10 productions from large and medium manufacturing industries that experienced negative growth. The industry with the highest negative growth was the metal goods industry at 22.95%, rubber at 16.63%, machinery and other equipment at 12.75%, tobacco processing at 12.73%, and motor vehicles at 12.32%. This is certainly influenced by various factors, both from within and outside the company, affecting manufacturing sector companies' value.

In implementing financial management policies and functions, manufacturing companies will be influenced by

internal and external parties. The relationship between these two parties will face the problem of information asymmetry. The existence of information asymmetry between company managers and shareholders due to the separation between owners and managers triggers agency conflicts. Managerial ownership is the level of share ownership by management parties involved in decision-making. The provision of share ownership is intended to attract and retain potential managers and direct manager actions to align with shareholder interests.

Managers can behave opportunistically by engaging in activities that only serve their own interests and do not benefit shareholders. Opportunistic managerial behavior will be discussed regarding free cash flow and company profitability. High free cash flow can create opportunities for managers to manage earnings and create agency problems [4] [5] [6]. Free cash flow often triggers conflicts of interest between shareholders and managers because managers are suspected of squandering free cash flow, resulting in inefficiency [7].

There is still inconsistency in the influence of the variables of free cash flow, investment opportunities, share ownership structure, and opportunistic managerial behavior on firm value. Therefore, researchers want to find more adequate results with data relevant to current conditions. A company is an organization that combines various resources to produce goods and services. According to the theory of the firm, the company's main goal is to maximize wealth or firm value. Maximizing firm value, in this case, also means maximising shareholder prosperity. Firm value is the price that a potential buyer is willing to pay if the company is sold.

1.2. Literature Review

Cash flow is something that is used in every economic activity. The hypothesis defines free cash flow as a market pressure pushing managers to distribute free cash flow to shareholders. Free cash flow is the excess cash from the company that can be distributed to creditors or shareholders that is no longer needed for working capital or investment in fixed assets [1]. Free cash flow is defined as cash flow that is the remainder from funding all projects that generate a positive net present value (NPV) discounted at the relevant cost of capital. This free cash flow often triggers conflicts of interest between shareholders and managers. When free cash flow is available, managers are suspected of squandering free cash flow, resulting in inefficiency in the company or investing in free cash flow with little return [8]. In this study, free cash flow is measured concerning [9]:

$$FCF = OCF - NCE – NCWC$$

Where:

OCF (operating cash flow) =
net increase/decrease in cash flow from the company's operating activities.

NCE (net capital expenditure) =
value of acquisition of fixed assets at the end of the period - the value of acquisition of fixed assets at the beginning of the period.

NCWC (net change in working capital) =
value of current assets - value of current liabilities

Free cash flow plays a crucial role in enhancing the firm value. Through dividend distributions, it serves as an internal funding source for operational expenses, investments, acquisitions, asset maintenance, and shareholder welfare. With an investment decisions approach, the cash flow theory states that positive cash flow reflects good operational performance, and utilizing internal funds for investments can have a more favorable impact than relying on external sources as it reduces interest burdens. A large free cash flow indicates better performance prospects and the potential to increase shareholder value. However, free cash flow also presents potential agency problems, wherein managers may engage in non-beneficial expenditures, reducing shareholder wealth and providing opportunities for fund misuse and earnings management. Despite differences in interpretation, overall, free cash flow has a positive influence on company value because it reflects good performance, serves as an internal funding source, and has the potential to enhance shareholder welfare if managed appropriately.

H1: Free Cash Flow has a positive effect on firm value.

The Investment Opportunity Set (IOS) refers to the combination of assets owned by a company, including both existing assets and potential future investment options. The IOS has a significant impact on the firm's value and is closely tied to the company's ability to capitalize on opportunities relative to other companies in the same industry. This company's capability is not observable. Researchers have created proxies for company growth in the IOS based on their research goals and the available data types. In addition, IOS is employed to ascertain the categorization of a firm's prospective growth, whether it is considered a burgeoning or stagnant company[10].

The Investment Opportunity Set (IOS) provides a broader indication wherein the value of a company, as its primary objective, depends on its future expenditures. The Investment Opportunity Set (IOS) depicts the extent of investment opportunities available to a company, but it heavily relies on the company's expenditure choices for future interests. This is because the Investment Opportunity Set (IOS) influences the perspectives of managers, owners, investors, and creditors toward the company. Based on the explanation above, it can be concluded that the Investment Opportunity Set (IOS) positively impacts the company's value.

H2: The Investment Opportunity Set has a positive effect on firm value.

Managerial ownership is the level of share ownership by management parties involved in decision-making, such as directors and commissioners. The step of granting share ownership to managers is aimed at (1) attracting and retaining potential managers and (2) directing manager actions to approach shareholder interests, especially to maximize stock prices. Shareholders who have a position in the company's management, either as a board of commissioners or a board of directors, are referred to as managerial ownership [13] [10].

Increasing the number of shares owned by managers through managerial ownership motivates management performance because managers feel they have a stake in the company, both as decision-makers and are responsible for every decision made. Managers involved as shareholders can enhance the company's value because managerial ownership is one way to reduce opportunistic behaviour. When a manager is involved in the ownership of company shares, they can maximize shareholder

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and company profits, thus providing a positive signal for the company and even positively impacting the company by increasing its value. This is supported by research [5] [14], which states that managerial ownership positively affects firm value.

H3: Managerial Ownership has a positive effect on firm value.

Opportunistic behaviour (managerial opportunistic behaviour) is an action managers take to benefit themselves. Still, it does not benefit or provide any benefits to the shareholders or owners of the company, but rather only for the managers' welfare. According to Ref. [3], opportunistic behaviour can be seen from the timing of earnings reporting conducted by company managers during the COVID-19 crisis in China. Ref. [3] stated that companies that practice integrated reporting tend to engage in lower levels of opportunistic behaviour regarding earnings management. Ref. [8] analyzed opportunistic behaviour from the perspective of perceived value in Sponge City public-private partnership (PPP) projects. They found that private companies can exploit information asymmetry and regulatory loopholes to behave opportunistically, affecting project delivery quality and public interests. In their research, Ref. [15] found that opportunistic CEO behaviour can moderate the relationship between sustainability reporting and corporate reputation. Based on these studies, it can be concluded that opportunistic behaviour (managerial opportunistic behaviour) can have a negative impact on firm value and the quality of financial reporting. This behaviour can occur due to conflicts of interest between managers and shareholders and information asymmetry that allows managers to act in their own self-interest.

H4: Opportunistic Managerial Behavior has a negative effect on firm value.

1.3. Research Objective

This research is an associative study. Associative can be defined as research that aims to explain the relationship between two or more variables that are causative in nature (causality. In addition, this form of research uses quantitative research, where the research aims to determine the effect of the independent variable(s) (X) on the dependent variable (Y).

2. MATERIALS AND METHODS

2.1. Population and Sample

The sampling technique in this study was to use a purposive sampling method. The sample in this study was 35 manufacturing companies on the Indonesia Stock Exchange (IDX). The requirements used to select samples are as follows:

1. Manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the research period 2018 to 2022.
2. The company presents complete financial reports consecutively from 2018 to 2022.
3. We have taken 25% of the 3 sectors of manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the research period 2018 to 2022.
4. Companies that have data related to research variables..

2.2. Operationalization and Measurement Variable

How to operationalise and measure the variables in this study can be seen in Table 1. The table shows how each variable is conceptually defined and operationally measured in this study.

Table 1.
Operational Definition of Variables

No	Research Variables	Indicator
1	*Free cash flow* (X_1)	*Free cash flow* = AKO – PM – NWC [1]
2	*Investment Opportunity Set* (X_2)	MVE/BVE = MC / TE [21]
3	*Management Ownership* (X_3)	Management Ownership = Total Share of Managerial / Total Share Outstanding [22]
4	*Opportunistic Behavior* (X_4)	$DAR = \frac{Total\ Liabilitas}{Total\ Aset}$ x 100 [23]
5	Firm Size (X_5)	Size = total assets [24]
6	Nilai Perusahaan (Y)	Q = (EMV + D) / (EBV + D) [25]

2.3. Analytical methods

The data used in this study combines time series and cross-section data. Therefore, the appropriate analysis technique is panel data regression. Panel data regression can analyze data with time dimensions and cross-sections simultaneously. The analytical tool used is Eviews software version 12.

The regression model used in this study is expressed in the following equation:

$$Yit = \alpha + \beta 1X1it + \beta 2X2\ it + \beta 3X3\ it + \beta 4X4\ it + \beta 5X5\ it + \varepsilon$$

3. RESULT AND DISCUSSION

3.1. Descriptive Analysis

Based on the descriptive data in Table 2, it can be observed that the Firm Value (FV) variable has a mean value of 0.74448 with a standard deviation of 0.61008. The median value is 0.58000, with a maximum value of 2.50000 and a minimum value of 0.06000. The Firm Value (FV) variable has a low level of data variation. This is indicated by the relatively small difference between the mean value (0.74448) and the median value (0.58000), as well as the standard deviation (0.61008) being smaller than the mean value.

The Free Cash Flow (FCF) variable has a mean value of -228.10060 and a standard deviation of 283.64000. The median value is -165.83000, with a maximum value of 346.91000 and a minimum value of -1111.58000. The Free Cash Flow (FCF) variable has high data variation. This is evident from the relatively large difference between the mean value (-228.10060) and the median value (-165.83000), as well as the standard deviation (283.64000) being larger than the mean value.

Table 2. Descriptive Statistics

	FV (Y)	FCF (X_1)	IOS (X_2)	MO (X_3)	OP (X_4)
Mean	0.74448	-228.10060	1.42646	0.27406	45.03365
Median	0.58000	-165.83000	1.12500	0.17000	43.19500
Maximum	2.50000	346.91000	4.12000	0.87000	91.51000
Minimum	0.06000	-1111.58000	0.12000	0.00000	7.58000
Std. Dev.	0.61008	283.64000	1.07717	0.28272	18.22708

Source: Secondary data processed

The Investment Opportunity Set (IOS) variable has a mean value of 1.42646 and a standard deviation of 1.07717. The median value is 1.12500, with a maximum value of 4.12000 and a minimum value of 0.12000. The Investment Opportunity Set (IOS) variable has high data variation. This is indicated by the relatively large difference between the mean value (1.42646) and the median value (1.12500), as well as the standard deviation (1.07717) being close to the mean value.

The Management Ownership (MO) variable has a mean value of 0.27406 and a standard deviation of 0.28272. The median value is 0.17000, with a maximum value of 0.87000 and a minimum value of 0.00000. The Management Ownership (MO) variable has low data variation. This is evident from the relatively small difference between the mean value (0.27406) and the median value (0.17000), as well as the standard deviation (0.28272) being slightly larger than the mean value.

The Managerial Opportunistic Behavior (OP) variable has a mean value of 45.03365 and a standard deviation of 18.22708. The median value is 43.19500, with a maximum value of 91.51000 and a minimum value of 7.58000. The Managerial Opportunistic Behavior (OP) variable has low data variation. This is indicated by the relatively small difference between the mean value (45.03365) and the median value (43.19500), as well as the standard deviation (18.22708) being smaller than the mean value.

3.2. Panel Data Regression

Table 3 shows the test results of the common effect, fixed effect, and random effect models. The regression results of the model used to test the hypothesis in this study use the random effect model.

Table 3. Regression Model Results

Variable	Random Effect		
	Coefficient	**t-Statistic**	**Prob.**
C	0.782877	11.42309	0.0000
FCF (X1)	0.000102	1.48617	0.1407
IOS (X2)	0.542951	32.45678	0.0000
MO (X3)	-0.283006	-4.44560	0.0000
OP (X4)	-0.014923	-13.76230	0.0000
UP (K)	-0.000026	-1.62815	0.1070

Source: Secondary data processed

3.2.1. The Effect of Free Cash Flow on Firm Value

The first hypothesis (H1) states that Free Cash Flow positively affects firm value. The t-test results show that Free Cash Flow has a t-value of 1.48617 and a probability value of 0.1407. Since the t-value is positive and smaller than the t-table value 1.48617<1.66940 and the probability value is greater than α=0.05 (0.1407>0.05), the first hypothesis (H1) is rejected. It can be concluded that Free Cash Flow has a positive and insignificant effect on firm value. The analysis results show a beta coefficient value of 0.000102. The findings in this study indicate a positive coefficient direction, which indicates that when free cash flow increases, firm value also increases. The significance value found in this study is 0.1407, which indicates that free cash flow does not significantly affect firm value. The results of this study are in line with the results of a study conducted by [16], who found that free cash flow does not have a significant and positive effect on firm value. Free cash flow is the excess cash flow needed to maintain existing assets and to finance new expected investments [11]. Free cash flow refers to the surplus cash flow required for the upkeep of current assets and the funding of anticipated new investments [11]. Free cash flow demonstrates the company's financial adaptability as it represents the cash flow that is available for the company's growth, repayment of debts to creditors, or distribution of dividends to shareholders. Based on the researchers' observations and studies, it was determined that the regression coefficient, which indicates a lack of significance, suggests that the company's generated free cash flow has not been successful in increasing the value of the firm. Where the company does not generate free cash flow or generates negative free cash flow, meaning that internal funds from operating activities are insufficient to meet investment needs, so the company requires additional external funds, either in the form of debt or issuance of new shares.

3.2.2. The Effect of Investment Opportunity Set on Firm Value

The second hypothesis (H2) states that the Investment Opportunity Set positively affects firm value. The t-test results show that the Investment Opportunity Set has a t-value of 32.45678 and a probability value of 0.0000. Because the t-value is positive and greater than the t-table value of 32.45678>1.66940 and the probability value is smaller than α=0.05 (0.0000<0.05), thus the second hypothesis (H2) is accepted. It can be concluded that the Investment Opportunity Set has a positive and significant effect on firm value. The analysis results show a beta coefficient value of 0.542951. The findings in this study indicate a positive coefficient direction, which suggests that when the Investment Opportunity Set increases, the firm value also increases. The significance value found in this study is 0.0000, which indicates that the Investment Opportunity Set significantly affects firm value. These research results are in line with the results of research conducted by Ref. [14] [17] [18], which found that the Investment Opportunity Set has a significant and positive effect on firm value. This means that the greater the investment opportunities or Investment Opportunity Set owned by the company, the greater the company's value. From the observations and analyses that the researchers conducted, it was found that the regression coefficient showing a significant number indicates that the results of this study also support the signalling theory, which states that investors will receive positive signals from companies

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that have a high Investment Opportunity Set value because they are considered to have good growth prospects in the future.

3.2.3. The Effect of Management Ownership on Firm Value

The third hypothesis (H3) states that the Managerial Ownership Structure positively affects firm value. The t-test results show that the Managerial Ownership Structure has a t-value of -4.44560 and a probability value of 0.0000. Since the t-value is negative and greater than the t-table value of -4.44560<1.66940 and the probability value is less than α=0.05 (0.0000<0.05), the third hypothesis (H3) is accepted. It can be concluded that the Managerial Ownership Structure has a positive and significant effect on firm value. The analysis results show a beta coefficient value of -0.283006. The findings in this study indicate a negative coefficient direction, which indicates that if the level of managerial ownership in the company decreases, it will increase the firm value. The significance value found in this study is 0.0000, which indicates that the Managerial Ownership Structure significantly affects firm value. This study's results align with the results of a study conducted by [24], who found that the Managerial Ownership Structure has a significant and negative effect on firm value. The test results show a negative effect on firm value. This negative effect is suspected because the proportion of managerial ownership may not help unite the interests between shareholders and management because management and outside shareholders have different goals, which can increase agency conflicts, making the firm value unfavourable. In theory, the greater the Managerial Ownership Structure, the more optimal management will try to increase the firm value [10]. This is because with a larger share ownership composition, management is interested in expecting a large share return, so the factor of management's involvement in share ownership will affect the company's overall development, including firm value [2] [13].

3.2.4. The Effect of Managerial Opportunistic Behavior on Firm Value

The fourth hypothesis (H4) states that Managerial Opportunistic Behavior has a negative effect on firm value. The t-test results show that Managerial Opportunistic Behavior has a t-value of -13.76230 and a probability value of 0.0000. Since the t-value is negative and greater than the t-table value of -13.76230<1.66940, and the probability value is less than α=0.05 (0.0000<0.05), the fourth hypothesis (H4) is accepted. It can be concluded that Managerial Opportunistic Behavior negatively and significantly affects firm value. The analysis results show a beta coefficient value of -0.014923. The findings in this study indicate a negative coefficient direction, which suggests that when Managerial Opportunistic Behavior decreases, firm value increases. The significance value found in this study is 0.0000, which indicates that Managerial Opportunistic Behavior significantly influences firm value. These research findings are in line with studies conducted by Ref. [4] [3] **,** which found that opportunistic behaviour has a negative impact on corporate performance and corporate governance. Managerial Opportunistic Behavior is the behavior of managers who take actions that only benefit themselves but do not benefit or provide advantages to shareholders or company owners. Managers tend to use high debt not to maximise firm value but for their opportunistic interests [20]. These findings are also supported by research by Ref. [7] [15] , which highlights that opportunistic behaviour can affect project quality and corporate reputation.

4. CONCLUSION

The research findings highlight the importance of optimal management of various factors, both financial and non-financial, to enhance firm value. Although free cash flow and firm size did not significantly impact, companies must evaluate their free cash flow utilization strategies to provide long-term benefits for shareholders. Substantial investment opportunities are a positive signal for investors, but proper execution is crucial to generate maximum returns. Meanwhile, a high level of managerial ownership can potentially trigger agency conflicts and diminish firm value, indicating the need for robust governance to align the interests of management and shareholders. Opportunistic managerial behavior also threatens firm value, reflecting management actions that prioritize personal interests, necessitating a strong culture and internal controls to prevent such behavior. Therefore, a well-balanced combination of managing factors such as investment opportunities, ownership structure, managerial conduct, and long-term investment strategies will assist companies in maximizing firm value and shareholder interests.

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