

What Factors Affect Debt Policy During the COVID-19 Outbreak? Case of Indonesia

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Abstract

This research examines the influence of free cash flow and company growth on debt policy at LQ 45 Companies on the Indonesia Stock Exchange in 2018-2021. We analyze 25 companies listed in the LQ-45 index during 2018-2021, with 100 firms-years observation in total. The sample is selected based on data availability using the purposive sample technique. We analyze the data using multiple regression analysis by using E-views software. The results indicate that Free cash flow has a positive effect on debt policy, while company growth does not affect debt policy. Our research contributes to the development of agency theory, and we use the new measurement of free cash flow. We also analyze the COVID-19 outbreak factors as a control variable, which becomes our important contribution to this research.

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INTRODUCTION

Seeing the development of the business world, companies are required to continuously increase innovation, implement performance improvements and continue to strive to increase business expansion. (Sumarata, 2022) stated that there are several objectives for establishing a company, the first objective of a company is to achieve maximum profits, the second objective is to make the company owner or share owner prosperous, and the third objective is to maximize the value of the company. To achieve its goals, a company needs good management.

From 2020 to 2021, economic growth in every country will experience a decline. According to official statistics from the Ministry of Finance, the Indonesian economy experienced a contraction of -2.07 percent at the end of 2020 (Muttaqin & Adiwibowo, 2023). The economic downturn occurred due to the Covid-19 virus outbreak. The economic crisis due to Covid-19 has had an impact on decreasing profitability and financial performance, so companies when making decisions must be careful so as not to create dangerous risks. for companies, such as in making debt policy decisions.

Debt policy is a policy carried out by a company to obtain funding sources that come from outside the company. Debt policy is carried out to obtain sources of financing for the company's operational activities. Debt policy decision making can be used to maximize company profits. Management must be able to make the best decisions so that the debt brings big profits to the company. Companies that have large profits are able to increase the prosperity of owners or shareholders and are able to achieve the company's main goals (Mufidah & Fachrurrozie, 2021).

It is important for management to make funding decisions for a company, because these decisions can affect the value of a company and thus have an impact on the prosperity of the company owner or share owners. According to (Aliansyah & Ratno, 2022) a high debt ratio will have an effect on increasing share prices, but at certain times it can reduce the value of the company because profits are smaller for the operational costs incurred.

Company owners or shareholders and management basically have different interests in relation to making decisions about funding policies. Shareholders hope that the management of the remaining funds will be distributed in order to improve the welfare of share owners. The manager has the desire that the existing funds be used for investment to enlarge the company. If managers make decisions that only benefit their own interests, it can cause problems because there are differences in interests between shareholders and managers, which can cause a conflict of interest (agency conflict). The use of debt can minimize agency costs due to conflicts of interest between shareholders and managers, and through the use of debt it can be used to control excessive free cash flow because the funds will be used to pay debts.

Most researches has been conducted on the factors that influence debt policy, including research conducted by (Afiezan et al., 2020) showing that free cash flow influences debt policy, while company growth has no effect on debt policy. The Research that conducted by (Supriadi, 2022) proved that free cash flow has a significant influence on debt policy. Apriyanti, (2018) found that free cash flow has no effect on debt policy. The study by Nurkholik & Khasanah, (2022) proved that free cash flow has no effect on debt policy. The other study in company growth is was conducted by Adnin & Triyonowati, (2021) showed that company growth has no effect on debt policy. This findings Research (Mufidah & Fachrurrozie, 2021) shows that company growth has a significant positive effect on debt policy. Research (Fauzi et al., 2022) shows that company growth has no effect on debt policy.

Free cash flow is usually the cause of conflicts of interest between management and shareholders. Management usually prefers to reinvest funds in projects that can generate profits. On the other hand, shareholders expect these funds to be distributed so that it will increase prosperity for shareholders. Companies that have high free cash flow have high levels of debt, so that high debt will reduce agency costs. Compared to companies that have a low level of free cash flow, they will have a low level of debt, because they do not rely on debt as a mechanism to reduce agency costs. The first hypothesis is stated as follows:

Company growth can be interpreted as increasing the company. High growth by the company will increase funds for operational needs. This means that if the company's internal funding is insufficient, the company will use funds from debt sources. The higher the company's growth rate, the higher it will be and the more funding it will need from debt. H3: *Free cash flow* dan pertumbuhan perusahaan berpengaruh terhadap hutang secara bersama-sama. Therefore, the second hypothesis is stated as follows:

Companies in making debt policies are influenced by internal and external factors. Free cash flow is free cash that can be used for various activities. This free cash flow can be used to be paid to investors (shareholders and debt holders) (Supriadi, 2022). Company growth can be interpreted as meaning that the company is expanding. Companies that have high growth rates tend to prefer to use debt. The larger the company, the greater the funds required to carry out the company's operational activities. The third hypothesis is proposed as follows:

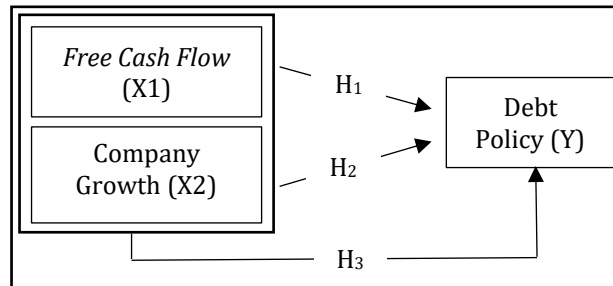


Figure 1. Theoretical Thinking Framework

H1: *Free cash flow* has a positive effect on debt decision.

H2: Company growth has a positive effect on debt policy.

H3: Free cash flow and company growth has a simultaneous effect on debt policy.

METHOD

This research uses a quantitative type of research. Quantitative data is used in testing certain theories to determine the influence of relationships between variables. The quantitative data used in this research are figures contained in the financial reports of the LQ 45 company on the Indonesia Stock Exchange (BEI) for 2018-2021. The LQ 45 index is an index that contains stocks which have a high level of liquidity and large market capitalization. Not all companies can be categorized as included in the LQ 45 index. The data source used in this research is a secondary data source. The data collection method used in this research is documentation techniques. The population in this research is all LQ 45 companies on the Indonesia Stock Exchange (BEI) in 2018-2021. The sampling technique uses purposive sampling or certain criteria with a sample size of 25 companies.

We use free cash flow and company growth as independent variables., while dependent variable is Debt Policy. Debt policy is measured by debt-to-equity ratio. Debt policy is a company funding policy that is used to finance the company's operational activities (Supriadi, 2022). Debt to equity ratio is measured by using this formula:

$$Debt\ to\ Equity\ Ratio\ (DER) = \frac{Total\ Hutang}{Total\ Ekuitas}$$

Free cash flow can be interpreted as cash available to a company that can be used for various activities. The focus of the free cash flow concept is cash obtained from operating activities after being used for reinvestment (Nurkholik & Khasanah, 2022). Free cash flow is measured by using this formula:

$$FCF = \frac{AKO - PM - MKB}{Total\ Asset}$$

Where:

FCF = *free cash flow*

AKO = operating cash flow firm i year t

PM = Capital expenditure firm i year t
MKB = Nett working capital firm i year t

Company growth is defined as the level of change in assets in a particular year compared to the previous year (Adnin & Triyonowati, 2021). Company growth is measured by asset growth using followed formula:

$$Growth = \frac{Total\ asset\ t - total\ asset\ t-1}{Total\ asset\ t-1}$$

We also use COVID-19 period as a control variable. We use code "1" as the period during COVID-19 outbreak and code "0" as the period before COVID-19 outbreak. We control the pandemic period because during COVID-19 outbreak, most company have a decrease on cash flow and company growth (Muttaqin & Adiwibowo, 2023).

Data Analysis Technique

Descriptive Statistic Analysis

Descriptive analysis will provide a general description of the characteristics of each research variable so that it can provide an explanation of the problem being analyzed.

Multiple Regression Analysis

Multiple regression analysis techniques are used to find out how much influence the independent variable has on the dependent variable. Multiple linear regression is formulated as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Where:

Y = Debt policy

α = Regression Constanta

$\beta_1, \beta_2, \beta_3$ = Regression coefficient

X1 = Free cash flow

X2 = Company growth

X3 = COVID-19 period control variable

e = other factors outside the model.

We apply classical assumption test before the multiple regression test. The classical assumption test ensures the best regression model. The hypotheses are tested using t-test with significant level at 0,05. We test the multiple regression using Eviews 12 software.

RESULT AND DISCUSSION

Descriptive Statistics

We use 100 companies listed in the LQ-45 Index during 2018 to 2021. Companies in the LQ-45 have the high market capitalization and stable growth of asset (Gabrilia et al., 2022), therefore we choose LQ-45 companies as our research object

The results of descriptive statistical analysis in this research using the Eviews 12 program are as follows:

Table 1. Descriptive Statistics Analysis

	DER	FCF	GROWTH	DUMMY
Mean	2.366300	0.063500	0.105800	0.500000
Median	0.995000	-0.020000	0.080000	0.500000
Maximum	17.07000	0.680000	1.680000	1.000000
Minimum	0.170000	-0.370000	-0.130000	0.000000
Std. Dev.	3.121258	0.301100	0.201134	0.502519
Skewness	2.677002	0.684472	5.272401	0.000000
Kurtosis	11.32631	2.166420	39.64255	1.000000
Jarque-Bera	408.3034	10.70358	6057.790	16.66667
Probability	0.000000	0.004740	0.000000	0.000240
Sum	236.6300	6.350000	10.58000	50.00000
Sum Sq. Dev.	964.4831	8.975475	4.005036	25.00000
Observations	100	100	100	100

Source: Primary Data, 2024

DER (Y) has a minimum value of 0.170000, a maximum value of 17.07000, an average value of 2.366300, and a standard deviation value of 3.121258.

FCF (X1) has a minimum value of -0.370000, a maximum value of 0.680000, an average value of 0.063500, and a standard deviation value of 0.301100.

GROWTH (X2) has a minimum value of -0.130000, a maximum value of 1.680000, an average value of 0.105800, and a standard deviation value of 0.201134.

The Dummy variable has a minimum value of 0.000000, a maximum value of 1.000000, an average value of 0.500000, and a standard deviation value of 0.502519.

Multiple regression testing using the Eviews 12 program. The results of multiple regression testing in this study are as follows:

Table 2. Regression Test Result Without HAC Newey-WEST Test

Dependent Variable: DER
 Method: Least Squares
 Date: 07/11/23 Time: 09:46
 Sample: 1 100
 Included observations: 100

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.775244	0.357659	4.963505	0.0000
FCF	6.885421	0.792500	8.688228	0.0000
GROWTH	0.396217	1.183650	0.334742	0.7386
DUMMY	0.223824	0.473882	0.472320	0.6378
R-squared	0.444285	Mean dependent var		2.366300
Adjusted R-squared	0.426919	S.D. dependent var		3.121258
S.E. of regression	2.362858	Akaike info criterion		4.596799
Sum squared resid	535.9774	Schwarz criterion		4.701006
Log likelihood	-225.8399	Hannan-Quinn criter.		4.638973
F-statistic	25.58351	Durbin-Watson stat		0.714642
Prob(F-statistic)	0.000000			

Source: Primary Data, 2023

Based on table 2, because in the multiple linear regression model without Newey-WEST HAC there are heteroscedasticity and autocorrelation problems, the resulting output cannot be used in analysis or drawing conclusions. Therefore, in treating heteroscedasticity and autocorrelation problems in the regression model, this research uses the Newey-WEST HAC method. The results using the Newey-WEST HAC method are as follows:

Table 3. Regression Test Result With HAC Newey-WEST Test

Dependent Variable: DER
 Method: Least Squares
 Date: 07/11/23 Time: 10:46
 Sample: 1 100
 Included observations: 100
 HAC standard errors & covariance (Bartlett kernel, Newey-West fixed bandwidth = 5.0000)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.775244	0.308095	5.761996	0.0000
FCF	6.885421	1.871941	3.678226	0.0004
GROWTH	0.396217	0.738815	0.536287	0.5930
DUMMY	0.223824	0.374656	0.597413	0.5516

R-squared	0.444285	Mean dependent var	2.366300
Adjusted R-squared	0.426919	S.D. dependent var	3.121258
S.E. of regression	2.362858	Akaike info criterion	4.596799
Sum squared resid	535.9774	Schwarz criterion	4.701006
Log likelihood	-225.8399	Hannan-Quinn criter.	4.638973
F-statistic	25.58351	Durbin-Watson stat	0.714642
Prob(F-statistic)	0.000000	Wald F-statistic	4.735323
Prob(Wald F-statistic)	0.004000		

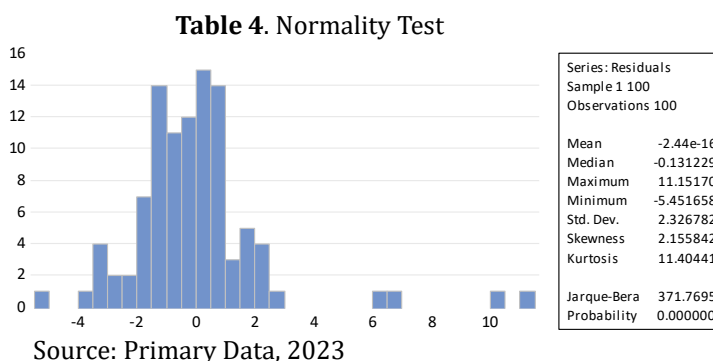
Source: Primary Data, 2023

Based on table 3, the results of the linear analysis suggest that the estimated coefficients are immune to violations of heteroscedasticity and autocorrelation. So the following regression equation is obtained:

$$Y = 1.775244 + 6.885421X_1 + 0.396217X_2 + 0.223824X_3 + e$$

Normality Test

Normality test using the Eviews 12 program. Based on table 3 it can be seen that the Jarque-Bera Probability value is 0.000000 which is smaller than 0.05. This explains that the data is not normally distributed.



The normality test used in the research is the Jarque-Bera (JB) test using the formula:

$$JB = n \left(\frac{S^2}{6} + \frac{(K - 3)^2}{24} \right)$$

Where:

n = the number of sample

S = skewness coefficient

K = kurtosis coefficient

Therefore, we have the result of normality test as follows:

$$JB = 100 \left(\frac{2.155842^2}{6} + \frac{(11.40441 - 3)^2}{24} \right) = 371.7697$$

The JB statistical value follows a Chi-square distribution with 2 df (degree of freedom). So the JB value is 371.7697, while the Chi-square table value with 2 df is 5.9915 at a significance of 0.05, meaning the data is not normally distributed. Even though the data is not normally distributed, the research can still be continued because the residual normal distribution assumption is used for small samples, so for large samples it can be ignored, and in classical assumption testing it can put more emphasis on heteroscedasticity and autocorrelation which can influence statistical decision making to become invalid. (Ghozali & Ratmono, 2017).

Multicollinearity Test

Multicollinearity test using the Eviews 12 program. Based on table 4 it can be seen in the Centered VIF table that each variable X1, X2, X3 has a value of less than 10, so there is no multicollinearity.

Table 5. Multicollinearity Test

Variance Inflation Factors
Date: 07/11/23 Time: 00:37
Sample: 1 100
Included observations: 100

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.127920	2.291205	NA
FCF	0.628056	1.055033	1.009673
GROWTH	1.401027	1.285921	1.005027
DUMMY	0.224564	2.011108	1.005554

Source: Primary Data, 2023

Heteroscedasticity Test

The heteroscedasticity test uses the White test in the Eviews 12 program. Based on table 6, the Chi-Square Prob value is 0.0148 which is smaller than 0.05, this explains that heteroscedasticity occurs.

Table 6. Heteroscedasticity Test

Heteroskedasticity Test: White
Null hypothesis: Homoskedasticity

F-statistic	2.670817	Prob. F(8,91)	0.0111
Obs*R-squared	19.01503	Prob. Chi-Square(8)	0.0148
Scaled explained SS	91.16475	Prob. Chi-Square(8)	0.0000

Source: Primary Data, 2023

This research uses the Newey-WEST HAC method to overcome heteroscedasticity. Table 3 shows the output results.

Autocorrelation Test

The autocorrelation test uses the Langrange Multiplier Test (LM Test) in the Eviews 12 program. Based on table 7, the Prob Chi-Square value of 0.0000 is smaller than 0.05, this explains that this research has autocorrelation.

Tabel 7. Autocorrelation Test

Breusch-Godfrey Serial Correlation LM Test:
Null hypothesis: No serial correlation at up to 2 lags

F-statistic	33.93574	Prob. F(2,94)	0.0000
Obs*R-squared	41.92924	Prob. Chi-Square(2)	0.0000

Source: Primary Data, 2023

The Newey-WEST method can be used to overcome heteroscedasticity and autocorrelation problems simultaneously (Gujarati, 2003). The results of using the Newey-WEST HAC method to overcome heteroscedasticity and autocorrelation problems can be seen in table 3.

Hypotheses Test

Based on table 3, the results of the t test for the variable X2 (company growth) show that it has a probability value of 0.5930 which is greater than 0.05, so X2 (company growth) has no effect on debt policy. The results of the t test for variable X3 (pandemic dummy) show that it has a probability value of 0.5516 which is greater than 0.05, so Based on table 3, the Prob value is obtained. (Wald F-statistic) $0.004000 < 0.05$ then H3 is accepted, meaning that simultaneously all independent variables, namely free cash flow and company growth, influence the dependent variable, namely debt policy.

The Effect of Free Cash Flow on Debt Policy

Free cash flow (FCF) has a probability value of 0.0004. The significance value is smaller than 0.05 so it can be concluded that free cash flow has a positive influence on debt policy (DER). From the results of this research, it can be concluded that if free cash flow increases, debt policy will also increase. Through the use of debt, agency costs can be minimized due to conflicts of interest between shareholders and managers because through the use of debt it can be used to control excessive free cash flow (Afiezan et al., 2020) because the funds will be used to pay debts and interest, therefore it can avoid wasted investment where debt increases. will bind managers to distribute cash flows in the future (Miglo, 2020).

The Effect of Company Growth on Debt Policy

Based on the results of variable statistical tests, it was found that company growth had a probability value of 0.5930. The significance value is greater than 0.05 so it can be concluded that company growth has no effect on debt policy (DER). From the results of this research, it can be concluded that every increase in company growth is not followed by a debt policy, so this is in accordance with the pecking order theory that companies tend to prefer internal funds rather than using external funds (Fatma & Chichti, 2011). Companies with high growth rates have sufficient internal resources for the company's operational needs. Companies that have a high growth rate maximize their use of funding from their own capital rather than debt. The company will continue to use internal funding sources as long as they are sufficient (Nurdani & Rahmawati, 2020).

The Simultaneous Effect of Free Cash Flow and Company Growth on debt Policy

Based on the simultaneous test above, the value of Prob. (Wald F-statistic) 0.004000 where this value is smaller than 0.05, which means that the model can be used to predict free cash flow and company growth which influence debt policy simultaneously.

The Effect of COVID-19 Outbreak on Debt Policy

Based on the results of statistical tests, the variable obtained is that the pandemic dummy has a probability value of 0.5516. The significance value is greater than 0.05 so it can be concluded that the pandemic dummy has no effect on debt policy (DER). This means that during the Covid-19 pandemic in 2020-2021 it will not affect debt policy making.

When the economic crisis occurs due to Covid-19 in 2020-2021, companies can use free cash flow for investment purposes rather than increasing debt, because using debt as a source of funding will have risks (mahadwartha & ismiyanti, 2008; nurdani & rahmawati, 2020). A company's liquidity will be threatened when the company chooses to use debt as a source of funding but is unable to pay the debt due to uncertain economic conditions due to Covid-19. This is also in line with the pecking order theory that companies tend to prefer internal funds rather than using external funds (Wahyuni, 2021).

Company growth has no effect on debt policy. During the Covid-19 pandemic in 2020-2021, which resulted in an economic crisis and economic conditions became uncertain, companies had to make careful decisions so as not to pose dangerous risks to the company. In order not to create dangerous risks for the company, in meeting operational needs the company maximizes the use of funding sourced from its own capital rather than debt, this means it is in accordance with the pecking order theory (Wahyudin, 2019). Because when debt cannot be paid due to uncertain economic conditions, it will increase liquidity risk.

CONCLUSION

Based on the research results and previous discussion regarding the influence of free cash flow and company growth on debt policy in LQ 45 companies on the Indonesia Stock Exchange (BEI) in 2018-2021, it was concluded that free cash flow had a positive effect on debt policy (DER). Company growth has no effect on debt policy (DER). The pandemic dummy has no effect on debt policy (DER). Free cash flow and company growth simultaneously influence debt policy. This research has limitations, namely that it only uses free cash flow and company growth variables and this less recent research only uses financial reports for 2018-2021. The suggestions that can be concluded are that companies can take this into consideration in making decisions in order to achieve company goals and avoid dangerous risks when uncertain economic conditions occur or in normal economic conditions. For future researchers, they can add variables such as adding the independent variable profitability, as well as adding a longer and more recent research period to get more accurate and statistically updated results.

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