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# Foreign Ownership, Free Cash Flow and Assets Utilization of Manufacturing Industry

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**ABSTRACT**

**Purpose :** This study aims to examine the effect of moderating role of foreign ownership in the relationship between net profit margin and free cash flow on assets utilization in Indonesian manufacturing companies.
**Method :** Net profit margin and free cash flow act as independent variables while assets utilization is the dependent variable and foreign ownership is the moderating variable. The research sample was determined using a purposive sampling approach with several criteria as the basis for determining it. Observations in this study were conducted from 2018 to 2020, manufacturing companies listed on the Indonesian Stock Exchange were the focus of this study. 36 companies were selected as samples with 108 observations. Testing the research hypothesis was conducted by using Moderated Regression Analysis (MRA).
**Findings :** The results of the tests showed that asset utilization was positively and significantly impacted by Net Profit Margin and Free Cash Flow. Additionally, foreign ownership was insignificant in strengthening the effect of net profit margin and free cash flow on asset utilization.
**Novelty :** The study specifically focused on foreign ownership, while previous research was based on structure ownership as a whole.



## INTRODUCTION

In the midst of intense competition and economic globalization, companies are required to maximize their performance in various ways, including through efficiency in production, human resources, and finances (Priyanto & Qibthiyyah, 2020). The allocation of productive assets in the form of capital ownership by foreigners has become an important theory in maximizing company performance (Raff et al., 2009). Foreign ownership of capital is considered to be able to influence investors' incentives to apply their resources as inputs to companies. According to Priyanto & Qibthiyyah (2020), foreign ownership of capital influences the cost of capital, the level of investment, the rate of technology transfer, and the share of profits from foreign investment. In addition, foreign ownership determines the extent to which a foreign company can control its subsidiaries and protect company assets. In the Asia Pacific context, a research by Greenaway et al. (2014) in China show that businesses with partly foreign ownership have superior performance compared to companies that are wholly foreign owned and purely domestic. Raff et al. (2009) found that Japanese local companies affiliated with foreign ownership have better utilization of potentially valuable assets to contribute to investment projects in the future. Moreoevr, Carney & Hamilton-Hart (2015) research on the banking sector in Indonesia found a relationship between foreign ownership and cash-flow of politically connected family firms from 1997 to 2008.

Asset utilization is considered to produce a positive return value as a result of using each company's assets, due to the fact that the assets used have generated costs for the company (Ocak & Fındık, 2019). In practice, there are two influential parts in asset utilization, namely profitability and capital such as net profit margin and free cash flow (Alghifari et al., 2022; Hirdinis, 2019). Free cash flow tends to be used by managers in activities that contribute low to firm value and this occurs when free cash flow is high which ends in agency problems (Iskandar et al., 2012). Free cash flow is a measure of the cash a company has after taking into account capital expenditures and dividend. Free cash flow encourages managers to utilize available funds in various activities that contribute or not increase

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company value (Iskandar et al., 2012). As a result, managers can use free cash flow to invest in assets that are more profitable than investing in assets that can increase firm value. When a company has a high level of free cash flow, it can lead to underutilized assets, as managers may have less incentive to invest in new projects or growth opportunities (Al-Zararee & Al-Azzawi, 2014; Mills & Yamamura, 1998). This negative impact on asset utilization is consistent with agency theory, which suggests that the interests of managers and shareholders may not always align.

By referring to agency theory, managers can prioritize their own goals and use free cash flow for non-productive purposes, such as repurchasing shares, instead of investing in assets that can increase the long-term value of the company (Anwar et al., 2018; Moin et al., 2020). This can lead to underutilized assets and potentially harm overall business performance and growth. On the other hand, a high net profit margin indicates that the company's operations operations are able to minimize costs and increase revenue. The net profit margin impact is in line with profitability level (Akben-Selcuk, 2016; Mishra et al., 2012; Nariswari & Nugraha, 2020; Supriono, 2022; Tantra, 2018). Profitability is closely related to the effectiveness of company activities (Chen et al., 2018; Purbawangsa et al., 2020; Zainudin et al., 2018). The company's ability to carry out cost efficiency is very necessary in producing high profitability (Sekhon & Kathuria, 2019). Assets that are used effectively are able to minimize unnecessary costs so that assets utilization is of high value. The most important components in calculating the net profit margin are net profit and company revenue or sales (Darko et al., 2016; Hayek, 2018; Sun et al., 2017). The ratio of net profit to net sales is used to calculate net profit margin so that a high net profit margin value means high net profit obtained from net sales, and the opposite applies (Amir et al., 2013). In fact, foreign ownership acts effectively in controlling and supervising managers' efforts to manipulate accounts (Alzoubi, 2016; Han et al., 2022; Hoang et al., 2019; Iskandar et al., 2012; Jao et al., 2020). Therefore, foreign ownership is needed in order to be able to minimize the agency problem between free cash flow and assets utilization and to maximize the positive impact of net profit margin on assets utilization.

This study aims to examine the effect of moderating role of foreign ownership in the relationship between net profit margin and free cash flow on assets utilization in Indonesian manufacturing companies. This study has novelty in using proxies of assets utilization focusing on the involvement of productive assets as a component of accumulating total manufacturing company assets in Indonesia. This was corroborated in previous studies demonstrating that effective implementation of asset utilization can increase corporate value (Mangesti Rahayu, 2019; Singh & Bansal, 2016; Voulgaris et al., 2002).

Return on assets (ROA) measures how efficiently a company uses its assets to generate profits. It is calculated by dividing net income by total assets (Claessens et al., 2006; La Porta et al., 2000). Net profit margin, on the other hand, measures the amount of net income a company generates in relation to its total revenue. ROA and net profit margin are both important metrics for evaluating a company's financial performance, and both can influence each other (Jelinek & Stuerke, 2009; Liu & Pang, 2009). For example, a company with a high net profit margin may also have a high ROA, because it generates more revenue from its assets. Likewise, companies with low net profit margins may also have low ROA, because they do not use their assets effectively to generate profits (Rashid, 2015). Therefore, it can be said that the return on assets is influenced both partially and jointly by the net profit margin. A higher net profit margin can result in a higher return on assets. The return on assets is affected in part or simultaneously by the net profit margin (Chowdhury et al., 2019; Darko et al., 2016; Masood & Ashraf, 2012; Mishra et al., 2012; Sekhon & Kathuria, 2019). Previous studies demonstrated that increasing net profit margin is more likely to have a positive effect on assets utilization. Thus, this study formulates the first hypothesis as follows:

**$H_1$: Net profit margin has a positive effect on assets utilization**

Free cash flow is the amount of cash a company has after taking into account capital expenditures (Mills et al., 2002). When a company has a high level of free cash flow, it can result in underutilized assets. This is because managers may have less incentive to invest in new projects or growth opportunities, and instead choose to hold cash. When free cash flow increases, the efficiency of asset utilization decreases significantly (Carroll & Griffith, 2001; Hribar & Yehuda, 2015; Waseem & Qamar, 2021). This is because with more cash available, there is less pressure to use assets productively. This can lead to missed opportunities for long-term growth and value creation. In addition, if free cash flow is not invested in assets, it can eventually lead to an excess supply of cash, which can have a negative impact on the company's overall financial performance (Agnes Cheng et al., 2020; Hanlon, 2005; Smith & Pennathur, 2019). Therefore, it can be said that free cash flow has a negative relationship with asset utilization, and the higher the free cash flow, the lower the asset utilization efficiency.

When a company has a high level of free cash flow, it can lead to increased agency costs and decreased asset utilization. Agency costs refer to the costs associated with aligning the interests of management and shareholders (Carroll & Griffith, 2001; Hribar & Yehuda, 2015). When there is a high level of free cash flow, managers may have more discretion to use it for their own benefit, rather than for the benefit of the company and its shareholders (Mann & Sicherman, 1991; Stulz, 1990). This can result in higher agency costs because management's actions may not be in the best interest of shareholders. In addition, high levels of free cash flow can also lead to underutilized assets. This is because managers may have less pressure to invest in new projects or growth opportunities, and instead prefer to hold cash (Hirshleifer, 1993). As a result, companies may miss opportunities for long-term growth and value creation. In addition, free cash flow increases agency costs (Ahmed AL-Dhamari & Nor Izah Ku Ismail,

2014; Barger et al., 2019; Okofo-Dartey & Kwenda, 2021) and reduces asset utilization (Abdullah, 2002; Barger et al., 2019; Okofo-Dartey & Kwenda, 2021). Free cash flow is negatively related to assets utilization and the higher the free cash flow, the efficiency of assets utilization is significantly reduced (Iskandar et al., 2012; Yero et al., 2021). Previous studies generally revealed that an increase in free cash flow can lead to higher agency costs and a decrease in asset utilization. Therefore, the second hypothesis was formulated as follows:

**$H_2$: Free cash flow has a negative effect on asset utilization**

Asset utilization refers to the way assets are used to produce goods and services or to generate income. Asset utilization is an important factor in determining the overall performance and efficiency of a company or economy (Naz et al., 2016). Foreign ownership can have a significant impact on asset utilization. If a foreign company acquires a local company or invests in local assets, it can bring in additional capital and technology that can be used to increase the utilization of these assets (Iskandar et al., 2012; Waseem & Qamar, 2021). For example, a foreign company may bring in new equipment or management techniques that can increase productivity. On the other hand, foreign ownership can also result in changes in control and decision-making, leading to different utilization strategies (Papadakis et al., 1998). For example, a foreign owner may have different goals or priorities than a local owner, leading to a different asset utilization strategy. Asset utilization is significantly influenced by foreign ownership, because it can bring additional capital and technology, but it also results in changes in control and decision-making (Chhibber & Majumdar, 1999; Lee et al., 2011).

Institutional ownership refers to the ownership of company stock by large financial institutions, such as pension funds, insurance companies, and mutual funds. Institutional ownership plays an important role in monitoring and evaluating management effectiveness (Demiralp et al., 2011). Institutional owners have a large number of resources, including expert staff and access to relevant information, which they can use to monitor and evaluate company management practices (Atkinson et al., 1997). They can provide companies with valuable feedback and take actions, such as voting against proposals or advocating for changes, to promote better management practices. Furthermore, empirical evidence has found that institutional ownership can reduce agency costs. Agency costs refer to costs arising from conflicts of interest between company owners (shareholders) and managers who run the company. Institutional ownership can help align the interests of managers and shareholders, because they have the same goal of maximizing firm value (Goranova et al., 2010; Kusumawati & Setiawan, 2019). Institutional ownership effectively monitors and evaluates management, and has been found to reduce agency costs, because it aligns the interests of managers and shareholders. Previous research showed different results in examining the mediating effect of foreign ownership in strengthening the effect of net profit margin on assets utilization. Some have found that asset utilization is significantly affected by foreign ownership (Iskandar et al., 2012; Yero et al., 2021). Foreign ownership is related to assets utilization but not significant (Iskandar et al., 2012). Institutional ownership effectively monitors and evaluates management. Moreover, institutional ownership is empirically found to reduce agency costs and has a negative and insignificant effect on agency costs (Khan et al., 2017; Lin & Fu, 2017; Nathania et al., 2020; Sartawi, 2018). Thus, this study formulates the following third hypothesis:

**$H_3$: Foreign ownership strengthens the effect of net profit margin on assets utilization**

Foreign ownership can strengthen the effect of net profit margin on asset utilization. Net profit margin refers to the amount of profit a company earns after taking into account all costs, and is often used as a measure of profitability (Ongore & Kusa, 2013). Foreign ownership can bring additional resources and technology that can improve asset utilization. If a company has a high net profit margin, it likely has the resources to invest in new assets or to increase the utilization of existing assets. The presence of foreign ownership can strengthen this effect, because foreign companies often have more resources and capital to invest in assets (Caves, 1971).

This showed that when foreign ownership decreases, asset utilization can also decrease. This can occur when a company lacks the funds to invest in new assets or to maintain and upgrade existing assets, leading to decreased utilization. However, foreign ownership and high levels of foreign ownership can weaken this negative relationship. Foreign ownership can bring in additional capital and resources, which can be used to increase asset utilization (Chinelo & Iyiegbuniwe, 2018). This can help reduce the impact of reduced FCF on asset utilization. In addition, high levels of foreign ownership may also lead to changes in control and decision-making, leading to different utilization strategies that may be less affected by a reduction in FCF. The negative relationship between FCF and asset utilization can be reduced by foreign ownership and high levels of foreign ownership, because it can bring additional capital and resources and cause changes in decision making (Iskandar et al., 2012). In addition, the negative relationship between free cash flow and asset utilization can be lessened with foreign ownership and high foreign the negative relationship between asset utilization and free cash flow can be weakened by high foreign ownership (Iskandar et al., 2012; Yero et al., 2021). Accordingly, the fourth hypothesis was proposed as follows:

**$H_4$: Foreign ownership strengthens the effect of free cash flow on assets utilization**

**Table 1.** Definition and Measurement of Variables

| Variable | Category | Measurement and Definition | Source |
|---|---|---|---|
| Assets Utilization | Dependent | Comparison of Sales to Total Assets multiplied by one hundred percent | (Iskandar et al., 2012; Nathania et al., 2020) |
| Net Profit Margin | Independent | Comparison of Net Profit to Sales multiplied by one hundred percent | (Darko et al., 2016; Hayek, 2018) |
| Free Cash Flow | Independent | Comparison of Total Net Operating Profit After Tax (NOPAT), Interest Expense less Dividends Distributed to Total Assets of the Previous Year | (Ahmed AL-Dhamari & Nor Izah Ku Ismail, 2014; Rusmin et al., 2014) |
| Foreign Ownership | Moderation | Comparison of Number of Shares of Foreign Ownership to Total Shares multiplied by one hundred percent | (Han et al., 2022; Jao et al., 2020) |

Source: Processed Data (2022)

## RESEARCH METHODS

The data presented in the form of numbers is quantitative data, while the research formulated and conducted to analyze the possibility of a causal relationship is a causal comparative study. This research applies a quantitative approach with a causal comparative design. Observations in this study were conducted from 2018 to 2020, manufacturing companies listed on the Indonesian Stock Exchange were the focus of this study. The research sample consisted of 36 manufacturing companies or 108 observations which were determined using a purposive sampling approach. The research data was obtained from the company's financial statements that have been audited and published through the official website of the Indonesia Stock Exchange, namely https://www.idx.co.id or the official website of the sample company. Measurement and definition of each variable are presented in table 1.

Statistical tests in this study used Moderated Regression Analysis (MRA)which tested the interaction between the independent variables and the moderating variables on the dependent variable. Moderated Regression Analysis (MRA) is to qualify data that is free from the classical assumption test, namely the autocorrelation test, normality test, multicollinearity test and heteroscedasticity test. The minimum and maximum values, mean, and standard deviation of the information analyzed are used to present descriptive data in this study. Data is said to be good when it can be presented in tabulations so that the characteristics of the data studied are described.

## RESULTS AND DISCUSSIONS

The results of research data processing present descriptive statistics as contained in Table 2. The verification analysis aims to identify the effect of the independent variables on the dependent variable through multiple regression tests. Regression test to identify changes in the dependent variable when the independent variables change (Ghozali, 2017). From the data table 2 shows that the Net profit margin value gets a minimum variance value of 0.00067 and a maximum variance of 0.34403 with an average score of 0.06954 and a standard deviation of 0.05680. Free cash flow shows a minimum variance of -0.09616 and a maximum variance of 0.15194 with an average score of 0.04174 and a standard deviation of 0.04309. Assets utilization shows a minimum variance of 0.27194 and a maximum variance of 2.29048 with an average score of 0.99208 and a standard deviation of 0.50520. Foreign ownership shows a minimum variance of 0.00001 and a maximum variance of 0.97665 with an average score of 0.24482 and a standard deviation of 0.30304. If the standard deviation value for each variable in Table 2 is smaller than the average score, then the performance of these variables can be said to be good.

Based on the presentation of Table 2, the descriptive statistics of the study showed that the net profit margin contains less varied research data as indicated by the low standard deviation value when compared to the mean and the average company's ability to generate an additional net profit of 6.95% of total sales. In addition, free cash flow contains research data that varies as indicated by the high standard deviation value when compared to the mean and

**Table 2.** Research Descriptive Statistics

| Information | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|
| Net Profit Margin | 0.00067 | 0.34403 | 0.06954 | 0.05680 |
| Free Cash Flow | -0.09616 | 0.15194 | 0.04174 | 0.04309 |
| Assets Utilization | 0.27194 | 2.29048 | 0.99208 | 0.50520 |
| Foreign Ownership | 0.00001 | 0.97665 | 0.24482 | 0.30304 |

Source: Processed Data (2022)

**Table 3.** Hypothesis Testing Results

| Equation Testing 1 | | | | Equation Testing 2 | | | |
|---|---|---|---|---|---|---|---|
| **Variable** | **Coefficient β** | **T** | **Sig.** | **Variable** | **Coefficient β** | **T** | **Sig.** |
| Constant | -0.013 | -0.112 | 0.911 | Constant | 0.654 | 17.103 | 0.000 |
| Net Profit Margin | 0.087 | 2.163 | 0.034 | Free Cash Flow | 4.98 | 8.073 | 0.000 |
| Foreign Ownership | 0.000 | -0.014 | 0.989 | Foreign Ownership | -0.141 | -1.836 | 0.071 |
| R-Square | | 0.091 | | R-Square | | 0.514 | |
| Adjusted R-Square | | 0.062 | | Adjusted R-Square | | 0.499 | |
| F | | 3.156 | | F | | 33.351 | |
| Sig. | | 0.049 | | Sig. | | 0.000 | |
| **Equation Testing 3** | | | | **Equation Testing 4** | | | |
| **Variable** | **Coefficient β** | **T** | **Sig.** | **Variable** | **Coefficient β** | **T** | **Sig.** |
| Constant | 0.552 | 8.778 | 0.000 | Constant | 0.603 | 15.097 | 0.000 |
| Net Profit Margin | 5.098 | 5.451 | 0.000 | Free Cash Flow | 6.611 | 8.267 | 0.000 |
| Foreign Ownership | 0.399 | 1.678 | 0.098 | Foreign Ownership | 0.029 | 0.317 | 0.752 |
| Net Profit Margin*Foreign Ownership | -7.957 | -3.35 | 0.001 | Free Cash Flow*Foreign Ownership | -5.024 | -2.972 | 0.004 |
| R-Square | | 0.332 | | R-Square | | 0.575 | |
| Adjusted R-Square | | 0.300 | | Adjusted R-Square | | 0.554 | |
| F | | 10.27 | | F | | 27.944 | |
| Sig. | | 0.000 | | Sig. | | 0.000 | |

Source: Processed Data (2022)

average value of companies funded with free cash flow of 4.17% of the company's total assets. Meanwhile, the asset utilization standard deviation value is lower than the mean value, meaning that the research data collected in assets utilization is less varied and the company's average asset utilization effectiveness is 99.21% for each asset used. The standard deviation value is higher than the mean value for data collected in foreign ownership the average company in this study has foreign ownership of 24.48% of the total shareholders contained in each entity. Testing the research hypothesis is done by processing the data of each variable using multiple regression analysis. The information presented by the hypothesis testing resultspresent information as contained in table 3.

**The Effect of Net Profit Margin on Assets Utilization**

According to the results of testing equation 1, it indicates that net profit margin simultaneously has a significant effect on assets utilization and has a positive and significant impact on assets utilization in part and this indicates that the first hypothesis is accepted. The results of testing equation 1 show that every time there is an increase in the net profit margin, asset utilization will also increase and the opposite applies, meaning that when a company has a high net profit margin, the effectiveness of the company's asset utilization is also high because it is impossible for low asset utilization effectiveness to be generate high net profit margins.

**Table 4.** Summary of Acceptance and Rejection of Hypothesis Testing Results

| No. | Hypothesis | Test Status | Information |
|---|---|---|---|
| 1 | Net profit margin has a positive effect on assets utilization. | Direct effect | Accepted |
| 2 | Free cash flow has a negative effect on asset utilization. | Direct effect | Rejected |
| 3 | Foreign ownership strengthens the effect of net profit margin on assets utilization. | Moderating effect | Rejected |
| 4 | Foreign ownership strengthens the effect of free cash flow on assets utilization. | Moderating effect | Rejected |

Source: Processed Data (2022)

**The Effect of Free Cash Flow on Asset Utilization**

Statistical results of testing equation 2 indicate that the second hypothesis is rejected. Free cash flow has a positive and significant effect on assets utilization and simultaneously has a significant effect on assets utilization. According to the findings of this test, the value of free cash flow increase will be more likely to increase assets utilization. Conversely, a decrease in the free cash flow in value will be more likely to decrease assets utilization. This mean that even though the company has high free cash flow funds, it can still make effective use of assets effectively and optimally so that additional assets from investment activities using free cash flow funds do not reduce the effectiveness of asset utilization. The companies are also capable of maintaining the effectiveness of asset utilization and this implies that every company asset invested is a productive asset capable of providing additional contributions to the company.

**The Moderating Effects of Foreign Ownership in The Relationship Between Net Profit Margin and Free Cash Flow on Assets Utilization**

The results of testing equation 3 indicate that foreign ownership is not empirically proven to strengthen the effect of net profit margin on assets utilization. Meanwhile, the results of testing equation 4 indicate that foreign ownership is not proven to strengthen the effect of free cash flow on assets utilization. The results of testing equations 3 and 4 indicate that the third hypothesis and the fourth hypothesis are rejected. The results of testing equations 3 and 4 inform that foreign ownership in this study does not increase the effectiveness of asset utilization, meaning that even though a company has foreign ownership with good monitoring characteristics, the effectiveness of asset utilization, net profit margin and free cash flow values, cannot be guaranteed to increase. In fact, the results of testing equations 3 and 4 provide an indication that even though a company has foreign ownership, the percentage of ownership is still a material consideration for influencing good corporate governance.

The results also showed the adjusted R-square as an indicator to measure the variability of independent variables. The testing results in Table 3 showed the Adjusted R-Square for Equation 1 was 0.062 (6.2 percent), and 0.499 (49.9 percent) for Adjusted R-Square of Equation 2. The adjusted R-square for Equation 3 was 0.300 (30 percent), while for Equation 3 was 0.554 (55.4 percent). This showed that the value was moderate as almost all examinations have the coefficient of determination more than 0.3 (30 percent). Furthermore, the overview of the confirmation of the hypothesis testing in this study is presented in table 4.

Overall, the findings are consistent with previous research. The findings regarding positive effect of net profit margin on assets utilization are in line with (Chowdhury et al., 2019; Darko et al., 2016; Masood & Ashraf, 2012; Mishra et al., 2012; Sekhon & Kathuria, 2019) stating that net profit margin has a positive effect on the return on assets. This indicates that higher net profit margin is more likely to increase a higher return on assets. Thus, the empirical investigation found by this study was supported by previous findings.

## CONCLUSIONS

The results of this study empirically found that net profit margin has a positive and significant effect, both partially and simultaneously, on asset utilization. The findings highlighted that the relationship between net profit margin and assets utilization was empirically proven. In general, the findings would imply that the increasing net profit margin will be more likely to increase the optimal and efficient assets utilization. Furthermore, in examining free cash flow on assets utilization, the findings showed that free cash flow has a simultaneous effect on assets utilization, but its partial effect was positive and significant on assets utilization. This showed that the hypothesis was rejected.

In examining the moderating effect of foreign ownership, the findings showed that foreign ownership is empirically proven to be pure moderating variable. It was able to moderate the positive effect of net profit margin on assets utilization. Foreign ownership is also found to be able to moderate the positive effect of free cash flow on assets utilization. However, further examination showed that foreign ownership was less likely to strengthen the positive effect of net profit margin on assets utilization and the effect of free cash flow on assets utilization.

Theoretical implications then can be conveyed as the direction for future research. Future studies are expected to apply measurement of assets and measurement of free cash flow. The expected results are to empirically reflect the role of productive assets and to describe the flow of operating cash flow and the company's capital expenditures. In addition, future studies are also expected to broaden the sample and compared the analysis with a more-long time to longitudinal studies technique. This is to confirm the effect of foreign ownership in publicly listed companies in Indonesia. Lastly, it is hoped that the results of subsequent research can analyze the possible influence of the Covid-19 pandemic on each of the research variables involved.

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