

Does Internal Fund Create Trouble for Firms? The Effect of Investment and Dividend Policy toward Firm Value

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Abstract

Agency theory occurs when shareholders recruit a manager to manage the company. Both shareholders and managers tend to work in their best interests. The free cash flow hypothesis states that managers tend to use internal funds to invest in an unprofitable project rather than pay a dividend to shareholders. This research investigates whether internal fund available creates trouble (agency conflict) that can reduce the firm value in Indonesia's company by examining the relationship of operating cash flow as the source of internal funds to firm value through investment decision and dividend policy. The research object is the consumer non-cyclical sector listed on Indonesia Stock Exchange from 2015-to 2019. The purposive sampling technique selects forty-seven companies. Panel data was analyzed using two stages least square (2SLS). This research finds that operating cash flow positively affects firm value. Nonetheless, operating cash flow does not affect firm value through investment decisions and dividend policy in Indonesia.

Keywords: Agency Problem; Firm Value; Internal Fund; Operating Cash Flow; Investment; Dividend.

1. Introduction

The goal of establishing a company is to maximize the shareholders' wealth. (Brigham & Houston, 2019). The shareholders' wealth is reflected in the firm's value (Brau, 2016). The firm's value is the price that investors are willing to pay to purchase the company if it is sold. Firm value is essential for the investor since it portrays firm performance and how the market views it (Hirdinis, 2019). In the capital market, firm value is reflected in the stock's price.

As the company grows bigger, shareholders will not be able to manage their company by themselves to maximize the firm value. Shareholders need other professional parties. They can recruit managers and give them authority to manage the company. However, the presence of trusted managers to manage the company creates new conflicts between shareholders (owners) and managers. This conflict is called agency conflict due to differences in interests between managers and owners (Jensen & Meckling, 1976). The difference in interests occurs because each individual tends to try to maximize his personal gain. Managers are more interested in maximizing their own wealth than in shareholders' wealth.

One source of agency conflict is free cash flow (Jensen, 1987). Free cash flow is excess cash flow after the company pays its operational cost and capital expenditure. Free cash flow is a form

of the internal fund owned by the company that can be used for investment, while the rest will be paid to creditors or distributed as a dividend to shareholders (Soeindra, Tandelilin, & Hermeindito, 2016). A high internal fund indicates that the company is in good condition because it still has a large amount of cash left after funding its operational costs and capital expenditures. This phenomenon signals to the investors that the company is well-performed so the firm value could increase.

Previous research conducted by Hashemi (2014) and Dewi, Sari, Budiasih, & Suprasto (2019) supports that internal fund proxied by free cash flow has a positive effect on firm value. However, these findings contradict research conducted by Asante-Darko, Adu Bonsu, Famiyeh, Kwarteng, and Goka (2018), which states that free cash flow has a negative effect on firm value while Profita & Ratnaningsih (2016) and Ni, Huang, Chiang, & Liao (2019) state that cash flow is not significant to firm value. The inconsistency of these findings makes the relationship between internal sources of funds and firm value need to be studied further.

A high source of internal funds owned by the company makes shareholders expect higher dividend payments. Nevertheless, this dividend payment is contrary to the interests of the manager. If those funds are distributed to shareholders as a dividend, managers will have fewer resources to manage and find it more challenging to develop

the company. It will cause managers to lose the opportunity to obtain greater compensation.

Therefore, managers from companies with high internal funds prefer to use these funds to invest in projects with negative NPV compared than paying a dividend. This phenomenon follows the free cash flow hypothesis. The use of internal funds by managers for investment activities is preferable because the cost of capital from internal funds is lower than the cost of capital from external funds. These internal funds should be used to fund investments that benefit the company to increase the firm value (alignment). Nevertheless, managers deviate by choosing not good enough projects that can reduce the value of the company.

Several past studies have carried out the effect of internal funds on investment decisions and dividend policy. Research conducted by Yeo (2018) using a sample of the shipping industry in China shows that internal funds, which are reflected in free cash flow, have a positive effect on investment but have a negative effect on a dividend. It indicates that the higher the cash flow, the higher the investment, while the lower the dividend. On the other hand, this finding contrasts with Dewi et al. (2019), who found that free cash flow had a high negative effect on investment but had a positive effect on dividends, while Giriati (2016) found that free cash flow had a negative effect on investment but had no effect on a dividend.

Investment decisions and dividend policies taken by the company will positively affect the firm value (Handriani & Robiyanto, 2018; Hendarto et al., 2021). This finding is supported by research conducted by Dewi et al. (2019). Murniati, Mus, Semmaila, & Nur (2019) also support the positive effect of investment decisions on firm value, but the dividend is not significant to firm value. This finding contrasts with Fajaria, Purnamasari, and Isnalita (2017), who state that investment decisions are not significant for firm value, while dividend policy positively affects firm value.

Based on the above explanation and inconsistencies from previous studies, this study aims to dig into whether internal fund available in a company creates trouble (agency conflict) that can reduce the firm value in Indonesia's company. This research analyzes internal funds' effect on firm value in which investment decisions and dividend policy act as a mediation. This study will use operating cash flow as a proxy of internal funds, different from previous studies that used

free cash flow because free cash flow has been reduced by capital expenditure, which is also part of the investment. The research object used in this research is companies listed on the Indonesia Stock Exchange for the 2015-2019 period in the non-cyclical consumer sector based on the latest sector classification, IDX Industrial Classification in 2021. The non-cyclical consumer sector is chosen to be the object of research because this sector is defensive and more stable in facing economic fluctuations.

This study has several contributions. First, this study extends agency theory literature by examining potential agency conflict in emerging markets such as Indonesia. Second, this study gives the methodological contribution of using two stages of least square (2SLS) in analyzing the agency problem in Indonesia. Third, the result of this study could be the reference for the policymaker to control agency problems due to internal funds if it exists.

The structure of the remainder of this paper is as follows. Section 2 introduces agency theory and proposes some hypotheses related to internal funds' effect on firm value. Section 3 describes the methodology, data, and variables. Section 4 and 5 empirically test the hypotheses, report the result and discuss the findings. Section 6 provides a conclusion.

2. Literature Review

2.1. Agency Theory

Agency theory explains about relationship between shareholders as principals and managers who run the company as agents. This relationship occurs when shareholders give authority to their managers to manage the company. Shareholders expect that managers will manage the company to meet shareholder goals, which is maximizing shareholder wealth. In fact, managers have better information than shareholders. Therefore, it creates asymmetric information between managers and shareholders so that managers have the opportunity to carry out moral hazard by making business decisions not based on shareholder interests but based on their own interests (Bendickson, Muldoon, Liguori, & Davis, 2016; Jensen & Meckling, 1976; Panda & Leepsa, 2017). Besides moral hazard, Jensen, & Meckling (1976), another asymmetric information besides moral hazard is adverse selection. Adverse selection is a condition where the principals do not know whether the decision taken by the agent is

really based on the information acquired or as a dereliction of duty.

The existence of agency conflict creates agency costs borne by both the principal and agent to resolve the conflict. Jensen and Meckling (1976) suggest two passive ways to reduce agency conflicts: debt and paying dividends. By using debt, managers are obliged to use internal funds to pay interest and principal debt, thereby reducing excess cash flow that may be used to invest in unfavorable projects. The dividend payment will also reduce internal funds, thereby minimizing the moral hazard of managers.

2.2. Free Cash Flow Hypothesis

Jensen (1986) argues that agency conflicts arise from the company's internal funds. That internal fund should be used to finance profitable investments, and the rest is returned to the owners in the form of dividends. However, managers will have fewer resources to manage when these internal funds are distributed in dividends. Therefore, managers tend to invest in projects that are not good (overinvestment) to reduce the firm value.

Free cash flow is excess cash flow owned by a company from operational activities after deducting capital expenditures. This free cash flow is a source of company agency conflict. The free cash flow hypothesis itself states that managers with excess cash flow will invest in negative net present value (NPV) projects rather than pay the dividend to the shareholders. Therefore, Jensen (1986) states that the free cash flow in the company must be returned to shareholders in the form of dividends or to creditors (free cash flow hypothesis) to avoid opportunities for overinvestment by managers.

2.3. The Effect of Operating Cash Flow Toward Firm Value

Operating cash flow is the cash flow generated by the company's normal business operations. Operating cash flow describes whether a company can generate positive cash flow to run its operational activities or a company that needs external resources. Operating cash flow is free cash flow before being deducted by capital expenditure. When the company has a high operating cash flow, the company has a high internal fund to use to grow its business.

Companies hold cash for three main reasons: transactional, precautionary, and speculative reasons (Chen, 2008). For transactional reasons, the

company holds cash because it is a source of internal funds and obtaining external financing has a higher cost of capital than internal funds. Lower cost of capital can make the company take more existing investment opportunities to increase the firm value.

For precautionary reasons, companies hold cash as a form of anticipation in facing business uncertainty or risk. Companies with cash are considered more prepared to face these risks so that their performance is not too disturbed. It is a good signal for investors and can increase company value. Due to speculative reasons, the company holds cash to take advantage of unexpected profits in the future, such as falling prices for raw goods in a short time. It can increase company profits which has a positive impact on firm value. The higher the cash owned by the company, the higher the firm value will be (Mansourlakoraj & Sepasi, 2015; Tangngisalu, 2020; Zararee & Al-Azzawi, 2014; Pappang & Anastasia, 2019). Based on this explanation, the hypothesis that can be formulated are as follows:

H₁: Operating cash flow affects firm value.

2.4. The Effect of Operating Cash Flow Toward Firm Value Through Investment Decision

Investment decisions are decisions taken by a manager to invest in several different assets to get the maximum rate of return. Investment decisions can be in long-term or short-term investments (Hendarto et al., 2021). Long-term investment decisions are considered using capital budgeting tools, while short-term investment decisions, known as working capital decisions, focus on cash, inventories, other current assets, and current liabilities.

Excess cash flow in the company is a source of internal funds. These internal funds are critical for company investment decisions because internal funds have lower costs than the external fund, either through debt or stocks (Ghafoor, 2018). In addition, by having excess cash flow in the company, managers will tend to make new investments to develop the company to get incentives from this development.

Managers need to invest in fear-invested investments (neither underinvestment nor overinvestment). However, managers often do overinvestment, in which they make bad investments (negative NPV) for their own interests. It is in line with the free cash flow hypothesis that states managers are better off investing in less profitable projects than

distributing dividends (Jensen, 1986). The poor investment will result in poor firm performance, reducing the firm value. Based on this explanation, the hypotheses that can be formulated are as follows:

H_{2a}: Operating cash flow affects investment decisions.

H_{2b}: Investment decision affects firm value.

H_{2c}: Operating cash flow affects firm value through investment decisions.

2.5. The Effect of Operating Cash Flow Toward Firm Value Through Dividend Policy

Dividend policy is the company's policy to distribute profit to shareholders in the form of dividends. The company allows not to distribute the profit but retain it as retained earnings to be reinvested. Excess cash flow in the company indicates the availability of large internal funds. Shareholders will seek permission from management to distribute these funds to shareholders in the form of dividends to improve shareholder's wealth.

Referring to previous research, the phenomenon in Indonesia shows that excess cash flow in a company can increase the level of dividend payment (Lestari, 2018; Malini & Fitratama, 2020; Sakir & Fadli, 2014; Suhartono, 2015; Pappang & Anastasia, 2019). The signaling theory states that companies that increase dividend payments have good prospects in the future (Loffi, 2019). They provide good expectations for shareholders that can increase company value. Lintner (1956) found that shareholders prefer to pay dividends today to reduce their uncertainty. On the other hand, paying no or small dividend to shareholders will increase investor uncertainty and decrease company value.

Based on this explanation, the hypotheses that can be formulated are as follows:

H_{3a}: Operating cash flow affects dividend policy.

H_{3b}: Dividend policy affects firm value.

H_{3c}: Operating cash flow affects firm value through dividend policy.

2.6. Research Framework

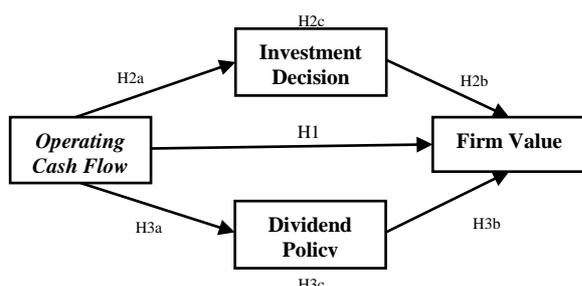


Figure 1. Research Model

3. Methods

This study aims to test the effect of operating cash flow toward firm value through investment decisions and dividend policy. The sample of this study is companies in consumer non-cyclical sector listed in Indonesia Stock Exchange from 2015 to 2019. Sampling method used is purposive sampling, in which companies with not complete data are excluded from the research. There are 47 companies (235 firm-year observations) that meet the requirements as the sample of this study. This study uses panel data, a combination of cross-section and time series, obtained from the firm's annual financial report from the official site of Indonesia Stock Exchange.

The dependent variable is firm value. Firm value is investor's assessment on firm performance. It is measured by using price to earning ratio (Sanjaya, 2019). Investment decision and dividend policy work as mediating variables. Investment decision is decision to allocate the funds to certain investment to obtain return in the future. Investment decision is proxied by *Capital Expenditure to Book Value Asset* (CEP/BVA). CEP/BVA is calculated from the difference of book value of fixed asset in t and $t-1$ divided by total assets (Daryanti, 2016). Dividend policy is a policy on how much profit will be paid as dividend to the shareholder. Dividend policy is measured using dividend payout ratio that divides dividend per share and earning per share (Sondakh, 2019).

The independent variable is operating cash flow. Operating cash flow is cash generated from the normal operating activities of a company and it has been stated in the cash flow statement. Operating cash flow indicates whether a company can generate positive cash flow from its operational activity or it needs external financing. There are three control variables used in this study: size, age and leverage. Size shows how big the company is and is calculated using natural logarithm of total assets (Isik, Unal, & Unal, 2017). Age is the difference between the year in the research period and the year when the company goes public (Kieschnick & Moussawi, 2018) while leverage is the ability of a firm to pay off debt. The ratio used to represent leverage is debt to equity ratio (DER) that divides total debt and total equity (Lenka, 2017).

The detail of operational variable definition and measurement used in this research can be seen in Table 1.

Table 1. Operational Variable Definition

Variable Types	Variable Name	Variable Description	Measurement Description
Dependent Variable	Firm value (FIRM_VAL _{<i>i,t</i>})	Investor's assessment on firm performance.	PER: Price per share divided by earning per share (Sanjaya, 2019).
	Investment Decision (INV _{<i>i,t</i>})	Decision to allocate a certain amount of funds to certain types of investments to obtain benefits in the future.	CEP/BVA: difference of book value of fixed asset in <i>t</i> and <i>t</i> – 1 divided by total assets (Daryanti, 2016).
	Dividend Policy (DIV _{<i>i,t</i>})	Policies regarding how much current profit will be paid as dividends to shareholders.	DPR: dividend per share divided by earning per share (Sondakh, 2019).
Independent Variable	Operating Cash Flow (OCF _{<i>i,t-1</i>})	Cash generated from the normal operating activities of a company.	Net operating cash flow in cash flow statement.
	Size (SIZE _{<i>i,t</i>})	How big the company is.	Natural logarithm of total assets (Isik et al., 2017).
Control Variables	Leverage (LEV _{<i>i,t</i>})	Firm's ability to pay off debt.	DER: Total debt divided by total equity (Lenka, 2017).
	Age (AGE _{<i>i,t</i>})		The difference between year in research period and year when the company goes public (Kieschnick & Moussawi, 2018).

Regression analysis in this study is simultaneous analysis. The regression model for testing the hypothesis is formulated with three models below:

$$(1) FIRM_VAL_{i,t} = \alpha_{10} + \beta_{11}OCF_{i,t-1} + \beta_{12}INV_{i,t} + \beta_{13}DIV_{i,t} + \varepsilon_{1,t}$$

$$(2) INV_{i,t} = \alpha_{20} + \beta_{21}OCF_{i,t-1} + \beta_{22}SIZE_{i,t} + \beta_{23}AGE_{i,t} + \varepsilon_{2,t}$$

$$(3) DIV_{i,t} = \alpha_{30} + \beta_{31}OCF_{i,t-1} + \beta_{32}LEV_{i,t} + \varepsilon_{3,t}$$

Before conducting hypothesis testing, a test to identify simultaneous equations is undertaken. Table 2 shows the result of identification testing. The table indicates that all three equations are overidentified. Overidentification occurs when the difference between the number of independent variables in the model and each specific equation is higher than the number of dependent variables in each particular equation. Since all equations are overidentified, the analysis method used in this study is two stages least square (2SLS).

The goodness of fit test (F-test) is conducted to know whether the model's data fits a particular distribution. The coefficient determination test is also performed to understand how big the effect of independent variables on the dependent variable, while the t-test is conducted to know the effects between variables. This research uses Sobel test to examine the significance of the mediating variables. Sobel test could be

calculated using this formula.

$$t = \frac{\alpha \cdot \delta}{\sqrt{\delta^2 SE_{\alpha}^2 + \alpha^2 SE_{\delta}^2}}$$

where:

α : regression coefficient independent variable to mediating variable.

δ : regression coefficient mediating variable to dependent variable.

SE_{α} : standard error of estimation independent variable to mediating variable.

SE_{δ} : standard error of estimation mediating variable to dependent variable.

With 5 percent significance level, if t-statistics is more than 1.96, the mediating variable can mediate the relationship between independent and dependent variables.

Table 2. Identification Testing of Simultaneous Equation

Equation	Independent Variable in Model	Independent Variable in Each Equation	Dependent Variable	Remarks
(1)	4	1	3	Over identified
(2)	4	3	1	Over identified
(3)	4	2	1	Over identified

4. Results

4.1 Descriptive Statistics Analysis

Table 3. Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Std. Dev.
OCF	4391.81	1723.00	23812.50	53.28	5444.81
INV	0.02	0.02	0.34	-1.57	0.15
DIV	0.23	0.17	1.22	0.00	0.29
FIRM_VAL	15.46	13.83	169.01	-131.96	28.84
SIZE	3.60	3.54	4.90	1.96	0.60
AGE	16.49	18.00	37.00	0.00	9.20
LEV	1.34	1.00	40.53	-45.93	4.60

The descriptive statistics analysis (Table 3) shows that the average operating cash flow held by the company is 4,391.81 million Rupiahs. It shows that the companies generally have excess cash flow from the operational process as the internal fund. Investment decision (INV) proxied by CEP/BVA has a maximum value of 0.34 and a minimum of -1.57. The average value of INV is 0.02, indicating an increase of fixed assets to total assets, reaching 2 percent.

Dividend policy (DIV) is the ratio between dividend payment and the price of the stock. The highest DIV is 1.22, while the lowest one is 0. The average value of DIV is 0.23, indicating that 23 percent of net income is distributed as dividends. The median dividend is slightly below its mean, 17 percent. The firm value variable is measured by Price Earning Ratio (PER). This variable is proscribed by comparing price per share and earning per share. The firm value variable has a maximum value of 169.01 and a minimum value of -131.96. The average value of firm value is 15.46, indicating an average price of the stock is 15.46 times of firm earnings.

Firm size (SIZE) is the control variable used in this study. The average firm size is 3.60 with a 0.60 standard deviation. It indicates that firm size has high data diversity. Firm age (AGE) is also a control variable. It is the length between the year when the financial statement was reported and when the firm went public. The average age of the company used in this study is 16.49 years. Leverage (LEV) also acts as a control variable. It is proscribed by comparing total debt and total equity. The average leverage is 1.34, indicating that the sample firm generally has higher debt than equity.

4.2. Hypothesis Testing

Table 4 presents the result of the coefficient of determination and F-test for three equations. All equations have an F-significant value of 0.000, which is significant at a 1 percent significance level. Thus, all equations fit a particular distribution. The coefficient of determination for each model is 0.468, 0.417, and 0.655, respectively, showing how big the independent variable explains the dependent variable.

Table 4. Coefficient of Determination and Goodness of Fit

Equation	R ²	Goodness of Fit	
		F	Sig.
(1)	0.468	3.924	0.000***
(2)	0.417	2.703	0.000***
(3)	0.655	7.354	0.000***

Table 5. Hypothesis Testing

Dependent	Independent	Coefficient	Std. Error	t	Sig.
	Constant	-10.287	13.323	-0.772	0.441
FIRM_VAL	OCF	0.005	0.002	2.543	0.012**
	INV	34.362	25.358	1.355	0.177
	DIV	18.513	40.576	0.456	0.649
INV	Constant	-2.472	0.405	-6.106	0.000***
	OCF	4.23E-05	1.09E-05	3.877	0.000***

The testing continues with the t-test. The result of the t-test can be seen in Table 5. The result shows that operating cash flow positively affects firm value with a coefficient of 0.005 and a significance level of 0.012. Thus, the first hypothesis (H1) is accepted. Furthermore, operating cash flow as the internal fund positively affects investment decisions with a significance value of 0.000. The higher the operating cash flow available in a firm, the more investment occurs. Thus, hypothesis 2a could not be rejected. However, the investment decision conducted does not affect firm value with a significance value of 0.177. It shows that investment activity conducted by the company does not have any effect on firm value. Therefore, hypothesis 2b is rejected. Hence, investment decisions could not mediate the relationship of operating cash flow to firm value, so hypothesis 2c is rejected.

This research also finds that operating cash flow is not significant toward dividend policy, with a significance value of 0.668. Therefore, it

shows that the increase in operating cash flow does not impact the dividend payment. In addition, dividend policy does not affect firm value with a significance value of 0.649. Therefore, hypotheses 3a and 3b are rejected. Thus, dividend policy could not mediate the relationship of operating cash flow to firm value so hypothesis 3c is rejected.

Table 6. Sobel Test t-Test

Mediating Variable	t-value of Sobel Test
Investment decision	1.279
Dividend policy	0.313

This research conducts Sobel Test to strengthen the mediating effect result. Table 6 shows the result of the t-value using the Sobel test formula. The t-value of investment decision and dividend policy is 1.279 and 0.313, respectively. Both values are less than 1.96. Our previous result convinces us that investment decisions and dividend policy do not mediate the relationship between operating cash flow as an internal fund and firm value.

5. Discussion

As shown in hypothesis testing, operating cash flow affects firm value positively. This finding aligns with the research conducted by Mansourlakoraj & Sepasi (2015) and Tangngisalu (2020), which states this positive relationship. It means that the higher the operating cash flow as a source of internal funds, the higher the firm value. The average operating cash flow of sample firms is positive, 4,391.81 million Rupiah, showing that those firms have available internal funds. This available internal fund could increase the firm value. The companies' higher cash flow makes them more flexible in making business decisions. The company is also considered to have good performance to produce high operating cash flow. It is a good signal for investors so that operating cash flow can increase firm value.

However, investment decisions and dividend policy could not mediate the relationship between operating cash flow and firm value. Only the effect of operating cash flow and investment decisions is positively significant. This finding aligns with the free cash flow hypothesis and reveals agency conflict in Indonesia's firm. Agency conflict theory states that managers work in their best interest, not in shareholders' interest (Bendickson et al., 2016; Jensen & Meckling, 1976; Panda & Leepsa, 2017). The managers in

Indonesia are trying to fulfill their interest by investing in many projects though it is not profitable, instead of paying a dividend to shareholders. Dividend payment is not appealing for the managers because it will reduce the resources that the managers can control. The descriptive statistics also show that the median of dividend payments is 17 percent. It means that half sample pays dividends only less than 17 percent. On the shareholders' side, the shareholders do not like investment conducted by the company, which causes investment decisions not significant toward firm value. In addition, they are also not satisfied with the dividend policy that makes dividend policy not affect firm value.

Due to excess cash flow earned, internal funds owned by a firm could increase firm value by showing its good performance. Yet, the use of internal funds inappropriately could not affect firm value. This research shows that the use of internal funds raises agency problems to occur. Managers tend to conduct over-investment that does not align with shareholders' goals.

This research conveys several implications for agency theory, shareholders and managers. The findings in this research strengthen the existence of agency problems in Indonesia. Therefore, shareholders need to increase monitoring to managers to reduce agency problems. The company can use debt and increase institutional ownership to control the managers (Jensen & Meckling, 1976). In addition, shareholders need to be more careful before investing in a company due to the agency problem caused by managers that can harm shareholders. On the other side, managers should manage firm resources efficiently. They have to work aligned with shareholders' interests to maximize shareholders' wealth because shareholders pay them.

This research has some limitations. First, this research only examines companies from the consumer non-cyclical sector in Indonesia. Second, this research does not involve using debt or financing decisions to determine the relationship between operating cash flow and firm value. Third, this study analyzes the relationship between operating cash flow and firm value linearly. With those limitations, future research can use a broader research sample to provide a bigger picture of the effect of operating cash flow on firm value. In addition, future research can add debt variables to the research model and analyze the non-linear effect of using cash flow on the firm value.

6. Conclusions

This research investigates whether internal fund available in a company creates trouble (agency conflict) that can reduce the firm value in Indonesia's company. It is portrayed by examining the relationship of operating cash flow as the source of internal funds to firm value through investment decisions and dividend policy. The result shows that working cash flow has a positive effect on firm value. Nonetheless, operating cash flow does not affect firm value through investment decisions and dividend policy in Indonesia. Both investment decisions and dividend policy are not significant toward firm value. As operating cash flow increases, it positively affects investment but no effect on a dividend. It suits the free cash flow hypothesis that managers prefer investing money in unprofitable projects to pay a dividend. Both decisions do not affect the firm value since they do not satisfy the investor. Therefore, internal funds lead to agency problems happening in Indonesia's firm.

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