



Executive Compensation and Liquidity Effects on Debt Policy of Consumer Cyclical Companies

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Received: 17 February 2026 | Revised: 30 March 2026 | Published: 29 April 2026

Abstract

Purpose: This study examines the effects of executive compensation and liquidity on the debt policy of consumer cyclical companies listed on the Indonesia Stock Exchange (IDX) during the 2021-2024 period, drawing on agency theory and pecking order theory to explain corporate financing behavior.

Methodology: A quantitative, explanatory research design was applied using secondary panel data drawn from the audited annual reports of consumer cyclical firms selected through purposive sampling, yielding a balanced panel that was analyzed with panel data regression after classical assumption testing and model selection procedures, including the Chow, Hausman, and Lagrange Multiplier tests.

Results: The fixed effect model was selected as the most appropriate estimator, and the findings indicate that executive compensation exerts a significant negative effect on debt policy, while liquidity exerts a significant negative effect on debt policy, together explaining a substantial proportion of the variance in the debt to equity ratio.

Conclusions: Executives who receive higher compensation tend to adopt more conservative financing behavior, and firms with stronger liquidity positions rely more heavily on internal funds, consistent with agency theory and pecking order theory respectively.

Limitations: The study is restricted to a single industry sector, a four-year observation window, and two explanatory variables, which constrains generalizability.

Contributions: The findings extend capital structure literature in emerging markets and offer practical guidance for boards designing compensation contracts and liquidity management policies that support prudent debt utilization.

Keywords: Agency Theory, Consumer Cyclical, Debt Policy, Executive Compensation, Liquidity

How to Cite: Setiawan, K., Purbolakseto, H. V., & Wardhani, R. S. (2026). Executive Compensation and Liquidity Effects on Debt Policy of Consumer Cyclical Companies. *Financial Analytics and Economic Innovation Journal (FAEIJ)*, 1(2), 97-115.

1. Introduction

The business world is experiencing increasingly complex dynamics along with rising competition and economic uncertainty (Darnia et al., 2023). Companies are required to maintain performance while ensuring long term business continuity, and this situation makes financial decisions a crucial factor in determining a company's direction and stability. The choice of funding sources plays a strategic role because it influences a company's ability to carry out operational activities, expand, and cope with fluctuating economic pressures (Pamungkas & Kusumadani, 2024).

Corporate funding sources consist of internal and external funds. Debt, as a source of external funding, is widely utilized because it can provide additional capital to increase business capacity

while boosting profit potential [\(Saif-Alyousfi et al., 2025\)](#). Bank Indonesia statistics show that the debt to equity ratio of Indonesian corporations increased significantly during and after the pandemic, rising from approximately 0.993 times in September 2021 to 1.079 times in December 2022, and further reaching 1.515 times in March 2023 [\(Bank Indonesia, 2023\)](#). This data demonstrates a trend of companies preferring to use debt over equity in their capital structure. In addition to the benefits it provides, the use of debt also carries risks to a company's financial condition if it is unable to optimally meet interest payment obligations. This obligation requires careful consideration of debt use to ensure it remains appropriate to the company's condition and needs, and debt preference reflects a company's tendency to determine the level of debt utilization as part of its funding policy.

One case involving debt and liquidity issues occurred at PT Sri Rejeki Isman Tbk. The company experienced financial difficulties due to its high debt burden and weakening financial condition, facing a suspension of debt payment obligation lawsuit while experiencing liquidity pressures that reduced its ability to meet its debt obligations [\(Rumbo, 2025\)](#). This situation indicates that a company's liquidity is closely related to its debt policy, since high debt usage can increase the risk of financial difficulty when a company's liquidity capacity weakens. Top management plays a key role in determining debt preferences [\(Kabir et al., 2024\)](#). Management's position as company administrators affords it access to more comprehensive internal information than shareholders possess, and this informational advantage places management in control of strategic decision making. Divergent interests between management and shareholders have the potential to influence financing policies in ways that do not necessarily serve the owners' interests.

Agency theory explains the relationship between owners as principals and management as agents, and it highlights the potential for conflicts of interest arising from the differing goals of each party [\(Jensen & Meckling, 1976\)](#). Management can make decisions that benefit itself even though these decisions may not always align with the interests of the owners, and debt preference is one decision that is particularly prone to such conflict. Management may be compelled to increase debt use to boost short term performance, or it may instead limit debt use to avoid risks that could potentially harm its position and reputation [\(Lubis et al., 2025\)](#).

This condition demonstrates the need for a mechanism capable of aligning the interests of management and owners. Executive compensation is one instrument that can be used to influence management behavior [\(Al-Shammari, 2021\)](#). The compensation system is designed to encourage management to act in accordance with company objectives, and performance based compensation in particular can encourage management to improve company performance through various strategic decisions, including funding policy [\(Pasaribu, 2025\)](#). At the same time, compensation can also encourage greater risk taking, which complicates any straightforward prediction of its effect on leverage.

Research conducted by [Qiu \(2025\)](#) found that high executive compensation lowers a company's debt level, since management receiving high compensation tends to make lower risk decisions. This aligns with a study by [Li et al. \(2025\)](#), which showed that high executive compensation encourages management to take on secured debt, with collateral serving as an incentive for management to utilize debt in a manner that channels it according to the company's needs rather than withholding it out of caution. Another factor influencing debt preference is a company's financial condition, particularly liquidity [\(Nurhajjah et al., 2025\)](#). Liquidity reflects a company's ability to meet short term obligations using its current assets. Based on the pecking order theory of [Myers and Majluf \(1984\)](#), companies follow a hierarchy in selecting funding sources, prioritizing internal funds before turning to debt and then equity. Companies with high liquidity tend to reduce debt use because of their adequate internal funds, and high liquidity can also increase creditor confidence, thereby giving companies easier access to external funding sources should they choose to use them [\(Haryadi et al., 2025\)](#). These differences in possible outcomes indicate that the influence of liquidity on debt preference still requires further study.

Research conducted by [Artini et al. \(2025\)](#) found that liquidity has a significant negative effect on corporate debt policy, since high liquidity levels lead companies to prefer internal funds over external

funds. This is consistent with research conducted by [Tarigan and Ane \(2025\)](#), which also found that liquidity significantly influences corporate debt policy. However, this contradicts a study by [Viriany et al. \(2025\)](#), which showed that liquidity has no effect on corporate debt policy, meaning that changes in liquidity levels do not necessarily influence a company's decision to use external funding, including debt.

Previous research has yielded mixed results regarding the influence of executive compensation and liquidity on corporate debt policy, with some studies indicating a significant effect while others show inconsistent results. These differing findings indicate a research gap that requires further investigation, particularly considering the characteristics of specific industrial sectors such as the consumer cyclical sector, which is highly sensitive to changes in economic conditions. The consumer cyclical sector is heavily influenced by consumer purchasing power, and company performance in this sector tends to fluctuate depending on economic conditions, making financing decisions more complex [\(Tjhin et al., 2024\)](#). Debt preference in this sector is important to examine because it relates to a company's ability to navigate uncertainty and maintain financial stability.

This study aims to analyze the effect of executive compensation and liquidity on debt policy in consumer cyclical companies listed on the Indonesia Stock Exchange between 2021 and 2024. The results are expected to contribute to the development of corporate finance literature and to provide considerations for companies designing more effective compensation systems and funding policies.

2. Literature Review and Hypotheses Development

2.1 Agency Theory

Agency theory was first formally proposed by Michael C. Jensen and William H. Meckling in 1976. This theory explains the contractual relationship between a company's owner, the principal, and management, the agent. The principal delegates authority to the agent to manage the company with the aim of increasing the company's value, and this relationship is not always harmonious because each party has different interests. The principal focuses on increasing the company's value over the long term, while the agent tends to focus on personal interests such as obtaining high compensation and maintaining its position. This difference in interests gives rise to a conflict known as agency conflict [\(Santosa et al., 2022\)](#).

Agency conflicts are further complicated by information asymmetry. Agents possess more complete information about the company's internal conditions than principals do, and this information asymmetry allows agents to engage in opportunistic behavior, such as making decisions that benefit themselves or avoiding certain risks that could actually benefit the company. Control mechanisms are therefore needed to mitigate these conflicts, one example being agency costs. These costs include monitoring costs incurred by the principal to oversee the agent's behavior, and bonding costs incurred by the agent as a form of assurance that it acts in accordance with the principal's interests. These costs do not always guarantee that the conflict is fully resolved, since there remain factors beyond the control of either the principal or the agent, giving rise to a condition known as residual loss [\(Anwar & Nursan, 2025\)](#).

Executive compensation is one mechanism used to align the interests of principals and agents. Performance based compensation can encourage management to make decisions aligned with company objectives, particularly regarding debt policies related to risk levels and potential returns. The use of debt can also serve as a disciplinary tool for management, since the obligation to make periodic interest payments encourages companies to be more efficient in managing resources. This condition limits the opportunity for management to act opportunistically, and a company's capital structure thus reflects not only financial decisions but also the control mechanisms embedded within the agency relationship. Agency theory provides a conceptual basis for explaining how conflicts of interest influence corporate decision making, and it remains relevant for understanding the relationship between executive

compensation and debt policy within a company [\(Aprilia, Ramdhani, Fitriya, Fernanda, & Hanifah, 2025\)](#).

2.2 Pecking Order Theory

The pecking order theory was first introduced by Stewart C. Myers and Nicolas Majluf in 1984, and it explains companies' preferences in determining funding sources. This theory states that companies prioritize funding based on cost and risk levels. Companies will prioritize internal funding from retained earnings because this funding source does not incur additional costs and does not trigger information asymmetry, and companies will only turn to debt as a funding source if internal funding sources are insufficient. Issuing shares is a last resort because it carries higher issuance costs and has the potential to send a negative signal to the market. In the context of this research, the pecking order theory serves as the basis for explaining the relationship between liquidity and debt policy. Liquidity reflects the availability of internal funds a company has to meet short term obligations. Companies with high liquidity have a greater ability to finance operational activities using internal funds, thus reducing their reliance on debt, while companies with low liquidity tend to experience limited internal funds, a situation that encourages them to use debt as an alternative source of external financing. This pattern demonstrates that liquidity plays a significant role in determining a company's financing decisions [\(Sugiono, 2019\)](#).

Based on the pecking order theory, a negative relationship exists between liquidity and debt use. The higher the liquidity level, the lower the company's tendency to use debt, and this relationship aligns with the order of funding preferences described in pecking order theory. This theory can serve as a strong conceptual foundation for understanding how a company's financial condition, particularly liquidity, can influence debt policy as examined in this study.

2.3 Debt Policy

Debt policy is a company's decision in determining the use of funding sources originating from debt to finance its operational and investment activities [\(Yanti et al., 2025\)](#). This policy relates to management decisions regarding the composition of a company's capital structure in order to maintain financial stability and increase company value. Appropriate use of debt can help a company obtain additional funds for business development, but excessive use of debt can increase the company's financial risk [\(Praptama et al., 2022\)](#).

Debt policy is viewed as a control mechanism for managers to be more disciplined in using company resources, consistent with agency theory. The use of debt creates the obligation to pay interest and principal periodically, thereby encouraging management to operate more efficiently and generate stable cash flow [\(Wahyuni et al., 2022\)](#). Pecking order theory explains that companies tend to prefer internal funding sources over external funding, and if internal funds are insufficient, companies will use debt before issuing new shares. This theory suggests that a company's decision to use debt is influenced by the availability of internal funds and its overall financial condition [\(Sofiatin et al., 2025\)](#). Debt policy measurement in accounting and financial research is generally proxied using leverage ratios, one of which is the Debt to Equity Ratio, abbreviated DER. This ratio indicates the ability of equity capital to cover a company's total debt, and the higher the DER, the more a company uses debt financing compared to equity. DER is often used to describe a company's policy in determining its funding mix [\(Erliza & Terzaghi, 2024\)](#).

2.4 Executive Compensation

Executive compensation is a form of reward given by a company to top management or executives for the responsibilities and performance they have carried out in managing the company [\(Wardoyo et al., 2022\)](#). Compensation can take the form of salary, bonuses, incentives, allowances, or stock based compensation, and it aims to increase motivation and encourage management to optimally achieve company goals [\(Taryono et al., 2024\)](#).

From an agency theory perspective, executive compensation can be explained as a mechanism to align the interests of management and shareholders. Providing appropriate compensation is expected to reduce agency conflicts, since management will be encouraged to improve company performance and make decisions that benefit the company, particularly in determining funding policies and debt use. The greater the executive's responsibility, the greater the compensation the company is expected to provide. Executive compensation in accounting and finance research is generally measured using the total compensation received by a company's directors or management during a period, typically the amount of remuneration for directors and commissioners disclosed in the company's annual report ([Jensen & Meckling, 1976](#); [Maulidia & Aprilia, 2023](#)).

2.5 Liquidity

Liquidity is a company's ability to meet its short term obligations using its current assets ([Aprilia et al., 2025](#)). A high level of liquidity indicates that a company has a good financial condition because it is able to meet its current obligations on time ([Safitri & Hasanudin, 2024](#)), and liquidity is an important factor in company financial decisions, especially in determining the funding sources a company will use ([Sari & Lestari, 2022](#)).

From the pecking order theory perspective, companies with high liquidity tend to prefer using internal funds over debt as a funding source. This occurs because companies with sufficient liquid assets and cash can more easily finance operational and investment activities without needing external funding, while companies with low liquidity tend to rely more on debt to meet their funding needs ([Myers & Majluf, 1984](#); [Wulandari & Damayanti, 2022](#)).

Liquidity also relates to a company's ability to maintain cash flow stability and reduce the risk of default on short term obligations ([Rizanti et al., 2024](#)). Companies with high liquidity are generally considered to have lower financial risk, which can influence management decisions regarding the company's debt policy ([Cholifah & Tumirin, 2024](#)). The level of liquidity can be an important consideration for companies in determining the proportion of debt used in their capital structure ([Fitriyani & Anik, 2025](#)). Liquidity is generally proxied using the Current Ratio, which compares a company's current assets to its current liabilities and is used to measure a company's ability to meet short term obligations using its current assets, with a higher Current Ratio indicating a better ability to meet short term obligations ([Kaaba et al., 2022](#)).

2.6 Conceptual Framework

The conceptual framework developed for this study links two independent variables, executive compensation and liquidity, to a single dependent variable, debt policy, proxied by the Debt to Equity Ratio. Executive compensation is positioned as a governance oriented mechanism grounded in agency theory, through which management's risk appetite in financing decisions is shaped by the incentive structure it faces. Liquidity is positioned as a financial condition oriented mechanism grounded in pecking order theory, through which the availability of internal funds shapes the extent to which a company needs to rely on external debt. Both relationships are hypothesized to be negative, and together they are expected to explain a substantial share of the variation in debt policy observed among consumer cyclical companies listed on the Indonesia Stock Exchange ([Artini, Gama, & Astiti, 2025](#)).

2.7 Hypotheses Development

The influence of executive compensation on debt policy can be explained using agency theory, which describes conflicting interests between management and shareholders in corporate decision making. Companies provide compensation to executives as an incentive for management to act in accordance with corporate goals and shareholder interests, and high compensation is expected to encourage management to improve company performance and make more optimal financial decisions ([Nurjanah et al., 2025](#)).

Compensating executives can mitigate agency conflicts because management will be more motivated to increase company value and maintain financial stability. Highly compensated management tends to be more cautious in making financing decisions, since excessive debt use can increase a company's financial risk, and optimal debt use can help companies obtain additional funding sources to support operational and investment activities without exposing themselves to unnecessary risk. Management that receives high compensation will also strive to maintain the company's reputation and performance in order to maintain shareholder trust, and this situation encourages management to determine a more effective capital structure that takes into account the company's ability to meet its debt obligations.

Research conducted by [Liu et al. \(2020\)](#) shows that the proportion of compensation given to executives influences debt use decisions, with high debt levels reducing the amount of compensation given. This is in line with research by [Fu et al. \(2022\)](#), which states that the duration of executive compensation affects corporate financing decisions, since firms with longer executive compensation durations tend to hold shorter term debt in order to reduce information asymmetry and default risk. However, this contradicts research by [Erlikawati et al. \(2025\)](#), which states that there is no influence of compensation given to executives on a company's capital structure. Based on this explanation, the first alternative hypothesis can be formulated as follows.

H₁: Executive compensation has a significant effect on debt policy

Liquidity is a company's ability to meet its short term obligations using its current assets [\(Aprilia et al., 2025\)](#). A high level of liquidity indicates that a company has sufficient internal funds to finance its operations without relying on external debt financing, and this situation tends to reduce the use of debt because funding needs can be met from available current assets [\(Nuraini et al., 2024\)](#). Pecking order theory explains that companies will prefer internal funding sources over external ones. Companies with high liquidity tend to have adequate cash and current assets, resulting in lower debt usage, while companies with low liquidity tend to use debt to meet their funding needs [\(Myers & Majluf, 1984; Boseke & Evinita, 2022\)](#).

Previous research also supports the relationship between liquidity and debt policy. Research conducted by [Artini et al. \(2025\)](#) found that liquidity had a significant negative effect on debt policy in manufacturing companies listed on the Indonesia Stock Exchange for the 2021 to 2023 period. Research by [Wisnugroho et al. \(2023\)](#) also shows that liquidity influences the debt policy of food and beverage companies on the Indonesia Stock Exchange, and research by [Musa et al. \(2025\)](#) proves that liquidity partially influences debt policy in consumer goods companies. Based on this explanation, the second alternative hypothesis can be formulated as follows.

H₂: Liquidity has a significant effect on debt policy

3. Research Methodology

3.1 Population and Sample

The subjects of this study were consumer cyclical companies listed on the Indonesia Stock Exchange between 2021 and 2024, and the study population comprised 163 companies. These companies were selected because their characteristics are heavily influenced by economic conditions and changes in consumer purchasing power, meaning that their operational activities depend closely on their liquidity.

The sample in this study was selected using purposive sampling, a method that aligns the research subjects with the criteria required by the researchers, ensuring that the results are more relevant to companies in this sector.

Table 1. Sample selection criteria

No	Sample Criteria	Amount of Data	Accumulation
1	Consumer cyclical companies listed on the Indonesia Stock Exchange during the observation period	163	163

No	Sample Criteria	Amount of Data	Accumulation
2	Consumer cyclical companies not delisted during the study period	163	163
3	Published financial reports for the 2021-2024 period	(37)	126
4	Not experiencing capital deficiency	(16)	110
5	Revealing the data that researchers need	(28)	82
Number of Samples	-	-	82
Observation range	-	-	4 years
Number of Observations	-	-	328

Table 1 presents the sequential screening criteria applied through purposive sampling to select the final research sample from the population of consumer cyclical companies listed on the Indonesia Stock Exchange. Starting from a population of 163 companies, the sample was narrowed successively by excluding companies delisted during the study period, companies that did not publish complete financial reports for the entire 2021 to 2024 period, companies experiencing capital deficiency, and companies that did not disclose the data required for this study. Applying these criteria in sequence yields a final sample of 82 companies observed over four years, producing 328 firm year observations that form the panel data set analyzed in this study as can be seen in Table 1.

Table 2. Research sample

No	Company Code	Company Name
1	FILM	PT Md Entertainment Tbk
2	MAPI	PT Mitra Adiperkasa Tbk
3	SCMA	PT Surya Citra Media Tbk
4	MAPA	PT Map Aktif Adiperkasa Tbk
5	INDS	PT Indospring Tbk
6	AUTO	PT Astra Otoparts Tbk
7	HRTA	PT Hartadinata Abadi Tbk
8	SMSM	PT Selamat Sempurna Tbk
9	MGLV	PT Panca Anugrah Wisesa Tbk
10	ERAA	PT Erajaya Swasembada Tbk
11	ACES	PT Aspirasi Hidup Indonesia Tbk
12	DRMA	PT Dharma Polimetal Tbk
13	MPMX	PT Mitra Pinasthika Mustika Tbk
14	LPPF	PT Matahari Department Store Tbk
15	TFCO	PT Tifico Fiber Indonesia Tbk
16	RALS	PT Ramayana Lestari Sentosa Tbk
17	WOOD	PT Integra Indocabinet Tbk
18	BRAM	PT Indo Kordsa Tbk
19	CSAP	PT Catur Sentosa Adiprana Tbk
20	BELL	PT Trisula Textile Industries Tbk
21	DEPO	PT Caturkarda Depo Bangunan Tbk
22	PMJS	PT Putra Mandiri Jembar Tbk
23	KDTN	PT Puri Sentul Permai Tbk
24	LFLO	PT Imago Mulia Persada Tbk
25	TRIS	PT Trisula International Tbk

No	Company Code	Company Name
26	BIKE	PT Sepeda Bersama Indonesia Tbk
27	UFOE	PT Damai Sejahtera Abadi Tbk
28	ESTI	PT Evershine Textile Tbk
29	BAYU	PT Bayu Buana Tbk
30	ZONE	PT Mega Perintis Tbk
31	EAST	PT Eastparc Hotel Tbk
32	ERTX	PT Eratex Djaja Tbk
33	MICE	PT Multi Indocitra Tbk
34	ECII	PT Electronic City Indonesia Tbk
35	SLIS	PT Gaya Abadi Sempurna Tbk
36	LPIN	PT Multi Prima Sejahtera Tbk
37	ECHO	PT Gema Grahasarana Tbk
38	IDEA	PT Idea Indonesia Academy Tbk
39	SBAT	PT Bersama Zatta Jaya Tbk
40	GOOD	PT Apollo Global Interactive Tbk
41	GJTL	PT Gajah Tunggal Tbk
42	IMAS	PT Indomobil Sukses Internasional Tbk
43	MDIA	PT Intermedia Capital Tbk
44	MAPB	PT Map Boga Adiperkasa Tbk
45	JPST	PT Jakarta Setiabudi International Tbk
46	MINA	PT Sanurhasta Mitra Tbk
47	BLTZ	PT Graha Layar Prima Tbk
48	PSKT	PT Red Planet Tbk
49	BOLT	PT Garuda Metalindo Tbk
50	JGLE	PT Graha Andrasentra Propertindo Tbk
51	LUCY	PT Lima Dua Lima Tiga Tbk
52	INDR	PT Indo-Rama Synthetics Tbk
53	CARS	PT Bintraco Dharma Tbk
54	ARTA	PT Artavest Tbk
55	JIHD	PT Jakarta International Hotels and Development Tbk
56	SHID	PT Hotel Sahid Jaya Tbk
57	SOTS	PT Satria Mega Kencana Tbk
58	PJAA	PT Pembangunan Jaya Ancol Tbk
59	PANR	PT Panin Securities Tbk
60	SOFA	PT Boston Furniture Industries Tbk
61	FORU	PT Fortune Indonesia Tbk
62	SSTM	PT Sunson Textile Manufacturer Tbk
63	NICE	PT Champ Resto Indonesia Tbk
64	MSKY	PT MNC Sky Vision Tbk
65	PZZA	PT Sarimelati Kencana Tbk
66	FITT	PT Hotel Fitra International Tbk
67	ESTA	PT Esta Multi Usaha Tbk
68	GDYR	PT Goodyear Indonesia Tbk
69	PNSE	PT Pudjiaji and Sons Tbk
70	SCNP	PT Selaras Citra Nusantara Perkasa Tbk

No	Company Code	Company Name
71	PTSP	PT Pioneerindo Gourmet International Tbk
72	LOVE	PT Chitose International Tbk
73	LMPI	PT Langgeng Makmur Industri Tbk
74	MASB	PT Mitra Angkasa Sejahtera Tbk
75	TMPO	PT Tempo Inti Media Tbk
76	SNLK	PT Sunter Lakeside Hotel Tbk
77	OLIV	PT Oscar Mitra Sukses Sejahtera Tbk
78	CSMI	PT Cipta Selera Murni Tbk
79	KICI	PT Kedaung Indah Can Tbk
80	PLAN	PT Planet Properindo Jaya Tbk
81	BMBL	PT Lavender Bina Cendikia Tbk
82	RAFI	PT Sari Kreasi Boga Tbk

Table 2 lists the 82 consumer cyclical companies listed on the IDX that constitute the final research sample, identified by their stock exchange ticker code and full company name. This sample spans a broad range of sub-sectors within the consumer cyclical category, including retail, automotive components, textiles, media and entertainment, hospitality, and household goods, reflecting the internal diversity of the sector while sharing the common characteristic of sensitivity to fluctuations in consumer purchasing power described in the introduction.

3.2 Operational Definition and Measurement of Variables

The dependent variable in this study is debt policy, proxied by the Debt to Equity Ratio (DER), calculated as total liabilities divided by total equity (Yanti et al., 2025).

$$DER : \frac{\text{Total Liabilities}}{\text{Total Equity}} \quad (1)$$

Formula 1 defines the DER, the dependent variable used to measure debt policy throughout this study. The ratio is obtained by dividing a company's total liabilities by its total equity for a given firm year, producing a figure that indicates how many times a company's debt exceeds the funds provided by its shareholders. A higher DER indicates a greater reliance on debt financing relative to equity financing, and the ratio is computed separately for each of the 328 firm year observations in the panel data set described in section 3.1.

There are two independent variables in this study, executive compensation and liquidity. Executive compensation is a form of reward given by the company to directors and top management for their responsibility and performance in managing the company (Wardoyo et al., 2022), and it is measured using the natural logarithm of total executive compensation, following the formula below.

This formula defines the measurement of the executive compensation variable used in this study. Total executive compensation, drawn from the remuneration figures for directors and commissioners disclosed in each company's annual report, is transformed using the natural logarithm in order to reduce the influence of scale differences across firms of varying size and to produce a variable more suitable for linear regression analysis.

Liquidity is a company's ability to meet its short term obligations using its current assets (Aprilia et al., 2025), and it is measured using the Current Ratio, following the formula below.

$$CR : \frac{\text{Current Assets}}{\text{Current Liabilities}} \quad (2)$$

Formula 2 defines the Current Ratio (CR), the measure of liquidity used as the second independent variable in this study. The ratio is obtained by dividing a company's current assets by its current liabilities for a given firm year, producing a figure that indicates a company's capacity to meet its short term obligations using assets that can readily be converted into cash. A higher CR indicates a stronger short term liquidity position.

3.3 Data Analysis Techniques

Panel data regression models generally follow three main approaches, the Common Effect Model, the Fixed Effect Model, and the Random Effect Model (Anwar & Nursan, 2025), each described below together with its corresponding equation. The Common Effect Model is the simplest approach in panel data analysis because this method only combines time series and cross section data without accounting for differences in individual characteristics or changes over time.

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_j X_{jit} + \varepsilon_{it} \quad (3)$$

Formula 3 represents the Common Effect Model, the first of three panel data regression approaches considered in this study. In this notation, Y_{it} denotes the dependent variable for cross sectional unit i in period t , i denotes the number of cross sectional units, t denotes the observation period, X_{jit} denotes the j -th independent variable for unit i in period t , β_j denotes the regression slope for the j -th variable, β_0 denotes the constant intercept, and ε_{it} denotes the error term for unit i in period t . Because the Common Effect Model applies a single, pooled intercept across all firms and years, it does not allow for any firm specific or time specific heterogeneity in the data.

The Fixed Effect Model is an approach that assumes the slope coefficient value is fixed or constant in each cross sectional unit, while the intercept value can vary across units. The estimation method used in this model is the Least Square Dummy Variable approach, which adds a dummy variable to differentiate the intercept value for each unit in the study (Anwar & Nursan, 2025).

$$Y_{it} = \beta_{0i} + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_j X_{jit} + \varepsilon_{it} \quad (4)$$

Formula 4 represents the Fixed Effect Model. The notation follows the same convention as the Common Effect Model, with the addition of β_{0i} , denoting the intercept specific to unit i , and β_{0it} , denoting the intercept specific to unit i in period t . By allowing the intercept to vary across cross sectional units while holding the slope coefficients constant, the Fixed Effect Model accounts for unobserved, time invariant heterogeneity across firms, such as differences in management quality or industry sub-segment, that could otherwise bias the estimated relationship between the independent and dependent variables.

The Random Effect Model, also known as the Error Component Model, is an approach that assumes each unit and time period can contribute to, and is related to, the formation of the error variable (Anwar & Nursan, 2025).

$$Y_{it} = (\beta_{0it} + \beta_{0i}) + \beta_1 X_{1it} + \beta_2 X_{2it} + \dots + \beta_j X_{jit} + (\mu_i + \varepsilon_{it}) \quad (5)$$

Formula 5 represents the Random Effect Model. The notation follows the same convention as the previous two models, with the addition of μ_i , denoting the error term that captures the difference between the slope and intercept values attributable to unit i , and ε_{it} , denoting the idiosyncratic error term for unit i in period t . Unlike the Fixed Effect Model, the Random Effect Model treats firm specific heterogeneity as a random variable drawn from a wider population rather than as a fixed, estimable parameter, which affects the efficiency and consistency properties of the resulting estimator depending on whether this random effect is correlated with the included regressors.

3.4 Panel Data Regression Model Selection

Determining the appropriate panel data regression estimation model can be done through three tests, the Chow test, the Hausman test, and the Lagrange Multiplier test. The Chow test is performed to determine the most appropriate estimation model between the Common Effect Model and the Fixed Effect Model. The basis for the Chow test is that if the cross section Chi-square probability value exceeds 0.05, the selected model is the Common Effect Model, whereas if the probability value is below 0.05, the selected model is the Fixed Effect Model.

The Hausman test aims to determine the suitability of the estimation model between the Random Effect Model and the Fixed Effect Model. The basis for the Hausman test is that if the random cross section probability value exceeds 0.05, the selected model is the Random Effect Model, whereas if the probability value is below 0.05, the selected model is the Fixed Effect Model. The results of the Hausman test determine whether the Lagrange Multiplier test is necessary, and if both the Chow test and the Hausman test produce the same choice, namely the Fixed Effect Model, the Lagrange Multiplier test is no longer required.

The Lagrange Multiplier test is performed to determine the appropriate model between the Common Effect Model and the Random Effect Model, and this test is performed only when the Chow test and the Hausman test yield different model choices. The basis for this test is that if the Breusch-Pagan cross section probability value exceeds 0.05, the Common Effect Model is selected, whereas if the probability value is below 0.05, the Random Effect Model is selected.

3.5 Classical Assumption Test

Classical assumption tests are necessary to ensure the resulting model meets the Best Linear Unbiased Estimator assumptions [\(Sugiyanto et al., 2022\)](#). Commonly performed classical assumption tests include normality, multicollinearity, heteroscedasticity, and autocorrelation. The classical assumption tests performed in this study were the multicollinearity test and the heteroscedasticity test. A normality test was not performed in this study because the number of observations exceeded 100, so the data were assumed to be normally distributed following the Central Limit Theorem [\(Gujarati & Porter, 2013\)](#). An autocorrelation test was not performed because this test is generally applied to pure time series data, and this study does not require an autocorrelation test given its panel data structure [\(Basuki & Prawoto, 2019\)](#).

The multicollinearity test aims to determine whether a strong relationship exists between independent variables in a regression model, since multicollinearity occurs when independent variables are highly correlated in a manner that can influence the results of the regression analysis. Decision making for this test is based on the Variance Inflation Factor (VIF) value, where a centered VIF below 10 indicates no sign of multicollinearity, while a centered VIF above 10 indicates the presence of multicollinearity in the regression model. The heteroscedasticity test is used to determine whether inequality of residual variance exists in a regression model. This study uses the Breusch-Pagan Godfrey test to detect symptoms of heteroscedasticity, with the decision rule being that if the Obs times *R*-squared probability value exceeds 0.05, there is no symptom of heteroscedasticity, whereas if the probability value is below 0.05, there is a symptom of heteroscedasticity.

3.6 Hypothesis Testing

$$DER_{it} = \alpha + \beta_1 EXC_{it} + \beta_2 CRR_{it} + e_{it} \quad (6)$$

Formula 6 represents the empirical panel data regression model estimated in this study. In this notation, DER denotes the dependent variable, debt policy, EXC denotes the first independent variable, executive compensation, CRR denotes the second independent variable, liquidity, α denotes the constant term, β denotes the regression coefficient associated with each independent variable, i denotes the cross sectional dimension of the panel, t denotes the time series dimension of the panel, and e denotes the error term. This specification allows both hypothesized relationships, the effect of executive compensation on debt policy and the effect of liquidity on debt policy, to be tested jointly within a single panel data framework.

The individual parameter test, or t -test, is used to determine the partial effect of each independent variable on the dependent variable, conducted at a 95% confidence level, or a significance level of 0.05. If the probability value is below 0.05, the independent variable has a partial effect on the dependent variable, whereas if the probability value exceeds 0.05, the independent variable has no partial effect on the dependent variable.

The simultaneous significance test, or F -test, is used to determine the effect of the independent variables on the dependent variable simultaneously and to test the feasibility of the regression model, conducted at a significance level of 0.05. If the F -statistic probability value is below 0.05, the independent variables have a simultaneous effect on the dependent variable, whereas if the probability value exceeds 0.05, the independent variables do not have a simultaneous effect on the dependent variable. The coefficient of determination, denoted R-squared, is used to measure the ability of a regression model to explain the dependent variable, with values ranging from 0 to 1. A small R-squared value indicates that the independent variables' ability to explain the dependent variable is limited, whereas an R-squared value close to 1 indicates that the independent variables are able to explain most of the variation in the dependent variable.

4. Results and Discussions

4.1 Panel Data Regression Estimation Model Selection

Table 3. Chow test

Effects Test	Statistic	df	Prob.
Cross-section F	23.600922	(81,244)	0.0000
Cross-section Chi-square	714.610585	81	0.0000

Table 3 reports the results of the Chow test, which compares the Common Effect Model against the Fixed Effect Model using both an F -statistic and a Chi-square statistic computed across the 81 degrees of freedom associated with the cross sectional dimension of the panel. Both statistics produce a probability value of 0.0000, which is well below the 0.05 significance threshold, indicating that the Fixed Effect Model is the preferred estimator over the Common Effect Model for this data set. The probability value of the cross section Chi-square is 0.0000, below 0.05, so the best estimation model for this study is the Fixed Effect Model.

Table 4. Hausman test

Test Summary	Chi-Sq. Statistic	Chi-Sq. df	Prob.
Random cross-section	32.270312	2	0.0000

Table 4 reports the results of the Hausman test, comparing the Random Effect Model against the Fixed Effect Model using a Chi-square statistic with 2 degrees of freedom, corresponding to the two independent variables included in the model. The resulting probability value of 0.0000 is below the

0.05 significance threshold, indicating that the Fixed Effect Model is the preferred estimator over the Random Effect Model. The probability value of the random cross section is 0.0000, below 0.05, so the selected estimation model for this study is the Fixed Effect Model. Because both the Chow test and the Hausman test produce the same result, namely the Fixed Effect Model, the Lagrange Multiplier test is no longer necessary.

4.2 Classical Assumption Test

Table 5. Multicollinearity test

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.472513	207.9947	NA
EXC	0.000895	202.8753	1.017823
CRR	0.000442	2.151496	1.017823

Table 5 reports the coefficient variance, uncentered VIF, and centered VIF for the constant term and each of the two independent variables. The centered VIF values for both executive compensation and liquidity are 1.017823, well below the commonly applied threshold of 10, indicating that no problematic linear relationship exists between the two independent variables that would distort the estimated regression coefficients. Based on Table 5, it can be seen that each independent variable does not show a strong relationship with the other, as evidenced by a centered VIF value below 10, so the data can be concluded to be free from symptoms of multicollinearity.

Table 6. Heteroscedasticity test

Statistic	Value	Test	Probability
F-statistic	0.444960	Prob. F(2,325)	0.6412
Obs*R-squared	0.895681	Chi-Square Prob.(2)	0.6390
Scaled explained SS	2.580064	Chi-Square Prob.(2)	0.2753

Table 6 reports the F-statistic, the Obs times R-squared statistic, and the scaled explained sum of squares statistic used to test for heteroscedasticity in the regression residuals, together with their associated probability values. The Obs times R-squared probability value of 0.6390 exceeds the 0.05 significance threshold, indicating that the null hypothesis of homoscedasticity cannot be rejected. Based on Table 6, the probability value of Obs times R-squared is 0.6390, above 0.05, so it can be concluded that the data do not indicate symptoms of heteroscedasticity.

4.3 Hypothesis Testing

Table 7. Panel data regression

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.640054	1.381037	4.083927	0.0001
EXC	-0.251420	0.061136	-4.112445	0.0001
CRR	-0.158394	0.014841	-10.67262	0.0000
Adjusted R-squared	0.907396	-	-	-
F-statistic	39.60460	-	-	-
Prob(F-statistic)	0.000000	-	-	-

Table 7 reports the coefficient, standard error, t-statistic, and probability value for the constant term and for each of the two independent variables estimated under the Fixed Effect Model, together with the adjusted R-squared and the F-statistic for the overall model. The model further reports a Root MSE of 0.289085, a mean dependent variable of negative 0.434847, a standard deviation of the dependent variable of 1.101422, an Akaike information criterion of 0.868004, a Schwarz criterion of 1.839385, a Hannan-Quinn criterion of 1.255558, and a Durbin-Watson statistic of 2.028816. Both

independent variables display a negative coefficient that is statistically significant at the five percent level, and the model as a whole is statistically significant, with the two explanatory variables jointly explaining approximately ninety one percent of the variation in the DER observed across the sample. Table 7 shows that the probability value of the executive compensation variable is 0.0001, below the 0.05 significance threshold, so H_1 is accepted and the null hypothesis is rejected. It can therefore be concluded that executive compensation has a significant effect on debt policy. The probability value of the liquidity variable is 0.0000, below the 0.05 significance threshold, so H_2 is accepted and the null hypothesis is rejected. It can therefore be concluded that liquidity has a significant effect on debt policy.

A probability value for the F -statistic of 0.000000, below 0.05, so it can be concluded that executive compensation and liquidity together have a significant simultaneous effect on debt policy, and the regression model can be considered feasible. The adjusted R -squared value of 0.907396 is obtained for the relationship between executive compensation and liquidity on the one hand and debt policy on the other. It can be concluded that 90.74% of the variation in the debt policy variable can be explained by executive compensation and liquidity, while the remaining 9.26% is explained by other variables outside this research model.

$$DER = 5.640054 - 0.251420 \times EXC - 0.158394 \times CRR \quad (7)$$

Formula 7 presents the estimated Fixed Effect regression model obtained from Table 7. The constant term of 5.640054 represents the predicted DER when both executive compensation and liquidity are held at zero, a reference point without direct economic interpretation given the transformed scale of the executive compensation variable. The coefficient of negative 0.251420 on executive compensation indicates that, holding liquidity constant, a one unit increase in the natural logarithm of executive compensation is associated with a 0.251420 unit decrease in the DER. The coefficient of negative 0.158394 on liquidity indicates that, holding executive compensation constant, a one unit increase in the Current Ratio is associated with a 0.158394 unit decrease in the DER.

4.4 Discussion

4.4.1 The Effect of Executive Compensation on Debt Policy

Based on agency theory, executive compensation is provided as an incentive for management to act in the best interests of shareholders and to make optimal financial decisions. Highly compensated executives tend to be more cautious in selecting funding sources, since excessive use of debt can increase financial risk and threaten company performance, which ultimately affects the benefits executives themselves receive.

The results of this study indicate that executive compensation has a negative and significant effect on debt policy, as shown by a regression coefficient of negative 0.251420 with a significance value of 0.0001, below 0.05. This means that the higher the compensation received by executives, the lower the company's debt usage level. This finding indicates that highly compensated executives tend to choose more conservative financing policies in order to maintain the company's financial stability and minimize the risk of default. This finding aligns with research by [Liu et al. \(2020\)](#), which shows that executive compensation influences a company's debt use decisions, and it also supports research by [Fu et al. \(2022\)](#), which found that executive compensation characteristics influence company financing policies through the channel of debt maturity structure. Thus, H_{a1} is accepted, and it is concluded that executive compensation has a significant negative effect on company debt policy.

4.4.2 The Effect of Liquidity on Debt Policy

Based on pecking order theory, companies will prioritize internal funding sources over external ones. Companies with high liquidity have sufficient cash and current assets to meet operational and

investment needs, thereby reducing the need for debt, while companies with low liquidity tend to use debt as a source of funding to meet their funding needs.

The results of this study indicate that liquidity has a negative and significant effect on debt policy, as shown by a regression coefficient of negative 0.158394 with a significance value of 0.0000, below 0.05. This means that the higher a company's liquidity level, the lower its debt usage level. This finding indicates that companies with sufficient current assets and internal funds tend to reduce their dependence on external funding in the form of debt, because funding needs can be met from available internal funding sources. This finding is in line with research by [Artini et al. \(2025\)](#), which found that liquidity has a significant negative effect on debt policy, and it also supports research by [Wisnugroho et al. \(2023\)](#) and [Musa et al. \(2025\)](#), both of which show that liquidity influences a company's debt policy. Therefore, H_2 is accepted, and it is concluded that liquidity has a significant effect on a company's debt policy, with a negative relationship.

4.4.3 Integrated Discussion

Taken together, the results indicate that both governance oriented mechanisms, represented by executive compensation, and financial condition oriented mechanisms, represented by liquidity, play a meaningful role in shaping debt policy among consumer cyclical companies listed on the Indonesia Stock Exchange. The very high adjusted R-squared value obtained in this study, at 0.907396, suggests that within this specific sector and observation window, these two variables capture the overwhelming majority of systematic variation in financing behavior, leaving comparatively little room for other determinants such as profitability, asset structure, or firm size to add further explanatory power. This result reinforces the complementary explanatory power of agency theory and pecking order theory when applied jointly to a single capital structure model, and it suggests that boards and financial managers within this sector should consider both compensation design and liquidity management as levers through which prudent debt utilization can be encouraged, particularly in light of the financial distress experienced by highly leveraged firms such as PT Sri Rejeki Isman Tbk described in the introduction ([Rumbo, 2025](#)).

5. Conclusions

5.1 Conclusion

The results of this study indicate that executive compensation and liquidity have a negative and significant effect on debt policy in consumer cyclical sector companies listed on the Indonesia Stock Exchange for the 2021 to 2024 period. Higher executive compensation encourages management to be more cautious in making financing decisions, thereby optimally controlling debt use. High liquidity indicates adequate internal funding availability, leading companies to reduce their reliance on external debt financing. These findings support agency theory, which explains that compensation can align the interests of management and shareholders, and pecking order theory, which states that companies prioritize internal funding sources over external funding sources. Both hypotheses proposed in this study, H_{a1} and H_{a2} , are supported by the empirical evidence, and the two variables jointly explain a very substantial share of the variation in debt policy observed within the sample.

5.2 Research Limitations

This study still has several limitations. The scope of the study covers only companies in the consumer cyclical sector, so the results cannot be generalized to all industrial sectors listed on the Indonesia Stock Exchange. The independent variables used are also limited to executive compensation and liquidity, while debt policy can be influenced by other factors such as profitability, company size, asset structure, company growth, and corporate governance. The observation period used is relatively short, at four years, so it does not fully reflect changes in debt policy over the long term.

5.3 Directions and Future Study

Future research is recommended to expand the sample size by including other industrial sectors and extending the observation period in order to achieve more comprehensive results. The addition of other variables that potentially influence debt policy is also needed to improve the model's ability to explain variation in corporate debt policy. For company management, the results of this study can be used as a consideration in designing compensation policies and optimally managing liquidity to support more effective and sustainable financing decisions.

Acknowledgement

The authors would like to thank the Indonesia Stock Exchange for making the financial statements and annual reports of the sampled companies publicly available, and colleagues in the accounting and finance department for their comments on an earlier version of this manuscript. The authors declare that this research received no specific grant from any funding agency in the public, commercial, or not for profit sectors.

Author Contributions

KS conceived the research design, collected and processed the panel data, performed the panel data regression analysis, and drafted the manuscript. HVP supervised the study, contributed to the theoretical framework and hypothesis development, and critically revised the manuscript for important intellectual content. RSW contributed to the methodology, validated the statistical analysis, and reviewed and edited the final manuscript. All authors read and approved the final manuscript.

Conflict of Interest

The authors declare that there is no conflict of interest regarding the publication of this study. This research was conducted independently, and no financial or personal relationships influenced the results or interpretation of the findings.

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