

The Effect of Managerial Overconfidence and Government Ownership to Financing Decision of State Owned Enterprises in Indonesia

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The Effect of Managerial Overconfidence and Government Ownership to Financing Decision of State-Owned Enterprises in Indonesia

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ABSTRACT

Company funding has an important role in the company because, with the optimal capital structure, the company can fund operational activities effectively. An optimal capital structure decision requires a competent managerial role to analyze funding needs. The manager's overconfidence has an effect on the company's capital structure. Besides this, the government's ownership is also a factor affecting the capital structure. This study aims to examine the effect of Managerial Overconfidence and Government Ownership on financing decisions of State-Owned Enterprises listed on the Indonesia Stock Exchange period year 2012 to 2016. The variables used in this study include Managerial Overconfidence which measured by indicators: Profile Photo, Educational Level, Work Experience, Gender, Networks, and Performance of the CEO; variable Government Ownership, and the control variable consisting: Profitability, Firm Size, Tangibility, Growth, and Research & Development. The method used is multiple linear regression. The type of data is the panel data. The samples are twenty-one State Owned Enterprises Going Public that has annual financial reports during the year 2012 to 2016. The research results showed the Managerial Overconfidence (CEO Network and CEO Performance), Government Ownership, and control variables consist Profitability, Growth, and Research & Development have a significant influence on the capital structure of Stated Owned Enterprise Going Public.

Keywords: **Financing Decision, Government Ownership, Managerial Overconfidence, State-Owned Enterprises**

JEL Classifications: G32, G41

1. Introduction

Company financing is one of the important elements in managing a company. The company's financing decision is a decision related to choosing the most profitable alternative in the company's financing needs. Company financing refers to where the source of funds is obtained and how the best financing composition so that it can form an optimal capital structure, with the consideration of the minimum cost of capital.

A company needs a managerial role in running its business activities. The managerial main role for the company is to estimate what might happen in the future and use these estimates as a benchmark or reference for making corporate policies (Ben-David, Graham, & Harvey, 2007). Company policy making requires good analytical skills from managers. It can not be denied, in addition to good analytical technique factors, psychological factors from within the manager also play an important role in determining the right company policy (Barros & Silveira, 2009).

The manager of the company must have confidence in making and deciding company policies. The manager's confidence also influences the company's behavior in determining its financing source. Financing decision making and determination of corporate optimal capital structure requires managerial that have confidence in proper proportions. But sometimes, confident managers do not make rational decisions or policies because of overestimating their capabilities and underestimate unanticipated risks (Ting, Lean, Kweh, & Azizan, 2016). Overestimate reflects the personal behavior of managers, which is closely related to overconfidence (Wei, Min, & Jiaying, 2011).

In addition to psychological factors, the ownership structure of the company is also one of the factors that can determine company policy. There are several types of ownership structures that exist in the company, and each type of ownership has different purposes and interests. One type of the company's ownership is government ownership. Government ownership is expressed through the number or percentage of shares owned by the government. In Indonesia, companies whose shares are owned by the government are commonly called State-Owned Enterprises (SOEs). The presence of government in the ownership structure of SOE companies gives the government a strong authority to regulate the policies within the company since the government is the one who makes regulations for all companies in Indonesia.

Government ownership in a State-Owned Enterprise can bring benefits to the company. Government ownership can help State-Owned Enterprises to overcome the external uncertainties that come from the government policies and also can facilitate access to

financial resources such as bank loans (Beuselinck, Cao, Deloof, & Xia, 2015). The creditor will not hesitate to provide debt to State-Owned Enterprises because the debt is guaranteed by the government. Thus, State-Owned Enterprises tend to use debt derived from state-owned banks. Therefore, the government ownership in the company may affect the consideration of the company's financing decision.

In Indonesia, State-Owned Enterprises listed on the Indonesia Stock Exchange (IDX) has more tendency to use debt as a source of financing. This can be seen from the average debt ratio value owned by each SOE listed on the Indonesia Stock Exchange. Fourteen of the twenty-one State-Owned Enterprises listed on the Indonesia Stock Exchange have average debt ratios worth more than 0.50 from 2012 to 2016. This shows that most of SOEs listed on the Indonesia Stock Exchange prefer to use more debt than equity.

The purpose of this research is to know the effect of managerial overconfidence and government ownership to financing decision of SOEs listed on the Indonesia Stock Exchange during the year 2012 to 2016.

2. Theories and Hypotheses

2.1 Theories

UU RI no. 19 Tahun 2003, State-Owned Enterprise (SOE) is defined as a business entity whose capital, wholly or partially, owned by the state through direct participation derived from separated state assets. SOEs are the dominant business actors in developing countries, including Indonesia (Pranoto, 2017). According to Savas (1987), the weakness of SOEs in developing countries, among others, continuing losses and rising debt; and lack of managerial skill or sufficient managerial authority. These two factors are studied further in this research.

SOEs in running their routine business operations require financing decisions. Financing decisions are usually closely related to the capital structure of the firm. Capital Structure is defined as the composition of the company's capital consisting of debt (creditor) and capital derived from the owners' equity. According to Mahendra (2011), the capital structure is a permanent financing consisting of long-term debt, preferred stock, and shareholder capital. The company's capital structure generally consists of :

1. Long-term debt, is debt that matures over 10 years of repayment. This component consists of mortgage and bond.
2. Share capital, consisting of preferred stock and common stock.

The sustainability of SOEs requires the role of the CEO to ensure that the institution is in line with the objectives of the company. The role of CEO is usually related to the financial behavior of the CEO. Financial Behavior is an integration between financial management theory and psychology especially related to decision making (Fuller, 2000). Shefrin (2000) defines behavior finance as a study of psychological phenomena that affect a person's financial behavior. One form of financial behavior discussed in this study is overconfidence. Overconfidence is a tendency to be overconfident of the ability and prediction to succeed. According to Adel and Mariem (2013), overconfidence is a person's attitude that tends to overestimate personal ability. In the psychological literature, overconfidence can be interpreted as a prediction of one's beliefs about a higher probability distribution than it really is. Whereas in various financial literature, overconfidence is defined as overestimating in judging something (Gervais & Odean, 2001). Overconfidence can be measured by several indicators, such as profile photo, education level, work experience, gender, work connections, and performance of someone.

SOEs is a company whose shares are owned by the government. Government ownership is the number of shares owned by the government. Huang and Xiao (2012) argue that the proportion of high government ownership in the company can provide "helping hand" because the company can obtain more capital subsidies from the government. Government ownership can bring benefits for companies to overcome external uncertainty and can facilitate access to financial resources such as bank loans by providing explicit and implicit guarantees to secure the debt financing (Beuselinck, Cao, Deloof, and Xia, 2015). The government ownership will provide a commitment to save the company when an economic crisis occurs so that it will minimize the risk of the company (Borisova & Megginson, 2011).

2.2 Hypotheses

According to Gervais, Heaton, and Odean (2006), the irrational behavior of managers, such as overconfidence, has contributed to decision making, especially corporate financing decisions. Managerial overconfidence can lead managers in determining preferred financing options (pecking order) for companies (Heaton, 2002). Overconfidence can be the cause of managers using debt as a financing source because managers feel capable to pay the debt despite exceeding the capacity and ability of companies to generate profits. This will cause the lender to provide the debt with a greater amount than the actual ability of the company and will increase the company's risk of paying off the debt indirectly. Hackbarth (2008) says

⁶ that overoptimistic and overconfident managers choose to use high debt levels and more frequently issue new debt. In this study, there are 6 variables used to measure the overconfidence level of the company CEO, i.e. ⁹ CEO profile photo, CEO education level, CEO work experience, CEO gender, CEO networks, and CEO performance.

According to Chatterjee and Hambrick (2007), the profile photo of CEOs present on the company's annual report can indicate the overconfidence of the CEO itself. The larger the profile photo of the CEO on the company's annual report, the higher the level of CEO's overconfidence.

⁶ Lichtenstein and Fischhoff (1977) say that the higher education level of the CEO, the more likely it is to be overconfident in making decisions. ³ In addition, the higher level of CEO education will be positively significant with the company's financial leverage (Rakhmayil & Yuce, 2013).

⁶ According to Ting, Lean, Kweh, and Azizan (2016), when CEOs have a lot of work experience, they can get information from various aspects and more careful in making decisions, so they will become more overconfident.

³ Organizational theory indicates that males on the board are more confident than females (Ting, Lean, Kweh, & Azizan, 2016). Abor and Biekpe (2007) argue that women who lead businesses typically use less debt for several reasons, such as discrimination and avoiding substantial risks.

³ March and Shapira (1992) argue that when a company's CEO also serves on the board of directors or board members of another company, it will tend to be cautious in making decisions and more confident. The more networks a CEO has with other companies, the CEO will have a higher level of overconfidence as well.

When CEOs have a good performance, it will have a good impact on the company, then this will encourage confidence or high overconfidence. According to Balafas and Florackis (2014), to identify the performance of CEOs, it can be seen from the operating performance of the previous year.

H1. ⁹ *Managerial overconfidence* (CEO Profile Photo, CEO Education Level, ¹¹ CEO Work Experience, CEO Gender, CEO Network, and CEO Performance) has a significant effect on the financing decision of SOEs listed on Indonesia Stock Exchange during the year 2012 to 2016.

⁴ Government ownership is the number of shares owned by the government. Through this ownership, the government ² can control the policies taken by management to suit the interests or aspirations of the government, as well as the company's financing policy. Government ownership can bring benefits to the company. Government ownership can help companies to overcome external uncertainty and can facilitate access to financial resources such as bank loans by providing explicit and implicit guarantees to secure debt financing (Beuselinck, Cao, Deloof, and Xia, 2015). With the government in the ownership structure of the company, managers will be more inclined to choose debt as an alternative corporate financing because the company will get an additional fund injection from the government. This causes the creditor will not hesitate to provide debt to state-owned enterprises because the debt is guaranteed by the government.

H2. Government ownership has ¹¹ a significant effect on the financing decision of SOEs listed on the Indonesia Stock Exchange during the year 2012 to 2016.

Companies with a higher level of profitability will also have a higher net profit or net income. It will cause a higher possibility for the companies to allocate these funds into retained earnings. The higher retained earnings held by the company, then the company will tend to choose to use equity as a source of financing compared to use debt. This is in accordance with the statement of Myers and Maljuf (1984) which states that there is a negative relationship between profitability with leverage.

Large companies will tend to use larger debts to increase the financing to support the company's growth. This concept is in line with Moeljadi's (2006) statement which says a large-sized company is easier to obtain loans than a small company.

Companies that ¹⁰ have large tangible assets can be used as debt collateral to creditors so that firms tend to use relatively large numbers of debt. The greater the tangibility ratio will be easier to lend to other company so the level of leverage will be increased (Antao & Bonfim, 2012).

Companies that want to grow their business and expanding their market share will need a large of financing. If internal financing is insufficient for expansion needs, companies should seek additional funds to meet those needs. According to Fama and French (2000), companies that are concerned about the future, the growth opportunities will be higher so the companies will try to use low-risk debt to anticipate the future of investment or issuing shares.

Research and Development is one of the important aspects of companies because they have to innovate to gain competitive advantage (Barney, 1991). In general, innovation needs a large of financing to support the Research and Development activities. If internal financing, such as retained earnings, are insufficient to finance Research and Development activities, companies should seek additional financing to meet these financing.

H3. ¹ Profitability, firm size, tangibility, corporate growth, and Research & Development as control variables significantly influence the financing decisions of SOEs ¹ listed on the Indonesia Stock Exchange period year 2012 to 2016

⁸ 3. Methodology

3.1 Data and Variable Construction

This study uses the entire population of State-Owned Enterprises in Indonesia. The sampling technique in this research is purposive sampling, with criteria: (1) The Company has been listed in Indonesia Stock Exchange before the year 2012; (2) The Company publishes the financial annual report during the period of year 2012 to 2016; (3) The company has the report on the personal characteristics of the CEO to measure managerial overconfidence; and (4) The Company has information of the ownership structure. Data sourced from the financial statements and annual reports that obtained from the website idx.co.id. Variables that used in the study are divided into dependent variables, independent variables, and control variables. The dependent variable is the leverage that measured by total debt to total assets. There are two independent variables, managerial overconfidence, and government ownership. There are six indicators to measure managerial overconfidence: The CEO profile photo (PP), divide become two categorize: full page and not a full page. The education level of CEO (EDU), divide become two categorize: postgraduate degree (master or doctorate or Ph.D.) and bachelor's degree. The CEO's work experience (EXP), divide become two categorize: have to work experience more than 8 years and have work experience up to 8 years. Gender CEO (GEN), is measured using dummy variable; 1 if the CEO is male and 0 if the CEO is female. Connection CEO (NET), measured by the number of CEO positions in other companies (including nonprofit organizations). Performance CEO (PERF), measured by dividing operating cash flow to total assets. Another independent variable, government ownership (GVO), measured by the percentage of total shares of State-Owned Enterprises.

There are five control variables used in this study. Profitability (ROA) is measured by using return on assets, i.e. the ratio of net income to total assets. Company size (SIZE) is measured by log sales. Tangibility (TANG) is measured by dividing tangible assets (fixed assets and inventories) to total assets. The company's growth (GROWTH) is measured by the annual change of total sales. Research and Development (R&D) is measured by dividing Research and Development costs to total assets.

3.2 Data Analysis

In this research, statistical software EViews 6 is used to analyze data. This research uses panel regression technique because the data consist of cross section and time series data. To test the validity and reliability of the data, it is necessary to test the classical assumptions. The classical assumptions test used in this research is multicollinearity test and heteroscedasticity test. While the autocorrelation test is not necessary for panel data because it is assumed that there is no autocorrelation from time to time (Gujarati, 2004). Proving hypotheses in this research is formulated through the model as follows:

Model 1 (without control variables) :

$$LEVE_{it} = \beta_0 + \beta_1 PP_{it} + \beta_2 EDU_{it} + \beta_3 EXP_{it} + \beta_4 GEN_{it} + \beta_5 NET_{it} + \beta_6 PERF_{it} + \beta_7 GVO_{it} + \varepsilon_{it}$$

Model 2 (with control variables) :

$$LEVE_{it} = \beta_0 + \beta_1 PP_{it} + \beta_2 EDU_{it} + \beta_3 EXP_{it} + \beta_4 GEN_{it} + \beta_5 NET_{it} + \beta_6 PERF_{it} + \beta_7 GVO_{it} + \beta_8 ROA_{it} + \beta_9 SIZE_{it} + \beta_{10} TANG_{it} + \beta_{11} GROWTH_{it} + \beta_{12} R\&D_{it} + \varepsilon_{it}$$

4. Empirical Results and Analysis

4.1 Descriptive Statistics

Table 1 shows descriptive statistics of the dependent variables, independent variables, and control variables which used in this study. The number of samples is twenty-one State-Owned Enterprises listed on the Indonesia Stock Exchange during the year 2012 to 2016.

Table 1. Descriptive Statistics

Variable	N	Mean	SD	Minimum	Maximum
LEVE	105	0.6313	0.1994	0.2565	0.9239
PP	105	1.5524	0.4996	1.0000	2.0000
EDU	105	1.7333	0.4443	1.0000	2.0000
EXP	105	1.3905	0.4902	1.0000	2.0000

GEN	105	0.9905	0.0976	0.0000	1.0000
NET	105	0.3333	0.7679	0.0000	4.0000
PERF	105	0.0586	0.0913	-0.2301	0.2984
GVO	105	0.5895	0.1797	0.1138	0.9003
ROA	105	0.0456	0.0640	-0.1185	0.2342
SIZE	105	12.6264	1.3742	9.1212	14.0657
TANG	105	0.4599	0.3119	0.0173	0.8990
GROWTH	105	0.1176	0.1633	-0.2927	0.8728
R&D	105	0.0004	0.0013	0.0000	0.0071

The average of leverage 63.13% is indicating that State-Owned Enterprises use debt financing 63.13% of assets. On average, CEOs of State-Owned Companies have not a full page size of profile photo in the annual report. Based on the level of education, CEO of the State-Owned Enterprises have been on average an undergraduate level. On average, CEOs of State-Owned Enterprises had work experience for 8 years. Approximately 99% of CEOs of State-Owned Enterprises are male. It proved that until now Indonesia still implements a patrilineal system. This system gives privilege to men as the leader of the institution. Variable CEOs network show that most of CEO of State-Owned Enterprises do not hold positions in other companies or foundations. The value of CEO performance measured by dividing operating cash flow to total assets is 0.0586, this value is relatively low. The average of Government of the Republic of Indonesia ownership on SOEs around 58.95% of the total shares. This is in line with the definition of Indonesian SOEs which states that government ownership in SOEs is above 50% (Pranoto, 2017). ROA has an average of 0.0456 which means that the average sample company is able to generate a net profit of 4.56% of total assets. The average firm size measured by log sales is 12.6264. Approximately 45.99% of the total assets of the company consist of fixed assets. The average growth rate of sample companies during the observation period was 11.76%. Only 0.04% of the total assets used to finance the company's Research and Development.

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4.2 Correlation Analysis

Table 2 shows the correlation coefficient for each variable in this study. The correlation coefficient can be used to detect the occurrence of multicollinearity among variables. If the value of the correlation coefficient greater than 0.8, it indicates there is multicollinearity (Gujarati, 2004). Overall the results show that the correlation coefficient less than 0.8. So,

there is no multicollinearity. The variables that have significant influence, the following will be submitted correlation coefficient between these variables. Leverage Variables and CEO Network has a correlation coefficient of -0.151. Leverage and Government Ownership variables have a correlation coefficient of -0.375. Leverage and Return On Assets variables have a correlation coefficient of -0.560. Leverage and Growth variables have a correlation coefficient of 0.340. Finally, Leverage and Research and Development variables have a correlation coefficient of -0.236.

4.3 Regression Analysis

This study uses panel regression technique because the data used in this study consisted of cross section and time series data. There are three regression models that can be used in panel regression techniques, Common Effect Model, Fixed Effect Model (FEM), and Random Effect Model (REM). A statistical test is needed in determining which regression model is most suitable to be used in this research. Based on a statistical test, the appropriate regression model is the Fixed Effect Model. Based on White Test, there is no heteroscedasticity in this regression model (Gujarati, 2004). SOEs in Indonesia has a strategic role because they are expected to be a driver of economic growth through capital expenditure (Pranoto, 2017).

Table 3 shows the finding of this study. Independent variables which significantly influence the decision of SOEs debt financing in Indonesia are the variable of CEO Network, CEO Performance, and Government Ownership. The finding indicates that the broader involvement of CEOs of State-Owned Enterprises in other companies will give greater opportunities for companies to get funding from debt. The increasing of CEO Performance which measured by the operating cash flow to total assets indicates the greater ability of SOEs to fund their operational activities, so the dependence of SOEs on the debt will decrease. At a time the government increasing their supporting in SOEs capital, this will tend to decrease the funding for debt. While the CEO Profile Photo, CEO Education, and CEO Experience variables have no significant effect on debt funding decisions on SOEs because the election process of CEO of SOEs in Indonesia is not solely based on leadership aspect, but also based on political considerations of government interests. So the overconfidence managerial indicators that consisting of CEO Profile Photo, CEO Education, and CEO Experience have no significant influence on the debt financing decision of SOEs.

Table 2. Correlation Matrix

	LEVE	PP	EDU	EXP	GEN	NET	PERF	GVO	ROA	SIZE	TANG	GROWTH	R&D
LEVE	1.0000												
PP	-0.0903	1.0000											
EDU	0.1194	-0.0231	1.0000										
EXP	-0.0710	-0.2217	-0.3561	1.0000									
GEN	-0.0313	-0.0883	-0.0591	0.0785	1.0000								
NET	-0.1511	-0.1337	-0.0470	-0.2214	0.0428	1.0000							
PERF	-0.5044	0.0610	-0.0108	-0.1062	0.0179	0.1243	1.0000						
GVO	-0.3752	-0.2038	-0.0339	0.2261	-0.0606	0.2288	-0.2075	1.0000					
ROA	-0.5604	-0.0477	-0.0777	0.0689	0.0183	0.0256	0.6433	0.0493	1.0000				
SIZE	0.1753	0.1174	0.3147	-0.1115	-0.0427	-0.4227	0.0419	-0.2678	0.1732	1.0000			
TANG	-0.7317	0.1161	-0.0323	0.0880	-0.0946	0.2427	0.4132	0.1784	0.1558	-0.3772	1.0000		
GROWTH	0.3036	0.0260	0.1383	0.0888	-0.3465	-0.1804	-0.0540	-0.0989	0.0852	0.2908	-0.2335	1.0000	
R&D	-0.2363	0.0955	0.1737	-0.1511	0.0285	-0.0202	0.0655	0.3326	0.1059	0.0367	0.0867	-0.0020	1.0000

To strengthen the influence of an independent variable in model 1, the researcher adds the control variables consisting of Return On Assets (ROA), Firm Size, Tangibility, Growth, and Research & Development which are formulated in model 2. The presence of this control variables will strengthen the influence of variables CEO Network, CEO Performance, and Government Ownership to Leverage. As Pecking Order Theory (Myers & Maljuf, 1984) stated when the State-Owned Enterprises who experiencing an increase in profitability will separate a portion of the net income to be reinvested. So, SOEs tend to be less dependent on debt. State-owned Enterprises who experiencing an increase in sales growth indicate the opportunity for the State-Owned Enterprises to expand their market. Market expansion will be achieved in the short term if the State-Owned Enterprises increase their funding from debt. While the reporting of Research and Development account on SOEs in Indonesia included in the category of General and Administration Expense. This indicates that SOEs in Indonesia have not positioned the role of Research and Development as an investment activity for the long-term strategy, but still positioned as operational activities of SOEs. The way in positioning Research and Development account cause the increase in Research and Development do not require an increase in funding for debt.

Table 3. Fixed Effect Model regression results

	Model 1	Model 2
Intercept	1.8871 (3.8738)***	3.2513 (3.0423)***
PP	-0.0041 (-0.2979)	-0.0097 (-0.7180)
EDU	-0.0125 (-0.6086)	-0.0076 (-0.3943)
EXP	0.0225 (1.1829)	0.0261 (1.4091)
NET	0.0227 (1.8475)*	0.0253 (2.1482)**
PERF	-0.2481 (-2.3267)**	-0.1708 (-1.6086)
GVO	-2.1239 (-2.6143)**	-2.0845 (-2.6410)**
ROA		-0.5871 (-3.2440)***
SIZE		-0.1034 (-1.5174)
TANG		-0.1229 (-1.1124)
GROWTH		0.0646 (1.6957)*
R&D		-44.6129 (-1.8000)*
Adjusted R^2	0.9353	0.9440
F-statistic	58.8083***	57.5248***
Notes: <i>t</i> -Statistics are shown in parentheses. *, **, *** are statistically significant at the 10 percent, 5 percent, and 1 percent level, respectively.		

5. Conclusion

The overconfidence of CEOs and government ownership of SOEs in Indonesia have a significant effect on funding decisions. CEOs of SOEs with wider relationships contribute positively to the level of leverage of SOEs in Indonesia. In addition, CEOs who have performance improvements as measured by operating cash flow to total assets will reduce their dependence on debt. This study also proves that the greater the government's ownership of SOEs will reduce the need for debt financing.

Control variables that consist Return On Assets (ROA), Growth, and Research & Development play a significant role in influencing SOEs funding decisions. The higher level of profitability (Return On Assets) of SOEs will reduce the level of dependency on debt funding of SOEs. Meanwhile, the higher rate of sales growth of SOEs when SOEs want to expand their market in the short-term will drive the companies to finance it by using debt. The increasing of the value of Research and Development does not cause an increase in debt funding because SOEs in Indonesia treat R&D as cost and not an investment.

Although this research has provided an explanation of the effect of managerial overconfidence and government ownership on SOES funding decisions in Indonesia, it still requires further study on the area of efficiency, productivity, and sustainability of SOESs in Indonesia.

Considering the managerial contribution of overconfidence and government ownership to financing decisions to SOEs in Indonesia is still relatively low, we propose that government ownership in SOEs be gradually reduced so that the role of SOES CEOs in making funding decisions can be more apparent.

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