

Financial Leverage and Managerial Compensation: Evidence from Non-Cyclical Industries in Indonesia

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ABSTRACT

This research analyzes the impact of financial leverage on managerial compensation. This study also explores the moderating effect of financial distress on the link between financial leverage and managerial compensation. This study used a quantitative approach with multi-linear regression analysis. The sample consisted of 26 firms from non-cyclical industries listed on the Indonesian Stock Exchange (IDX) from 2018 to 2022, with a total observation of 130. The data research was derived from firms' annual reports. The empirical result shows that financial leverage positively affects managerial compensation. It suggests that firms incentivize management with higher compensation, aiming for more professional leverage management to maximize firm value. This finding is relevant to the trade-off theory. This study also demonstrates that the variable of financial distress is categorized as a pure moderator. It is confirmed that financially distressed firms determine financial leverage as a negotiation tool to reduce the cost of salaries. This finding implies the importance of the firms carefully balancing human capital and compensation schemes because the manager's interest might be given up if the company is in financial distress.

ABSTRAK

Artikel ini menganalisis dampak leverage keuangan terhadap kompensasi manajemen. Penelitian ini juga mengeskporasi efek moderasi financial distress pada hubungan antara leverage keuangan dan kompensasi manajemen. Penelitian menggunakan pendekatan kuantitatif dengan menggunakan analisis regresi linear berganda. Sampel yang digunakan adalah 26 perusahaan dari industri non-siklis, yang melantai di Bursa Efek Indonesia (BEI) mulai periode 2018 sampai 2022, dimana total observasi 130 perusahaan-tahun. Data penelitian berasal dari laporan tahunan perusahaan. Hasil empiris menunjukkan bahwa leverage keuangan berpengaruh positif terhadap kompensasi manajemen. Hal ini mengindikasikan bahwa perusahaan memberikan kompensasi yang lebih kepada manajer dengan harapan agar manajer dapat mengelola hutang dengan lebih profesional sehingga mampu menaikkan nilai perusahaan. Penelitian ini juga mendokumentasikan bahwa variabel financial distress dikategorikan sebagai pure moderator. Hal ini menunjukkan bahwa perusahaan yang mengalami financial distress mempertimbangkan leverage sebagai alat negosiasi untuk mengurangi biaya gaji. Hasil penelitian ini mengimplikasikan pentingnya perusahaan agar berhati-hati untuk menjaga keseimbangan antara human capital dan skema kompensasi karena kepentingan manajer mungkin dikorbankan jika perusahaan mengalami financial distress.

1. INTRODUCTION

COVID-19 has created unpredictable shocks against businesses on all sides of the planet and dramatically

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increased uncertainty in economic activities. It has negatively impacted the company's income, operational margin, and core net profit. In this context, corporate financing is one of the critical business decisions. The company is likely to correct leverage ratio achievement. A sample of various countries presents the rise of leverage ratio covered by the effect of the time of difficulty caused by the COVID-19 pandemic (Anh et al., 2022; Tarkom & Huang, 2022). Arguably, it may be driven by several factors. First, some businesses have been forced to take more debt to keep operations going as the economy slows. Second, other companies may need more investment, especially in technology development, to mitigate the effect of COVID-19 (Almeida et al., 2020). Other reasons may be driven by the ability to access and the amount of credit (Aristei & Gallo, 2023). Government intervention in economies during COVID-19 offered credit at lower interest rates and greater credit availability for companies that decided to take on new debt.

The leverage-targeting behavior, primarily through economic uncertainty, has great value implications. Incorrect debt use can worsen the firm's condition. The role of the manager must be addressed. Then, managerial compensation cannot be separated. Gurkov (2022) suggested increasing managerial remuneration during extreme COVID-19 is the most effective policy. The logical argument of that policy is to motivate the manager toward more creative solutions in achieving the "stretch goal," which inevitably appears during this crisis. Also, managers are expected to manage the debt more professionally, which can increase the firm value. This suggests evidence of the potential impact of financial leverage against managerial compensation.

The debate on managerial compensation policy has attracted much attention among policymakers, firms, academics, researchers, and the common party, specifically given the harmful impacts of the global crisis, e.g., the pandemic crisis (Core & Guay, 2010; Gurkov, 2022). The incentives for short-term achievements, likely cash incentives, can support the manager in engaging in excessive risk-taking behavior. Consider the firm's long-term sustainability to avoid excessive risk-taking behavior leading to a systematic financial crisis (Fitzpatrick, 2010; von Ehrlich & Radulescu, 2017). Many countries enacted legislation regarding shareholder votes to determine the managerial remuneration plans at the general meetings of shareholders (Atif et al., 2020).

More than two researches empirically show the relationship between financial leverage and managerial compensation. Chemmanur et al. (2013) and Lin et al. (2019) documented that the link between financial leverage and managerial compensation in non-financial companies is positive, which aligns with the capital structure policy, namely trade-off theory. It indicates that companies pay managers more to stimulate their professionalism in debt management. Other studies show that financial leverage hurts executive compensation (Balafas & Florackis, 2014). The previous study conducted in Indonesia by Kunaifi et al. (2021) also showed the negative relationship between leverage and top management pay performance in family companies. This result supports the agency cost theory. The argument underlying this empirical result is that the two have substitution functions in mitigating agency problems. If the function of financial leverage in mitigating agency problems arises, the function of managerial compensation will decrease, and *vice versa*. Therefore, it is necessary to discuss the impact of financial leverage against managerial compensation, whether it is consistent with the previous research, especially under the effect of COVID-19.

In a situation under the impact of COVID-19, it is also relevant to discuss financial distress. The previous research pioneered by Berk et al. (2010) and Lin et al. (2019) documented that financial distress is related to the nexus of financial leverage and managerial compensation. When the firm suffers from financial distress, the firm tends to use leverage as a negotiation tool to depress the salary cost. Another research also indicated that financial distress, as the predicted variable, positively affects managerial compensation (Chang et al., 2022). Unhealthy firms tend to give higher salaries to managers because managers need to make a great effort to operate the business to save the firm from bankruptcy. Thus, it is assumed that financial distress moderates the link between financial leverage and managerial compensation.

This study focuses on non-cyclical industries listed on the Indonesian Stock Exchange (IDX) for 2018-2022. Firms in this industry produce or distribute goods and services classified as daily needs. Their financial performance is relatively stable and does not depend on economic fluctuation. Nevertheless, this industry has not spread the impact of COVID-19. During the lockdowns, many sales transactions that traditionally needed physical presence between retailers and customers were restricted (Purwanto et al., 2020). Customers are required to prevent frequent visits to markets. Thus, the non-cyclical industry figures a special discussion for testing how financial leverage triggers the managerial compensation policy.

This study focuses on managerial compensation rather than all employee compensation. This is because managers are considered the main strategic decision-makers, so practitioners and scholars pay more attention. Moreover, their skills in action and creativity are important and should be considered part of the company's human capital.

This study contributes to the discussion in the following ways. In particular, this research examines the link between financial leverage and managerial compensation and whether the recent global pandemic crisis has impacted this relationship. This finding will benefit the firms and regulators by increasing the requirements for setting managerial compensation. It may impact the firm value and, hence, the shareholders' wealth. Another novelty is the discussion of the role of financial distress in moderating the influence of financial leverage on managerial compensation.

2. THEORETICAL FRAMEWORK AND HYPOTHESES

2.2. Financial Leverage

Financial leverage is closely related to capital structure. It arises when a company finances its business activities using funds that cause fixed expenses, namely debt. Companies need to find efficient alternatives to meeting funding needs. It can be realized if the capital structure is optimal. Optimal capital structure can be defined as the composition of long-term debt and equity, which can maximize firm value (Engels, 2019). Determining capital structure takes work since incorrect decisions can cause the firm to experience financial distress, even bankruptcy (Ellul & Pagano, 2019).

There are several theories about capital structure policy. However, this study will discuss trade-offs and agency cost theories relevant to the research topic. Each theory will provide a different insight into the nexus of financial leverage and compensation policy.

The first is the trade-off theory. Under this theoretical view, firms make trade-off decisions between leverage and equity as the source of financing (Rahman, 2019). Assuming that business operations and assets remain the same, the increase in leverage will generate more tax benefits and incur bankruptcy costs. The maximum firm value will be achieved if the capital structure is optimal, where the tax benefits of debt are equal to the bankruptcy cost. In this context, the firms must compensate the managers more for their professionalism in managing the debt optimally (Chemmanur et al., 2013; Lin et al., 2019).

The second is agency cost theory. An agency problem arises due to differences in interests between managers and shareholders, managers and creditors, and shareholders and creditors. One of the causes of agency problems is high free cash flow (Chen et al., 2016). Shareholders expect that the free cash flow will be distributed in the form of dividends, while creditors prefer the free cash flow to pay the debt, and on the manager side, the free cash flow will be profitable for long-term investment. An agency problem will occur when the manager uses the free cash flow for an overinvestment project, where the project is large but not profitable. The manager is only oriented to the project size to get more compensation without considering the shareholder wealth.

Agency cost theory states that debt financing can minimize agency problems (Chechet, 2014) and optimal managerial compensation (Pepper & Gore, 2015). Financial leverage can reduce free cash flow to minimize managers' excessive behavior in overinvestment (Khan et al., 2012). On the other hand, higher

leverage can increase bankruptcy risk, while investors prefer companies with low debt levels due to the lower risk. Meanwhile, compensation can minimize the agency problem by aligning the interests of corporate managers with those of shareholders. Thus, debt and managerial compensation have substitution functions in mitigating agency problems (Balafas & Florackis, 2014; Kunaifi et al., 2021).

2.3. Managerial Compensation

Managerial compensation can be defined as a reward given to managers for their performance in maximizing firm value. It aims to align the interests of shareholders and managers. In Indonesia, managerial compensation is determined through the General Meeting of Shareholders (RUPS). The management referred to here is the commissioner and director board. It is because Indonesia adheres to a two-tier board system where duties and authorities are separated between those doing management and monitoring (Elly et al., 2017). The commissioner's board is tasked with supervising the directors, while the board of directors is tasked with managing the company.

Managerial compensation can be classified into cash salaries and benefits. Based on the previous literature (Lin et al., 2019), the amount of compensation is proxied by cash salaries and benefits. However, this work only used cash salaries and benefits as the proxy for managerial compensation. In Indonesia, only about 8% of non-financial companies implemented the stock option (Anela & Prasetyo, 2020). Meanwhile, this study uses only non-cyclical company samples, which is inadequate if it also uses stock options as part of the proxy. Furthermore, compensation measured in this work is the total compensation received by commissioners and director board because, in the financial report, there is no separation in salaries received by commissioners and directors.

2.4. Hypotheses Development

Previous research provides contrasting findings regarding the nexus of financial leverage and managerial compensation. Based on Chemmanur et al. (2013) and Lin et al. (2019), the effect of financial leverage on managerial compensation is positive. This finding supports the trade-off theory. Under this theory, increasing debt may invite bankruptcy costs even though it can lead to more tax benefits. Inappropriate debt management can result in a company going bankrupt. In a condition where the company has a higher level of leverage, the company should pay managers with higher incentives with the hope that the manager will manage the debt well, increasing the firm value. On the contrary, the empirical studies pioneered by Balafas & Florackis (2014) and Kunaifi et al. (2021) suggested that the impact of financial leverage on compensation is negative. The theory that supports this result is agency theory, which assumes a conflict of interest between shareholders (principal) and management (agent). Excessive use of debt may be considered an action that increases a firm's risk, which shareholders may not desire. Consequently, shareholders may suppress managerial compensation to avoid undesirable risks. Because previous research showed opposite results, this study cannot assume the direction of the nexus is positive or negative. Thus, the hypothesis developed in this study is as follows:

H1 Financial leverage has an impact on managerial compensation

This study also takes into consideration financial distress. The recent literature (Berk et al., 2010; Lin et al., 2019) compares financially distressed and healthy companies in testing the impact of financial leverage against managerial compensation. The findings show that the positive relationship between debt and managerial incentives is less pronounced for unhealthy firms. When the firm suffers from financial distress, leverage can be used to negotiate with its manager. The financially distressed firm needs help to pay its debt. In this situation, the greater the debt, the higher the company's burden to pay the debt. One of

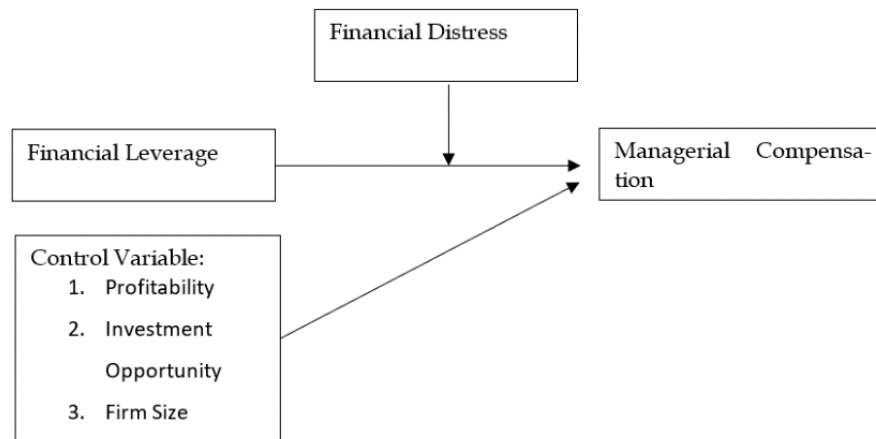


Figure 1. Research framework

the solutions that can be done is depressing the salary cost. Thus, managers in financially distressed companies might accept lower compensation to minimize financial distress risk. Accordingly, it can be assumed that the firm in financial distress uses leverage to depress salary costs. Besides that, another study by Chang et al. (2022) also showed that financial distress, as the predictor variable, positively affects managerial compensation. It is because managers, as the main strategic decision makers, are expected to make appropriate policies to save the firm from bankruptcy so that the firm will pay them more for their efforts. So, financial distress may become a moderating variable in the interaction between financial leverage and managerial compensation, affecting managerial compensation independently. However, in line with the objective research, this study will focus more on how financial distress affects the nexus of financial leverage and managerial compensation. This study develops a hypothesis:

H2 Financial distress can moderate the relationship of financial leverage with managerial compensation.

Other factors may affect managerial compensation, including profitability, investment opportunity, firm size, and ownership (Lin et al., 2019;). It is expected that profitability and firm size positively affect managerial compensation, while investment opportunity and managerial ownership harm managerial compensation. This study also adds COVID-19 as a factor that may influence managerial compensation. Based on the discussion above, the research framework can be presented in Figure 1.

3. RESEARCH METHOD

3.1. Population and Sample

This study focused on non-cyclical industries listed on the Indonesian Stock Exchange (IDX) 2018-2022. Non-cyclical industries are classified into food and beverage, food and staples retailing, non-durable household products, and tobacco. The databases result in a population of 119 companies. The data set was obtained from the company's annual report. The sample was selected by purposive sampling technique. One major criterion for the sample selection was the balance panel nature – only companies that issued annual reports from 2018-2022. There were 30 firms eliminated. Next, the sample was eliminated by considering the completeness of managerial compensation information on the 2018-2022 annual report. There were 54 firms eliminated. This selection also excluded the firms with foreign currency in their financial

Table 1. Criteria of the sample

Total population	119
Less:	
Not issuing an annual report in 2018-2022	30
Non-availability of managerial compensation	54
Firms reporting in foreign currency	1
Corporate action	8
Total deduction	(93)
Sample Totals (Firms)	26
Final Number of Observations (26x5)	130

statement and corporate actions during the research period. There were nine firms eliminated. Based on the criteria (see Table 1), the total sample was 130 observations from 26 firms in 2018-2022.

3.2. Variable Measurement

This study's research variables consist of dependent, independent, moderating, and control variables. This study used managerial compensation as the dependent variable. The managerial compensation may be categorized into cash as salaries and benefits given to the managerial level. Financial leverage, consisting of short-term and long-term debt, is the independent variable. Long-term debt reflects financing activities for long-term investment, and total debt reflects the company's overall financial position. This proxy was measured as long-term debt divided by total assets and total debt divided by total assets. The moderating variable in this study is financial distress. The moderating variable serves as a variable that strengthens or weakens the impact of the independent variable against the dependent variable. This variable is classified into 4 (four) types (Sharma et al., 1981), namely:

- Pure moderator is a variable that moderates the relationship between the predictor and dependent variable. This variable only interacts with the predictor without being the predictor variable (β_1 non-significant, β_2 significant).
- Quasi moderator is a variable that moderates the relationship between the predictor and dependent variable where the pseudo-variable interacts with the predictor and is the predictor variable (β_1 significant, β_2 significant).
- Homologizes moderator is a variable that does not interact with the predictor or affect the dependent variable (β_1 non-significant, β_2 non-significant).
- Moderating predictor is a variable that does not interact with the predictor and affects the dependent variable (β_1 significant, β_2 non-significant).

This study also controlled for Return on Assets (ROA), market-to-book ratio (M/B ratio), firm size, managerial ownership, and Covid Year. It is important to avoid omitting variable biases in the models. The acronyms and operational definitions of variables are presented in Table 2.

3.3. Data Analysis Method

This study employed panel data regression analysis. Panel data integrates time series and cross-section data types. Utilizing panel data offers various benefits, including explicitly describing individual heterogeneity, reducing collinearity among variables, offering a higher degree of freedom, and enhancing efficiency. This data type is also suitable for examining the dynamic changes, capturing effects that cannot be seen from pure cross-sectional and time series, and potentially mitigating bias effects in the data collected at both individual and group levels on a large scale. Thus, panel data models do not necessitate testing for

Table 2. Description of variables

Variable	Description
Managerial Compensation (MCOMP)	MCOMP = Log of total salaries and benefits cash bonus compensation
Financial Leverage (LEV1)	$LEV1 = \frac{\text{Long term debt}}{\text{Total assets}}$
Financial Leverage (LEV2)	$LEV2 = \frac{\text{Total debt}}{\text{Total assets}}$
Financial Distress (FD)	Z-score (dummy variable: 1 (distress) if the firm's Z score < 1,8 and 0 (non-distress) otherwise) Altman Z-score = 3,3 (EBIT/Total Assets) + 1,4 (Retained Earning/Total Assets) + 1,2 (Working Capital/Total Assets) + 0,6 (market value of equity/total liability) + (Sales/Total Assets)
Return on Assets (ROA)	$ROA = \frac{\text{Net Income}}{\text{Total assets}}$
Market to Book Ratio (MB)	$M/B \text{ ratio} = \frac{\text{market value of equity}}{\text{book value of equity}}$
Firm Size (FZ)	FZ = Ln of total assets
Managerial Ownership (MOWN)	Ownership of shares by management (%)
Covid Year	COVID-19 year (dummy variable: 1 for 2020 and 2021, 0 for others)

classical assumptions (Ajija et al., 2011). In panel data regression, testing is needed to select the best model among Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Firstly, the Chow test is used to determine the model between CEM and FEM. If the chow test shows an F-prob value of less than 5%, the temporally model chosen is FEM. Then, the Hausman test is used to determine the model between FEM and REM. If the Hausman test shows an F-prob value of less than 5%, the temporally model chosen is FEM.

3.4. Research Model

The models were developed to test the hypotheses of this research. The regression model 1 for the first hypothesis of this study, is as follows:

$$MCOMP_{it} = LEV_{it} + ROA_{it} + MB_{it} + FZ_{it} + MOWN_{it} + COVID\ Year_{it} + \varepsilon_{it} \quad (1)$$

The model above estimated the impact of financial leverage against managerial compensation. Meanwhile, to show the impact of financial distress in moderating financial leverage and managerial compensation, regression model 2 for the second hypothesis was carried out as follows:

$$MCOMP_{it} = LEV_{it} + FD_{it} + LEV.FD_{it} + ROA_{it} + MB_{it} + FZ_{it} + MOWN_{it} + COVID\ Year_{it} + \varepsilon_{it} \quad (2)$$

4. DATA ANALYSIS AND DISCUSSION

4.1. Descriptive Statistics

Table 3 presents the description of the variables used in this research. A few results are worth figuring out. The managerial compensation (MCOMP) had a minimum value of 9.3189, maximum value of 12.9863, average of 10.7180, and standard deviations of 0.6498. It signifies a low degree of heterogeneity in managerial compensation practices. The long-term debt ratio (LEV1) has a mean (standard deviation) of 0.1610 (0.1126). Then, the minimum and maximum LEV1 range is extensive, from 0.0029 to 0.5052. The total debt ratio

(LEV2) mean (standard deviation) is 0,4637 (0.1949). Then, the minimum and maximum LEV2 range is extensive, from 0.0979 to 0.9590. It indicates a big disparity in the leverage between the observed companies.

4.2. Model Selection Test

Table 4 describes the Chow test results. Based on Table 4, the F-prob value in model 1 and model 2 in the Chow test shows a value of more than 5%. Therefore, the Common Effect Model (CEM) is appropriate for estimating panel data.

4.3. Results and Discussion

Estimation Results

Table 5 shows the regression results for model 1 and model 2. The coefficients of financial leverage (LEV1) are significantly positively related to managerial compensation (MCOMP) (models 1 and 2). The coefficients of financial leverage (LEV2) are significantly positively related to managerial compensation (MCOMP) (models 1 and 2). These findings are consistent with hypothesis one, which suggests that financial leverage impacts managerial compensation. The coefficient of the interaction between financial leverage and financial distress (LEV1.FD) on model 2 was significantly negative. The coefficient of the interaction between financial leverage and financial distress (LEV2.FD) in model 2 is significantly positive. These results align with the second hypothesis, which indicates that financial distress can moderate the relationship of financial leverage with managerial compensation. It can be summarized that the function of the financial distress (FD) variable is classified as a pure moderator, which indicates that financial distress has a role as a moderating variable without being a predictor.

The estimation results in Table 5 also present the influence of control variables on managerial compensation. The profitability ratio (ROA), market-to-book ratio (MB), and CRISIS have no significant effect on managerial compensation (MCOMP). Meanwhile, the firm size (FZ) and managerial ownership (MCOMP) affected managerial compensation (MCOMP) positively and significantly.

Table 3. Descriptive statistics

	Minimum	Maximum	Mean	Std. Deviation
MCOMP	9.3189	12.9863	10.7180	0.6498
LEV1	0.0029	0.5052	0.1610	0.1126
LEV2	0.0979	0.9590	0,4637	0.1949
FD	0.5359	10.2807	3.2388	1.5856
ROA	-0.2024	0.2925	0.0587	0.0710
MB	0.2945	12.2048	2.3346	2.1943
FZ	27.4355	32.8264	29.6948	1.5412
MOWN	0.0000	0.5380	0.0337	0.0993
CRISIS	0	1	0.4000	0.4920

Table 4. Model 1 chow test

	Model 1		Model 2	
	LEV1	LEV2	LEV1	LEV2
F statistic	-3.596	-5.938	-3.491	-3.5
Df	(25, 98)	(25, 98)	(25, 96)	(25, 96)
Prob	0.106	0.325	0.267	0.317

Table 5. Estimation results of model 1 and model 2

Variable	Model 1		Model 2	
	Coeff. (Sig)	Coeff. (Sig)	Coeff. (Sig)	Coeff. (Sig)
C	1.690 (0.004)	0.901 (0.108)	1.694 (0.006)	1.244 (0.334) ***
LEV1	1.067 (0.004) **	-	1.067(0.001) ***	-
LEV2	-	-0.369 (0.045) **	-	-0.977 (0.001) ***
FD	-	-	0.004(0.964)	0.286 (0.060) *
LEV1.FD	-	-	-0.007(0.043) **	-
LEV2.FD	-	-	-	0.159(0.013) **
ROA	1.311 (0.309)	-0.041 (0.938)	1.310 (0.863)	-0.532 (0.389)
MB	-0.165 (0.219)	0.002 (0.875)	-0.015(0.331)	-0.01 (0.500)
FZ	0.2958 (0.000) ***	0.335 (0.000) ***	0.296(0.000) ***	0.326 (0.000) ***
MOWN	0.980(0.017) **	0.805 (0.006) **	0.977(0.007) **	0.751 (0.016) **
CRISIS (COVID)	-0.074 (0.189)	-0.053 (0.362)	-0.073(0.196)	-0.061 (0.334)
R ²	0.746	0.728	0.746	0.747
Prob. (F-stat)	0.000	0.000	0.0000	0.000

Notes: p-value *, **, and *** significant at the 10%, 5%, and 1%

Discussions

Based on the findings of models 1 and 2, financial leverage (LEV1) positively affects managerial compensation (MCOMP). It suggests that the firm compensates management parties with more incentives when the firms have a higher leverage level. This finding is relevant to the trade-off theory and supports the previous studies by Chemmanur et al. (2013) and Lin et al. (2019). The proxy of LEV1 uses long-term debt, which is generally used to finance long-term investments. It is expected that using long-term debt may help companies allocate funds to investments that produce a high rate of return. In this case, the firms pay more compensation to the manager, hoping that the managers maintain their performance by managing the debt professionally. Meanwhile, the proxy of LEV2 shows a different result. LEV2 has a negative effect on managerial compensation (MCOMP). This finding is relevant to the agency theory and supports the studies by Balafas & Florackis (2014) and Kunaifi et al. (2021). The proxy of LEV2 uses total debt, consisting of short-term and long-term debt. In a pandemic crisis, companies use more debt to keep operations going as the economy slows. The descriptive statistics of this research show that the proportion of short-term debt used is greater than that of long-term debt. It indicates that the companies increase short-term debt to keep operational activities. Excessive use of debt may be considered an action that increases a firm's risk, which shareholders may not desire. Therefore, the companies reduce managerial compensation to avoid financial risk. On the other hand, in COVID-19 conditions, companies may experience deep financial pressure so that the companies save operational cost, including reducing the amount of managerial compensation.

The influence of financial distress as (FD) the moderation variable can be seen in model 2. This finding supports Berk et al. (2010) and Lin et al. (2019), which documented that financial distress (FD) significantly moderates the relationship between financial leverage (LEV) and managerial compensation (MCOMP). The interaction of LEV1 and FD was significantly negative. At a high level of long-term debt, the financially distressed firms may face pressure to reduce the debt burden. Therefore, firms may prioritize long-term debt reduction over high compensation payments. On the other hand, the interaction of LEV2 and FD was significantly positive. In depressed financial conditions, firms need to make efficiencies, including allocations for management compensation, to survive. Management may be given additional financial incentives to overcome financial distress and minimize the risk of bankruptcy. In situations of distress, management who are successful in implementing effective action may receive additional incentives as a reward for efforts in managing risk and securing the company's future.

The empirical result of this study shows that profitability (ROA) does not affect managerial compensation (MCOMP). It does not support the previous study. This research included the year of COVID-19 as part of the research period. On average, the sample firm's revenue, operating profit, and net income tend to decrease, but the decline in managerial professionalism does not have an effect. Therefore, profitability should have been considered in determining the managerial scheme during this research period.

Based on Table 5, the investment opportunity (MB) variable is insignificant. It shows that this variable is not considered in managerial compensation policy. The argument underlying this finding is that investment opportunity is not described as the firm's real opportunity investment but only shows investors' expectations regarding the investment opportunity.

In line with the findings of the previous research (Lin et al., 2019), the significant positive effect of firm size (FZ) on managerial compensation (MCOMP) suggests that larger firms offer better compensation schemes for managers. The larger the firm, the more complex the operating activity. The larger firm requires a professional person who can manage the firm. Consequently, the firm needs much money to pay the manager.

In contrast with the previous research (Lin et al., 2019), this finding confirms a positive significant relationship between managerial ownership (MOWN) and managerial compensation (MCOMP). It suggests that higher managerial ownership is associated with higher managerial compensations. The existence of managerial ownership in the firms will create a common interest between shareholders and managers. In this case, the manager also determines the compensation scheme.

The COVID-19 year (CRISIS) does not influence managerial compensation (MCOMP). This cannot be separated from the nature of non-cyclical industries' defensive business processes against economic conditions. It implies that in non-cyclical industries, the crisis is not considered in determining the incentive scheme. It indicates that the internal condition of the company determines the managerial compensation policy.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

Based on the data analysis and discussion submitted, financial leverage positively affects managerial compensation. It shows that the firm compensates management parties with more incentives in the hope that the manager can manage the leverage more professionally to maximize firm value, where the firms have higher leverage. This finding is relevant to the trade-off theory. The variable of financial distress is categorized as a pure moderator, which indicates that financial distress has a role as a moderating variable and predictor. As the predictor variable, financial distress was positively associated with managerial compensation. It reflects that financially distressed firms have higher managerial incentives than healthy ones. As the moderating variable, financial distress weakens the correlation between financial leverage and managerial compensation. It is proved that financially distressed firms determine financial leverage as a negotiation tool to reduce the cost of salaries.

This research contributes to the existing discussion and adds the study on the link between financial leverage and managerial compensation by examining the global pandemic crisis. It provides evidence that the capital structure policy of firms in non-cyclical industries is relevant to the trade-off theory. This article also adds to the literature by providing that the firm might only partially compensate managers in the case of financial distress. As we know, the manager is a part of the firm's human capital, but the manager's interest may be sacrificed if the company is in financial distress. As a consequence, how to keep a balance between human capital and compensation scheme is very important.

This research has several implications. The company must consider financial leverage and distress in determining the optimal compensation scheme. The companies in this investigation pay more compensation to the manager in the hope that the manager can manage the leverage more professionally so that it

can maximize firm value. This may impact the firm value and, hence, the shareholders' wealth. This finding is also crucial for companies in minimizing the probability of bankruptcy, especially in the pandemic crisis.

This research has several limitations. Firstly, this research only focuses on the non-cyclical industry, so more is needed to provide a general basis for this finding. It is important to highlight other industries because every industry has special characteristics. The comparison studies along industrial lines can be carried out to understand how the nexus of financial leverage and managerial compensation matters across different industries. Secondly, it only focuses on managerial compensation. Future research may consider employee compensation to provide different insights. Thirdly, compensation is based only on the cash salary. Future research may use another component of compensation (e.g., stock option) sensitive to corporate performance. Therefore, further research is suggested to expand the sample to non-financial companies to use stock options as the proxy.

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