

CHAPTER I

INTRODUCTION

1.1 Background of the Research

The capital market is a place for trading various long-term financial instruments, both in the form of debt and equity, issued by the government, public authorities, and private companies (Husnan, 2001). One of the financial instruments that are traded and attractive for investment is bonds. Bonds have fixed income that is earned from the interest that will be received periodically and the principal of the bonds at maturity. For issuers, bonds are safe securities because their issuance costs are cheaper than stocks.

One of the things that investors must pay attention to when buying bonds is bond ratings, because this provides an informative statement and gives a signal about the probability of a company's debt failure. The bond rating is divided into two ratings, namely investment grade (AAA, AA, A, BBB) and non-investment grade (BB, B, CCC, and D). Bonds rated investment grade indicate that the bonds are investment grade and are said to be safe because the company has the ability to pay interest and principal on the loan.

In Indonesia, there are two debt securities rating agencies, namely PT PEFINDO (Indonesian Securities Rating) and PT Kasnic Credit Rating Indonesia. Pefindo's rating of bonds is carried out by assessing business risk, industry risk and corporate financial risk (www.pefindo.com). However, some companies that issue bonds and are classified as investment grade are at risk of default. This case

occurred because of the lack of anticipation by the bond rating agency on changes in the financial condition of a company that issued bonds.

An investor who is going to buy bonds should still pay attention to default risk, which is an opportunity where the issuer will experience an inability to fulfil its financial obligations (default). According to Manurung et al. (2008), bonds issued by the government, usually get an investment grade bond rating (level A), because the government is considered to be able to pay off coupons and principal debt when the bonds mature. However, bonds issued by companies (corporate bonds), there is a default risk, which depends on the financial health of the company. To avoid this risk, investors must pay attention to several things, one of which is the issuer's bond rating.

Foster (1986) reveals factors that can be considered by rating agents in determining the rating of a bond including various financial ratios, provision for indenture agreements, protection of existing assets and quality of management. There is no further explanation from the rating agency how financial statements can be used in determining bond ratings. This is what encourages researchers to conduct research on bond ratings using financial ratios based on the company's financial statements, with the assumption that the company's financial statements are more representative of the company's condition. Financial statement analysis in the form of financial ratio analysis and statistical calculations can be used to detect under or overvalued securities (Kaplan and Urwitz, 1979 in Raharja and Sari, 2008).

Financial ratios are a tool for corporate financial analysis assess the performance of a company based on the comparison of financial data contained in

the financial statements (balance sheet, profit / loss statement, cash flow statement). The ratio describes a relationship or balance (mathematical relationship) between a certain amount and another. Ratio analysis can be used to guide investors and creditors to make decisions or considerations about the company's achievements and future prospects. One way of processing and interpreting accounting information, which is expressed in relative or absolute terms to explain certain relationships between one number and another from a financial statement. The better the financial ratios, the higher the bond rating of a company.

Magreta and Nurmayanti (2009) found that financial ratios such as profitability, productivity, have the ability to predict bond ratings, while liquidity and leverage ratios do not have the ability to predict bond ratings. Almilia and Devi (2007) found that the liquidity variable, measured by the current ratio, is the dominant variable for predicting bond ratings.

Several previous studies on the effect of financial ratios on bond ratings include, Bramasta (2012) "*Pengaruh Manajemen Laba dan Rasio Keuangan Perusahaan Terhadap Peringkat Obligasi*" leverage ratios, solvency and liquidity do not have a significant effect on bond ratings while profitability ratios and productivity have a significant effect on bond ratings., Purwaningsih (2008) "*Pemilihan Rasio Keuangan Terbaik Untuk Memprediksi Peringkat Obligasi: Studi Pada Perusahaan Manufaktur yang terdaftar di BEJ*" results of processing with backward regression, financial ratios that can be used to predict bond ratings are LTLTA (leverage ratio), NWTa (leverage ratio), CFOTL (solvency ratio), and SFA (productivity) ratios; (2) the results of processing with factor analysis, the best

financial ratio to predict bond ratings is the CACL ratio (liquidity ratio). , Kingkin Sandra Melani and Paulus Sulluk Kananlua (2007) “*Analisis Pengaruh Rasio Keuangan Terhadap Peringkat Obligasi Perusahaan Manufaktur yang Terdaftar di BEI*” this research result that Return on Assets and Firm Size positive effect on bond ratings. This shows that the Return on Assets and Firm Size can affect the good and bad bond rating companies manufacturing. While the Current Ratio and Debt-to-Equity Ratio has no effect on bond ratings., Ni Made Sri Kristina Sari and Ida Bagus Badjra (2016) “*Pengaruh Likuiditas, Ukuran Perusahaan, Leverage, dan Jaminan Terhadap Peringkat Obligasi Pada Sektor Keuangan*” regarding the effect of liquidity, company size, leverage and collateral in influencing the bond rating, which is 0.740 or 74%, while the remaining 26% is influenced by other variables not included in this research model all have their differences in result.

The variety and inequality of the results of the above research is the background for conducting further research on the factors that affect bond ratings, especially financial ratios.

1.2 Statements of the Problem

Based on this description, the research problem is formulated in the form of questions as follows:

1. Does the liquidity ratio have a positive effect on the bond ratings of companies listed on the IDX and PEFINDO?
2. Does the profitability ratio have a positive effect on the bond ratings of companies listed on the IDX and PEFINDO?

3. Does the leverage ratio have a negative effect on the bond ratings of companies listed on the IDX and PEFINDO?

1.3 Objective of the Research

To provide empirical evidence regarding the effect of financial ratios on corporate bond ratings, so this study can show the decision usefulness of financial ratios based on the PEFINDO ratings.

1.4 Significance of the Research

Researchers conducted this research in hopes of giving contributions, including the following:

1. Contribution Theory

The contribution of theory to academic world as empirical evidence about analysis of whether financial ratios has a positive effect on bond ratings to companies listed on IDX and PEFINDO on years 2014-2019. Besides this research expected to be reference material for future researchers who will conduct similar research.

2. Contribution of Practice

This research is expected to provide benefits for users of credit ratings and financial statements to be able to analyse the effect of financial ratios on bond ratings, so that it can help in decision making.

1.5 Data Analysis

The steps in writing this research were carried out as follows:

1. Collecting data in the form of bond ratings listed on PEFINDO and financial statements of companies listed on the IDX in all industrial sectors for the 2014-2019 period.
2. Data measurement is done by:
 - a. Liquidity, profitability, and leverage as a proxy for financial ratios.
 - b. Bond ratings or ratings which are denoted by a number that are not related to one another.
3. Testing data normality using the Kolmogorov-Smirnov test using SPSS software.
4. Testing classical assumptions using heteroscedasticity, multicollinearity, and autocorrelation tests.
5. Hypothesis testing by performing multiple regression analysis on SPSS and comparing adjusted R square.

1.6 Writing Structure

CHAPTER I : Introduction

This chapter contains an explanation of the background of the problem, problem formulation, problem boundaries, research objectives, research benefits, data analysis, and writing systematics.

CHAPTER II : Theory Basis and Hypothesis Development

This chapter consists of the theories that are used as the theoretical basis to support this research, the writing framework and the hypotheses.

CHAPTER III : Research Methods

The content of this chapter is a research method consisting of the type of research, object, population, and sample, research variables, operationalization of variables, research models, and technical data analysis.

CHAPTER IV : Data Analysis and Discussion

This chapter discusses data analysis and the results obtained in the study.

CHAPTER V : Conclusion

This chapter contains the conclusions of the study, the limitations of the study, and the suggestions put forward by the author for consideration for interested parties.