CHAPTER I

INTRODUCTION

1.1. Background

Cash and Cash Equivalent is one of important elements included in current asset section. Cash and Cash Equivalent will be stated in the balance sheet and cash flows statement. Cash is the amount of money that is ready to be used. Based on IAS 7 Paragraph 7, Cash Equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes (IFRS Interpretations Committee , 2013). In 2014, Alam Karya Unggul Tbk., Budi Starch & Sweetener Tbk., Unilever Indonesia Tbk., Astra Internasional Tbk., Duta Pertiwi Nusantara Tbk., and Taisho Pharmaceutical Indonesia Tbk., hold 0.078%, 1.408%, 6.016%, 8.856%, 25.914%, 41.968% cash to total assets consecutively. The greater amount of cash held by a firm does not reflect the good performance or the profitability of firm. The various amounts of percentage cash to total assets show that there should be some factors influence the determinant of firm's cash holdings.

Every firm will have different decision related to cash holdings. There are so many motives or the determinants of cash holdings. At least, there are four motives for firms to hold cash. There are transaction motive, precautionary motive, tax motive, and agency motive. There is one additional motive to hold cash that is speculative motive. Every firm can decide its own cash level. Static trade off, pecking order, and free cash flow theory also

explain the determinant of cash holdings. All the theories predict the relationship of some factors that influence cash holdings. The prediction may be same each other, but sometime one theory gives different arguments with other theory and it will be contradicted each other. No theory can be 100% right to be implemented, because one theory will complement the others. The theory can be proven by conducting the research.

Firm should determine cash holdings wisely. Having a lot of cash might invite problem. Having a little cash also can be bad. Based on static trade off theory, the good one for holding cash is by weighting the marginal cost and marginal benefits of holding cash. Ferreira & Vilela (2004) said that the benefits related to cash holdings are the following: reduces the likelihood of financial distress, allows the pursuance of investment policy when financial constraints are met, and minimizes the costs of raising external funds or liquidating existing assets. Ferreira & Vilela (2004) also said that the main cost of holding cash is the opportunity cost of the capital invested in liquid assets. The benefits and costs of holding cash should be equal, therefore the optimal level of cash holdings can be achieved (Schuite, 2012). In the reality, there are no perfect optimal cash holdings, but there can be almost perfect optimal cash holdings.

Based on pecking order theory, firms will choose retained earnings as the priority for financing, and then choose safe debt and risky debt, and finally will issue equity. Internal financing is better compared to external financing in pecking order theory. This theory suggests that firms do not have target cash levels, but cash is used as a buffer between retained earnings and

investment needs (Ferreira & Vilela, 2004). The free cash flow theory predicts that cash holdings are positively related to shareholder dispersion and negatively related to managerial ownership (Nguyen, 2005). Ferreira & Vilela (2004) said that having cash available to invest, the manager does not need to raise external funds and to provide capital markets detailed information about the firm's investment projects. Hence, managers could undertake investments that have a negative impact on shareholders wealth (Ferreira & Vilela, 2004).

The proportion of cash holdings can be affected by several factors. Prior researchers already conducted many researches relate to the determinants or factors that influence the proportion of cash holdings. The empirical findings of Magerakis (2015) suggest that cash holdings are positively related to investment opportunity and industry cash flow volatility. Cash holdings also negatively affected by cash flow, net working capital, capital expenditures, leverage, tax expenses, age, and size (Magerakis, 2015). Consistent with previous findings, cash holdings are decreasing with the firm's size and debt ratio, and increasing with its profitability, growth prospects, and dividend payout ratio (Nguyen, 2005). The evidence provides strong support for the hypotheses that growth options, size and cash flows of firms exert a positive impact on firm's cash holding decisions (Ozkan & Ozkan, 2004). There is a significant positive impact of cash flow, leverage, ROA and investment opportunity and negative impact of net working capital on the cash holdings except for the growth opportunity and firm size that have insignificant positive impact on cash holdings (Ogundipe, Ogundipe, & Ajao, 2012).

In Indonesia, similar researches are also conducted. Jinkar (2013) conducted research to analyze the factors that determine cash holdings in Indonesian manufacturing firms for the period of 2007 – 2011. Jinkar (2013) research found that growth opportunity, net working capital, leverage, and dividend payment are significantly affect cash holdings. Jinkar (2013) also found that there is no significant relationship of firm size, capital expenditures, and cash flow to cash holdings. Pranowo (2015) found that there is significant positive relationship of growth opportunity, leverage, net working capital, and cash flow from operation, independent board director, and board director size to cash holdings. There is also significant negative effect of dividend payment to cash holdings in Indonesian non-financial firms for the period 2011-2013 (Pranowo, 2015). Based on multiple regression analysis, it showed that the growth opportunity and net working capital have significant positive effect on cash holdings, while the cash conversion cycle and leverage have significant negative effect on cash holding company (Zulhilmi, 2015).

Those all researches relate to the determinant of cash holdings give various results. One research might found the same result with another, but it also can generate different finding. The period of study can influence the results of study. The results also can be different because the object of the result is not same. Suppose the study in manufacturing firms will not give the same result if the study is conducted in service firms. The cash holdings policy in one country also can be different in other country. The different results that found by the prior researchers become one of the motives for

conducting this research. Finding the factors that influence the cash holdings determinant in Indonesia especially in manufacturing industry for period 2006 until 2014 will give additional empirical evidence for the similar research.

In prior researches, there are many variables that are tested for the effect to cash holdings. This research cannot test all variables that are ever used to be determinant of cash holdings. This research just take some common variables that are usually be tested for cash holdings determinant which are firm size, net working capital, dividend payment, growth opportunity, and cash from operations. Later on, dividend payment will be represented by dividend dummy and growth opportunity represented by sales growth. There is one additional variable which is firm age that rarely to be used for the determinant of cash holdings. Firm age is ever proven by some researchers having significant effect to cash holdings. In Indonesia, there is no researchers yet analyze the relationship of firm age to cash holdings.

1.2. Problem Statement

Analyzing the factors that can influence the determinant of cash holdings can give the explanation why every firm has different policy relate to its cash level or cash holdings. Firm size, net working capital, dividend payment, sales growth, cash flow from operations and firm age are the independent variables that will be tested to dependent variable which is cash holdings. Based on static trade off theory, firm size, net working capital, dividend payment, cash from operations and firm age will negatively affect

cash holdings. Pecking order theory predicts that there is positive relationship of firm size, firm age, sales growth, dividend payment, and cash flow from operations to cash holdings. Free cash flow theory predicts that firm size will positively affect cash holdings and sales growth will negatively affect firm's cash holdings. Supporting by previous researches, firm size, net working capital, dividend payment, sales growth, cash from operations and firm age will affect firm's cash holdings. This research will find the factors that determine cash holdings and analysis the effect of those factors to cash holdings. Therefore, the research questions in this research are formulated as:

1. Does firm size affect firm's cash holdings?

2. Does net working capital affect firm's cash holdings?

3. Does dividend payment affect firm's cash holdings?

4. Does sales growth affect firm's cash holdings?

5. Does cash from operations affect firm's cash holdings?

6. Does firm age affect firm's cash holdings?

1.3. Research Objectives

This research will give the empirical evidences that:

1. Firm size affects firm's cash holdings.

2. Net working capital affects firm's cash holdings.

3. Dividend payment affects firm's cash holdings.

4. Sales growth affects firm's cash holdings.

5. Cash from operations affects firm's cash holdings.

6. Firm age affects firm's cash holdings.

1.4. Contribution of Research

This research is expected to giving contributions for:

1. Theoretical development

This research can be used as additional literature for analyzing the factors that influence cash holdings determinant. Future researchers can use this research for reference in conducting the similar research.

2. Practitioners

By knowing the factors that influence the determinant of cash holdings, the firms' managers can be more careful in determining the level of cash. The decisions related to cash holdings determinant might influence the liquidity ratio of firms. This research will give information, understanding, and knowledge for investors about the determinants of cash holdings.

1.5. Data Analysis

In conducting this research, some steps are performed to find the reliable result. The steps are:

1. Data Collection

In collecting the data, secondary data are used. This research collects the data by downloading financial statements, financial reports, and performance reports from www.idx.co.id. The branch of Indonesian Stock Exchange office (Kantor Bursa Efek Indonesia) at

Mangkubumi Street 111, Yogyakarta also gives additional data for the research.

2. Filtering The Samples

This research chooses Indonesian manufacturing firms as samples. After collecting the data of Indonesian manufacturing firms, the firms will be filtered by some established criteria.

3. Measuring The Variables

This research contains two types of variables which are independent and dependent variables. The dependent variable is cash holdings measured by cash and cash equivalents divided by total assets minus cash and cash equivalents. Independent variables are measured as follows:

    a. Firm size

    Firm size is measured as natural log of total assets.

    b. Net working capital

$$NWC = \frac{Net\ Current\ Assets - Cash\&CashEquivalent}{Total\ Assets - Cash\&Cash\ Equivalent}$$

    c. Dividend payment

    Dividend payment is represented by dividend dummy. Dummy variable for firms that currently pay dividend is equal to 1 and 0 for firms that do not pay dividend.

    d. Sales growth

$$Sales\ Growth = \frac{Current\ Net\ Sales - Prior\ Year\ Net\ Sales}{Prior\ Year\ Net\ Sales}$$

e. Cash from operations

$$CFO = \frac{Cash\ Flow\ From\ Operation}{Total\ Assets - Cash\&Cash\ Equivalents}$$

f. Firm age

Firm age = Ln (Fiscal Year – (Year included in idx + 1))

4. Classical Assumption Tests

These tests are normality test which is Kolmogorov-Smirnov test, autocorrelation, heteroscedasticity, and multicollinearity test in SPSS software. The data should be normal and free from autocorrelation, heteroscedasticity, and multicollinearity. After classical assumption tests are performed, multiple regression analysis can be conducted.

5. Multiple Regression Analysis

This test is performed to answer research questions and find the empirical evidences of cash holdings determinants.

6. Making Conclusion

After doing multiple regression analysis, the interpretation and conclusion can be formulated.

1.6. Writing Structure

This paper is organized as follows:

CHAPTER I   INTRODUCTION

Chapter I will contain background, problem statement, research objectives, contribution of research,

data analysis, and writing structure of conducting and formulating this research.

CHAPTER II   LITERATURE REVIEWS AND HYPOTHESIS DEVELOPMENT

This chapter will show the theoretical background or the foundation literatures and previous researches that study the determinant of cash holdings. This chapter also explains the process of hypothesis formulations.

CHAPTER III   RESEARCH METHODOLOGY

This chapter shows the research design in conducting this research.

CHAPTER IV   DATA ANALYSIS AND DISCUSSION

In this chapter, several tests are conducted to find the empirical evidence of cash holdings determination.

CHAPTER V   CONCLUSION

After the research is done, this chapter will give the conclusion and it also presents the limitation in conducting the research and suggestion for the future researchers.