

CHAPTER I

INTRODUCTION

1.1 BACKGROUND OF STUDY

Agricultural industry is an interconnected activity in the production, processing, transportation, storage, funding, marketing and distribution of agricultural products. Agricultural industry includes activities that utilize agricultural products such as raw materials, design and provide equipment and services for these activities. Explicitly the notion of Agroindustry was first expressed by Austin (1981), which is a company that processes vegetable (plant-derived) or animal-based (animal-produced) ingredients.

In Indonesia most of the agricultural industry listed in Indonesia play a big role in palm oil industry. Moreover, the agricultural industry plays a major role in contributing to global vegetable oil production. According to Mielke (2017), vegetable oil extracted from palm oil is the most efficient vegetable oil since 16 million hectare of palm oil could produce 4 tons of vegetable oil per hectare which is higher than the vegetable oil extracted from the rapeseed.

Financing decision is a decision that is made by the company in order to finance either their operational or non-operational activities. Financing decision could be categorized in two primary categories which is internal or external financing activity. Internal financing refers to the ability of the company to generate fund for the company's interest. On the other hand, external financing focus on obtaining additional fund from the third party such as creditor. Moreover, the shareholder entrusts the financing decision to the manager that is believed to be act on the behalf of the shareholder. However, in practice, the manager tends to make decision for the welfare of themselves. One of the decisions is regarding the debt financing.

Debt financing is a decision made when the company plans to borrow additional fund for operating, development, and investing activities.

Nowadays, company can easily acquire debt financing since there are many options of the debt to facility made available by the creditors. Moreover, the nature of debt itself have limited time and cost less than internal financing which make this option sounds more promising. On the other hand, the use of debt financing could harm the shareholder since debt financing cause the company to be exposed with the risk of bankruptcy. As a result, the use of debt financing could cause agency problem between shareholder and manager. When manager exercise more on debt financing, shareholder will secure their investment through participating in high risk project which will increase the risk of the creditor in collecting the debt that they have provided to the company.

Profitability is a factor that is considered in determining the company's capital structure. This is because companies that have high profitability tend to use relatively small debt because high retained earnings are sufficient to finance most of the funding needs, if the funding needs are not sufficient, the company can use debt as an alternative external funding. The higher the profit the company gets, the smaller the debt usage within the company. According to Yetty (2016), company with high profitability have the tendency to use less debt financing since the company will have the chance to utilize the internal fund generated from the company profit for financing the operational activities.

Free cash flow is the cash flow that is truly available to be paid to all investors (shareholders and debt owners) after the company puts all of its investment in fixed assets, new products and working capital needed to maintain ongoing operations. It can be concluded that free cash flow is the cash flow available to be distributed to all investors (shareholders and debt owners) after the company has placed all of its investment and also needed to sustain its business, and as a tool for measure the company's ability to engage in long-term investment opportunities provided by operating activities. Moreover, free cash flow adds a far greater advantage to the company itself. Ifada and Yunandriatna (2017) stated that company with

considerable amount of free cash flow has more advantages compare to the company that has no free cash flow.

The Asset Structure is the property owned by the company used for its operations. In general, there are two types of assets owned by the company, namely current and fixed assets, where one account of the asset structure is that assets can still be considered as collateral by creditors in giving loans. The amount of fixed assets of a company can determine the amount of debt usage. Companies that have large amounts of fixed assets can use large amounts of debt because these assets can be used as collateral for loans. Moreover, Anam, Ernayani and Dewi (2015) stated that asset structure is highly related to company assets that can be guaranteed that is more flexible will tend to use debt more than companies whose asset structure is not flexible.

Ownership concentration is shareholders with the greatest share portion who have power to control the managers to make a decision. The large shareholders hold a sizable fraction of all voting shares in publicly held corporations. Shareholders, who control the firm, are expected to choose the investment and financial decision to maximize their own wealth by shifting their business risk to the debt holders.

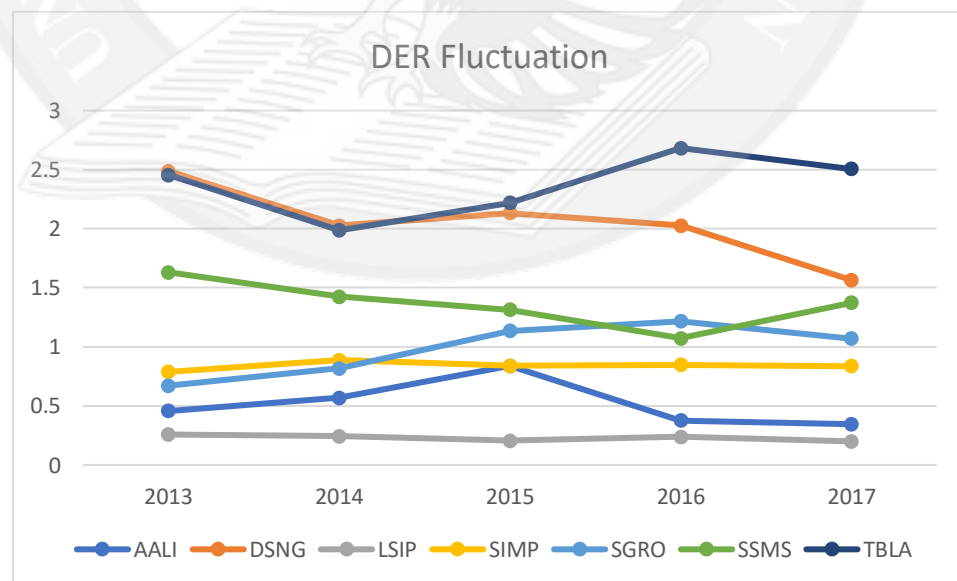


Figure 1.1 DER Fluctuation

Source: Data processed by the writer (2019)

The graph above shows the average of the conditions of the companies' debt policy through the debt of the agriculture sector experience various conditions where each company has a different condition. This causes price fluctuations and in the appearance of published financial statements there appears to be a company profit company that experiences sharp fluctuations, the cause of the problem is a sharp increase in the decision on funding corporate debt due to lack of resources to finance its business, this assumes that the company will use funds external to its operational financing, therefore there is a significant increase in capital structure, and conversely a significant decrease in the company in the table above assumes that the company has sufficient profit so that the company does not require the use of debt (external) in financing its operational activities. With this and based on previous studies, the researcher is encouraged to conduct research on factors that can affect the company in determining long-term debt policy. Given that funding decisions are an important decision that will directly determine the company to continue to grow.

Moreover, several researches have been conducted about the debt policy, but few have the same conclusion about which elements has a significant impact on the debt policy. This is resulted from the object research taken has different focus and the variable that is taken into account are different.

This research is the aggregation of previous research with the differences that are taken into account are the object of the research. The object that is used in prior research is the manufacturing sector while the focus of this research is on the agriculture listed company as an input from prior research which recommended the use of difference industry sector in order to witness whether changes in the research object will result in difference conclusion. Agriculture company have several factors that suitable for this research since it consists of different types of long term and

short-term asset. Moreover, this industry is categorized as a growing industry which enabled the researcher to observe several variable concisely.

Based on the background explained above related with factors that will affect the debt policy, research with the title of **“The Impact of Profitability, Free Cash Flow, Asset Structure and Ownership Concentration Towards Debt Policy in Indonesia (Agriculture Company Listed in Indonesia Stock Exchange)”** will be conducted.

1.2 PROBLEM LIMITATION

From the background of the study that has been described in the previous section, there are some limitations to the study that is conducted such as

1. The research is limited to the public listed agriculture company in Indonesia.
2. The company is listed from year 2013 until 2017.
3. The company has not been delisted during the past 5 years since the research is conducted.

1.3 PROBLEM FORMULATION

In this research, based on the definition above there are several issues that need to be formulated such as

1. Does profitability partially have significant impact towards debt policy?
2. Does free cash flow partially have significant impact towards debt policy?
3. Does asset structure partially have significant impact towards debt policy?
4. Does ownership concentration partially have significant impact towards debt policy?
5. Do free cash flow, ownership concentration, profitability and asset structure simultaneously have significant impact towards debt policy?

1.4 OBJECTIVE OF THE RESEARCH

Based on the Problem formulation, the objective of this research is

1. To analyze the partial impact of profitability towards debt policy in agriculture company that is listed in IDX 2013 – 2017
2. To analyze the partial impact of free cash flow towards debt policy in agriculture company that is listed in IDX 2013 – 2017.
3. To analyze the partial impact of asset structure towards debt policy in agriculture company that is listed in IDX 2013 – 2017
4. To analyze the partial impact of ownership concentration towards debt policy in agriculture company that is listed in IDX 2013 – 2017
5. To analyze the simultaneous impact of free cash flow, ownership concentration, profitability and Asset Structure towards debt policy in agriculture company that is listed in IDX 2013 – 2017

1.5 BENEFIT OF THE RESEARCH

Benefits that can be obtained from this research are:

1. Theoretical Benefit

This research is expected to be useful as a source of information and references to enable further research on topics that are related to be conducted, whether it is continuing or complementary.

2. Practical Benefit

a. For the Company

This research is expected to contribute information to the management of the company in determining debt policies, especially concerning finance and other policies based on financial ratios.

b. For Investors

This research is expected to be used as contribute information for investors to make decisions in determining their investment.

c. For Researcher

Aid the researcher to increase insight and knowledge that has been obtained on this research especially about correlation between debt policy along with other parameters.

1.6 SYSTEM OF WRITING

To simplify the writing of this *Skripsi*, a system of writing is arranged which consists of five chapters with the following details:

Chapter I : Introduction

This chapter consists of background, problem limitation, problem formulation, objective of the research, benefit of the research, and systems of writing.

Chapter II : Literature Review and Hypothesis Development

This chapter briefly describes the theoretical background include the discussion of understanding about theory of performance measurement in calculating financial ratios. Besides that, this chapter also consists of previous research, hypothesis development, research model and framework of thinking.

Chapter III : Research Methodology

In this chapter, there are research design, population and sample, data collection method, operational variable definition and variable measurement, and data analysis method.

Chapter IV : Data Analysis and Discussion

In this chapter, the result of the research is presented in the form of the implication and relationship between profitability, free cash flow, asset structure, and ownership concentrations towards debt policy in Indonesia agriculture company listed in Indonesia stock exchange and the analysis result.

Chapter V : Conclusion

This chapter will conclude the problem formulation based on the analysis that have been done, implication, and recommendation.