CHAPTER I
INTRODUCTION

1.1 Background of the Study

The development of business is growing rapidly. Many companies begin to compete in order to maintain their business by taking into account risk and associated time in order to get more profit. Companies should pay special attention to their use of fund. The provision of fund may come from internal source which is retained earnings. And the external source is debt financing and equity (Sojeva, 2015).

According to Schroeder, Clark, and Cathey (2014, p. 231), “The equity is the ownership interest. Equity in a business enterprise stems from ownership rights”. Actually company can meet its funding needs by prioritizing the source that comes from within, but when start up business company need to fulfill their equipment, inventory, and payroll of course investor will help using capital. It means that company has to sacrifice future profit by using indefinitely to fulfill short term needs.

According to Plummer et al., (2016) that quoted by Omoshagba T.p & Zubairu (2018, p. 35), “Funding through debts proves to be critical to business success”. Although debt financing is charged with interest it is much better because it is temporary and capped. When company pays it back, equity remains intact. Moreover, according to the cost of debt interest reduces taxable profit, and automatically reduces tax expenses.

Debt financing is referred to leverage because company borrows against futures earnings of the business. When debt is too high, it will become difficult to company to balance its expenses and payment of debt and that matter will lead to financial distress. According to Xu Lixin (p. 44): Disadvantage of debt financing is financial risk. After the need for regular business borrowing to pay interest on the cash flow will produce a lot of pressure, when the debt expired, a one-time payment of principal, which requires companies with cash flow. Once the poor business or not raise the necessary cash would be in financial difficulty, or even lead to bankruptcy (interest fixed, the principal focus on payments).

It is also reflected to the reinvestment in new business, when company grows through research, product or service development and business expansion to attract customers. High leverage will become obstacle for company to do that kind of activities.

Debt financing can be linked to firm value, because it is about how much company uses debt. The higher proportion of debt, the higher the share price of the company and it reflects to shareholder's wealth. However, debt financing should be well managed since too high can reduce the value of company. The most appropriate way to measures firm value is by using valuation ratio since it directly related to the goal of maximizing the firm value and shareholder wealth, valuation ratio consist of price earnings ratio, cash flow ratio and price to book value ratio.

The size of the company directly reflects high or low operating activities of a company. Generally the larger the company the greater the activity. So company size can be linked to the company's wealth (Anam, Ernayani , & Dwi , 2014). A company can be admitted as a big company, if it is wealthy and vice versa. It can be seen from the table below that firm size is considered capable to measure firm value because the larger the company size, the easier for company to obtain source of funding (Hery, 2017) which that fund will be managed to increase firm value and can be seen from the table below.

Table 1.1 Data of Debt, Firm Value and Firm Size of some basic industry companies listed on IDX in 2015-2017

CODE	Debt			Firm Value			Firm Size		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
JPFA	1.81	1.05	1.15	1.11	1.7	1.51	30.47	30.59	30.68
KDSI	2.11	1.72	1.74	0.20	0.34	0.46	27.79	27.76	27.91

Source: Prepared by the Writer

Table 1.1 shows the data ratio of debt, firm value and firm size. JPFA and KDSI are the companies engaged in basic industry and chemical. It is very clear that the ratio of both company experiences fluctuation every year. It can be seen from the table 1.1 that JPFA company is larger than KDSI company. The size of company owned by JPFA is increasing from 2015 until 2017. While for KDSI it has fluctuation in which the size of the company slightly decreases but in 2017 is increasing. Debts used by JPFA and KDSI in 2016 decrease, hence the company value is increasing. While in 2017 debt used by both company is increasing that shows the firm value of JPFA in 2017 decrease but firm value of KDSI increase. As a result, this means that there is an inconsistency happening between debt and firm value and moderated by firm size.

From the previous research conducted by Xu Lixin and Chen Lin (2017) concluded that type of debt selected has positive impact on firm value. The results indicate that firms that use corporate bonds more frequently than bank loans have a higher value. Research conducted by Setiadharma & Machali (2017) shows that there is no direct effect of firm size on firm value. In addition, research from Antwi , Mills, & Zhao (2012) stated that capital structure is relevant to a value of the firm. Nevertheless, research conducted from Purwohandoko, (2017) firm size has no effect on capital structure.

Based on the phenomenon and inconsistency result that has been disclosed in this research, the researcher is interested to conduct research by looking at **"EFFECT OF DEBT ON FIRM VALUE WITH COMPANY SIZE AS A MODERATING VARIABLE (Study on Basic Industry and Chemical Manufacturing Companies Listed on Indonesia Stock Exchange period 2015-2017)"**

1.2 Problem Limitation

The issues studied in this research are limited to the effect of debt on firm value with company size as a moderating variable in basic industry and chemical manufacturing companies listed on Indonesia Stock Exchange Period 2015-2017

1.3 Problem Formulation

1. Does debt affect the value of basic industry and chemical manufacturing companies listed on Indonesia Stock exchange period 2015-2017?
2. Does the firm size moderate the effect of debt toward firm value on basic industry and chemical manufacturing companies listed on Indonesia Stock Exchange period 2015-2017?

1.4 Objective of the Research

1. To know the effect of debt toward the firm value of basic industry and chemical manufacturing companies listed on Indonesia Stock Exchange period 2015-2017.

2. To know the effect of debt on firm value after moderated by the firm size of basic industry and chemical manufacturing companies which listed on Indonesia Stock Exchange period 2015-2017.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

The benefit that expected from this research is to enlarge the knowledge of the readers and as a reference for future research associated with the effect of debt on firm value.

1.5.2 Practical Benefit

This research is expected to give additional information and consideration for investor to take important decision in investing fund for manufacturing company. Then it is useful for issuer to make decision for funding optimal capital structure in order to maximize firm value.

1.6 System of Writing

The systems of writing in this research will be;

Chapter I: Introduction

Consist of the background of the study, problem limitation, problem formulation, objective of the research, benefit of the research and system of writing. The section of background of the study discusses the problem and the reason for the research, also the phenomenon regarding the object of the study and inconsistency result of previous research. The objective of the research outlined the purpose of the research which is expected to be achieved.

The benefit of research outlined the uses of the research for related parties. The system of writing outlined the process of each chapter.

Chapter II: Literature Review and Hypothesis Development

Consist of theoretical basis which contains grand theories such as: pecking order theory and trade off theory. These theories also become the basis in formulating hypothesis and assist in the research results. Prior research is research conducted by previous authors regarding to the topic interest. Hypothesis development is the statement made and concluded from literature reviews and to answer the research problem. This chapter also contains research model and theoretical framework.

Chapter III: Research Methodology

Consist of quantitative design of the study, population and sample, data collection method, operational variable definition and variable measurement, and the method of analysis shows how the description of the analysis model used in the research.

Chapter IV: Data Analysis and Discussion

Consist of the result of the research and also the discussion of the findings. The contents of this chapter are the general view of research object which contains a brief description of the object of the study includes the vision, mission and operational goals. The data analysis contains descriptive statistic, result of data quality testing and result of hypothesis testing.

The last part is discussion which assesses the effect of debt and moderating variable of company size towards firm value.

Chapter V: Conclusion

The last chapters summarize the effect of debt and moderating variable of firm size towards firm value and its implication for future studies. This chapter also provides sections of recommendation.