CHAPTER I
INTRODUCTION

1.1 BACKGROUND OF THE STUDY

In some circumstances, when a company's plan for either expansion or acquiring an asset is hindered by insufficient income or reserves, this indicates that the company is experiencing financial constraint. According to Farre-Mensa and Ljungqvist (2016), financial constraint can be a measure of the firm's financial condition or the firm's balance sheet condition such as firm cash flow, leverage and size. Hence, conditions that suggest a firm is financially constrained include low liquidity, low capital and high default risk (inability to pay debt obligations) (Lerskullawat, 2018). In the event of a financial constraint, external financing is another solution. Sources of external financing a company can obtain comes in various forms – equity capital, preferred stock, debentures, term loans, venture capital, hire purchase, trade credit and leasing (Borad, 2018).

A lease occurs when a lessor, the property owner, rents his or her property to a lessee, the user of the property, and, in return, the lessee will make regular payments for a specific time period to the lessor. The amount to be paid to the lessor and the duration of the lease, either in months or years, is commonly specified and written on an agreement known as a lease agreement (Kieso, Weygandt and Warfield, 2014). Lease financing is further categorized into two types, finance lease and operating lease. In a finance lease, the lessee will gain ownership of the asset leased after making the full payment stated in the lease agreement and therefore the lessor no longer bears the risk of the asset. On the other hand, the lessee in an operating lease agreement is not entitled any ownership of the asset, thus the lessor will bear the risk of the asset leased (Borad, 2018).

Companies take leasing because it is a method to acquire assets which can generate cash inflows or profits for them, whereby increasing profits is an indicator of growth. Moreover, an advantage of leasing is its off-balance-sheet financing, which is the other underlying reason why companies take leasing. Managers can avoid reporting debt on the balance sheet to undervalue debt-related financial ratios such as debt utilization ratios, maximize their profits or their companies' profits, reflect a good financial performance and eventually attract prospective investors.

Slotty's (2009) research on "Financial Constraints and the Decision to Lease – Evidence from German SME" showed that firms with financial constraint, smaller asset value (firm size) and high company growth rate have a larger tendency to opt for leasing (operating and financing) as a source of external financing. In other words, financial constraint has an influence on leasing. However, a journal on "Capitalization of Operating Lease and Its Impact on Firm's Financial Ratios" (Nuryani, Heng and Juliesta, 2015) suggested otherwise. Results of the research concluded that operating lease is unaffected by financial constraint. Hence, there is still no absolute certainty as to whether financial constraint has an impact on leasing.

The following table further shows that companies with high financial constraint and most of those with low financial constraints take operating lease, opposing Slotty's (2009) finding that firms with financial constraint have a larger tendency to opt for leasing.

Table 1.1 Data of Financial Constraint from Several Companies taking Operating Lease for the period 2015-2017

Code	Financial Constraint		
	2015	2016	2017
UNVR	-11.93627963	-11.94659389	-12.03612339
TRIO	-1.91815149	-4.97903910	11.25334193
BUVA	-9.81249695	-9.96103476	-10.21792163
MDIA	-10.24458775	-10.34479001	-10.11721577
MFMI	-9.41249879	-9.47956862	-9.52039208

Source: Prepared by the writer (2019)

Based on the phenomenon and the aforementioned issue, the writer decides to carry out the research study entitled “The Impact of Financial Constraint, Asset Value and Company Growth on the Operating Lease Decision: Evidence from Indonesia Stock Exchange for the Period 2015 to 2017” to identify, determine and explain whether a relationship (as a whole and respectively) among financial constraint, asset value, company growth and the operating lease decision exist.

This research paper will be conducted on 421 non-financial companies in Indonesia listed on the 2015 Indonesia Stock Exchange (IDX) from 2015 to 2017 as leasing activities occur more frequently in this sector. Non-financial companies apply to companies which are not engaged in financial services, such as agriculture, mining, basic industry and chemicals, miscellaneous industry, consumer goods industry, property, real estate and building construction, infrastructure, utilities and transportation, and trade, services and investment. Furthermore, this paper replicates Nuryani’s three independent variables to be tested and constructs a similar hypothesis model to Nuryani’s, however, the time period which this research will be conducted differs from Nuryani’s (2008-2011).

1.2 PROBLEM LIMITATION

The scope of this research paper is limited to:

1. The assessment of the relationship between three factors (financial constraint, asset value and company growth) and the operating lease decision, to determine whether each factor affects the operating lease decision.
2. A research sample of Indonesian non-financial publicly listed companies that issued audited, complete financial statements in Rupiah currency during 2015-2017 and take operating lease will be analyzed.
3. A research period between 2015 and 2017.

1.3 PROBLEM FORMULATION

Based on the aforementioned research background, the problems of this research paper are as follows:

1. Is there a significant, simultaneous relationship between financial constraint, asset value, company growth and the operating lease decision?
2. Is there a significant, partial relationship between financial constraint and the operating lease decision?
3. Is there a significant, partial relationship between asset value and the operating lease decision?
4. Is there a significant, partial relationship between company growth and the operating lease decision?

1.4 OBJECTIVES OF THE RESEARCH

The objectives of the research are:

1. To assess and provide empirical evidence on the relationship between financial constraint, asset value, company growth and the operating lease decision.
2. To assess and provide empirical evidence on the relationship between financial constraint and the operating lease decision.
3. To assess and provide empirical evidence on the relationship between asset value and the operating lease decision.
4. To assess and provide empirical evidence on the relationship between company growth and the operating lease decision.

1.5 BENEFIT OF THE RESEARCH

1.5.1 THEORETICAL BENEFIT

Based on the aforementioned objectives and the results to be achieved, the research findings intend to explain the empirical relationship between the independent variables – financial constraint, asset value and company growth – and the dependent variable, the operating lease decision. These empirical statements will then prove whether they are consistent with the results of previous researches and provide supporting reasons in the event that the results lead to inconsistency of conclusion. Specifically, this research will conclude whether financial constraint influences the operating lease decision. These conclusions will thereby provide the basis for future researches on theory of economic determinants of leasing.

1.5.2 PRACTICAL BENEFIT

In practice, firms may have to evaluate whether operating lease should be taken as a means of resolving financial constraint, acquiring assets or expanding its size. With the results concluded in this research, firms may be able to identify and categorize their current condition into the economic determinants of leasing and therefore decide on whether to undertake operating lease activity.

1.6 SYSTEMS OF WRITING

The paper consists of six sections, with chapter 1 being the introduction. This chapter outlines the background of the study, states the problem limitation, formulates the problem, sets the objectives of the research, describes the benefits of the research and systems of writing.

Chapter 2 focuses on the literature review. It comprises of fundamental theories and background information underlying the problems which will be discussed in the paper as well as the overview of previous journals, along with the hypotheses, research model and framework of this research paper. There are five sub-sections: the theoretical background of pecking order theory, financial constraint, asset value, company growth and lease financing (finance and operating lease), the previous researches, the hypothesis development, the research model and framework of thinking.

Chapter 3 explains in detail about the data used for analysis. This section describes the setting of the research to be conducted, introduces the companies selected as sample, explains how they are selected and analyzed and presents the independent and dependent variables to be tested as well as the quantitative methods of analyzing data.

Chapter 4 initially gives a general view of all the companies listed in the 2015 Indonesia Stock Exchange, presents the data results and subsequently makes an analysis of the data. The first section of the data analysis is analyzing the descriptive statistics of the sample. Afterwards, the association between economic determinants of leasing (financial constraint, asset value and company growth) and the operating lease decision will be analyzed and discussed.

Chapter 5 concludes the research paper along with the results' implications and recommendation.