

CASH FLOW, DEBT ISSUANCE, EQUITY ISSUANCE, AND FIXED ASSET INVESTMENT ON MANUFACTURE COMPANY 2010-2014

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ABSTRACT

Matters about financing decision based on pecking order theory's hierarchy are currently appealing. This research strives to discover how corporate's fixed asset investment reacts to cash flow, debt issuance, and equity issuance. Researcher uses 75 samples of manufacturing company in Indonesia during 2010-2014 period with 199 firm-year observation. Multiple linear regression's result indicates that cash flow and debt issuance have influence towards corporate's fixed asset investment, but the equity issuance have no influence towards corporate's fixed asset investment. Also regression coefficient exhibits that manufacturing company in Indonesia follows pecking order theory's hierarchy. Cash flow's influence towards fixed asset investment is more significant than debt issuance's, and debt issuance's influence is stronger than equity issuance. This points out that corporate's fixed asset investment is more sensitive towards cash flow (internal fund) compared to debt issuance (external fund), and so is debt issuance is more sensitive compared to equity issuance. With all that in mind, it is concluded that manufacturing company in Indonesia follows pecking order theory in terms of financing decision, which uses internal fund at first then started to use external fund if deemed necessary.

Keyword : Investing decision, Financing decision, pecking order theory

INTRODUCTION

Today the business competition faced by companies is getting tougher, includes in Indonesia. The increasing number of new companies from day to day makes competition in the business world in Indonesia become tighter. Companies engaged in services, manufacturing and trade compete with each other to be able to survive and become the best. The company is an important axis in developing Indonesia's economic system. Every company is required to manage its management functions properly so that a company that grows and develops can have a positive impact on the Indonesian economy. This encourages each company to make various innovations and business strategies to avoid bankruptcy.

Business development in companies is a way to overcome intense competition, which is carried out by the company. The effort is a separate problem for the company, because it involves the fulfillment of funds needed to finance the company's operational activities or the company's business development. Funding decisions relate to alternative funding made by companies (Brown et al., 2009).

Funding decisions are activities related to the process of selecting the source of funds used to finance planned investments with various alternative sources of funds available, so that a combination of expenditure is most effective (Sudana, 2011: 6). The company needs a source of funding in carrying out its business activities to fund investment. Companies in developing their business need the right policies or decisions in financing. Companies can use funds from internal sources which are the main priority in investment funding, and funds from external sources. If the need for funds from internal companies is not sufficient to meet the needs of company funds, then the company needs funds from outside the company both from debt and by issuing new shares in meeting their funding needs. Corporate funding is closely related to the selection and combination of sources of funds that originate from within (internal) or from outside (external) (Brealey et al., 2008). The form of an ideal composition of funding, whether through shares, short-term debt, or long-term debt, will reduce capital costs and maximize profits. Based on this, knowing the ins and outs of corporate funding decisions is very important for a manager. The decision to determine capital structure funding will determine the company in carrying out its operating activities which will affect the value of the company.

In this study refers to funding decisions based on the pecking order theory hierarchy, funding hierarchy in a company is one of the main topics in corporate financial research. Pecking order theory put forward by Myers and Majluf (1984) argues that the information asymmetry between managers and investors raises the ranking preference among financing sources. As a result, companies prefer internal financing over external financing (that is, the first hierarchy of pecking orders) and, if external funding is used, they prefer debt to equity (ie, the second hierarchy of pecking orders). A manager will do internal funding first (internal financing), then when there is a financial deficit a manager will first choose external funding with low funding costs (low-cost external financing), and the last alternative is to choose external funding with high costs (high -cost external financing).

At the level of the first funding hierarchy the company will use internal funds rather than external funds to fund its investment activities, cash flow is a source of internal funding used in this study. If a company experiences financial financial constraints, the investment in its fixed assets will be sensitive to the availability of internal funds Fazzari et al., (1988). This happens because of the asymmetry of information between external and internal parties of the company. In conditions of limited external funding sources, the company relies on the use of its own funds from cash flow receipts from the company's operations.

The second hierarchy in pecking order theory is that when cash flow is no longer able to meet the company's investment activities, the company will use external funding sources in the form of debt and equity. Debt to the company consists of two types, namely current debt and long-term debt that originates from banks and debt to other parties such as debt obligations, in taking debt policy, financial managers must consider the benefits and costs of using debt to its capital structure. The company will publish equity in the form of shares when funding investment using debt is no longer sufficient, but

with the information asymmetry, investors will usually interpret this as bad news (bad news) if the company makes a financing decision by issuing equity so that if there is a lack of corporate cash, then the company will choose to issue the safest security first in this case is debt and if it still requires a fee then issue equity as a last resort. The company will use external funds in the form of debt and equity as the last alternative in the pecking order hierarchy because the cost of long-term debt issuance is cheaper than the cost of issuing shares.

Chay et al., (2015) suggested the hierarchy of pecking order theory that cash flow has a greater sensitivity compared to external funding of corporate investment and the second hierarchy shows that the addition of debt has a greater sensitivity than the addition of equity to investment.

This research is different from other pecking order studies such as Shyam Sunder and Myers (1999) and Frank and Goyal (2003) who use financing deficit as a measurement of pecking order theory, in this study using sensitivity to fixed asset investment as a measurement of the hierarchy of pecking order theory, pecking order theory research using this method is rarely done in Indonesia, therefore researchers are interested in doing this research.

Based on the background description above, the formulation of the problem of this research is as follows :

1. Does cash flow have a positive effect on investment?
2. Does the addition of debt have a positive effect on investment?
3. Does adding equity have a positive effect on investment?

LITERATURE REVIEW

1. Financing Decision

Sudana (2011: 6) states that, "the funding decision is related to the process of selecting the source of funds used to finance planned investments with various alternative sources of funds available, so that the most effective combination of expenditure is obtained"

2. Pecking Order Theory

Pecking order theory is one of the theories that underlies corporate funding decisions. Myers (1984) put forward an argument about the tendency of a company to determine the selection of funding sources based on pecking order theory. Myers (1984) argues that funding decisions based on the pecking order theory put forward in 1961 follow the funding sequence as follows:

- a. Companies prefer funding from internal sources.
- b. The company adjusts the dividend payment target to investment opportunities.
- c. If external funds are needed, the company will choose the source of funds from debt because it is considered safer than adding new equity as a last resort as a source to meet investment needs.

In the pecking order theory, it is stated that company managers will choose internal funding first from retained earnings and then choose external funding sources, external funding sources are chosen, starting from the safest debt, to common stock until the last choice, this is done because of the asymmetric information which ultimately leads to adverse selection, from internal retained earnings, and then very safe debt as external funding to common stock, sequentially having

asymmetric information problems from the lowest to the highest. The asymmetric information referred to here is the imbalance of information between managers and outside investors. The company manager is assumed to have more information about profits, investment opportunities or financial condition of the company than outside investors, in this theory it is also assumed that every manager's action is taken to maximize profits for existing shareholders.

Pecking order theory is one theory that bases on information asymmetry. Information asymmetry will affect the company's capital structure by limiting access to external funding sources. Myers and Majluf (1984) show that with information asymmetry, investors will usually interpret it as bad news if the company funds its investment by issuing equity.

Investors assume that the addition of new equity is done by managers if the company's shares are valued higher. Baskin (1989) and Myers (1984) suggested that the notification of the addition of new equities caused the value of the company reflected in the stock price to fall.

Pecking order behavior, in addition to being influenced by information asymmetry, also tends to be driven by taxes and transaction costs. There are several reasons why the direct costs of retained earnings will be smaller than adding new equity. The first reason is the existence of substantial savings in banker fees. The second reason is that companies can reduce dividends that can be taxed at this time by limiting the addition of securities. In this case, by setting the amount of debt and investment to remain constant, an increase in the addition of equity will always lead to greater dividends. A larger dividend will further increase the burden of personal taxes. Therefore it would be reasonable if the company tried to suppress the addition of new equity. In addition, costs are generally lower if the company issues debt rather than issuing new shares. Companies in issuing external securities will prefer debt over shares to reduce the various costs arising from the choice between debt and stock, Brigham (1999).

3. Investment Decision

Horne (1998: 6) revealed that investment policy is the most important policy because investment policy has a direct influence on the amount of profitability and cash flow of the company in the future.

4. Effect of Cash flow on Fixed Asset Investment

Cash flow has a significant positive effect on investment in fixed assets of the company. This shows that the fixed assets investment of manufacturing companies in Indonesia is sensitive to their cash flow, in other words that manufacturing companies in Indonesia are in accordance with pecking order theory, where companies will take priority over the availability of internal funds in funding their investments. If a company experiences financial financial constraints, the investment in its fixed assets will be sensitive to the availability of internal funds. This happens because of the asymmetry of information between external and internal parties of the company. In this context is the management of the company.

In conditions of limited external funding sources, the company relies on the use of its own funds from cash flow receipts from the company's operations. In line with the research of Chay et al., (2015) that investments in fixed assets of companies will be sensitive to cash flow, research Ding et al., (2013) and Fazzari et al., (1988) which states that if the company experiences problems in

financing external (financial constraint), then investment in fixed assets will be sensitive to the availability of internal funds. This happens because of the asymmetry of information between external parties and the company's internal parties. In this context external parties are potential investors and creditors, while internal parties are the company's management. In these conditions the company relies on the use of its own funds (internal financing) that comes from receiving cash flow from operating activities.

5. Effect of Addition of Debt to Fixed Asset Investment

Addition of debt has a significant positive effect on investment. This shows that the investment in fixed assets of manufacturing companies in Indonesia is sensitive to the level of additional debt they make, the company will issue debt when they feel that internal funds are insufficient to fund investment activities in the company. the funds spent for investment by the company exceed the amount of internal funds held by the company resulting in demands for external funding, namely debt. Debt in this context is current debt and long-term debt in the form of bond debt and bank debt.

With more debt obtained by the company, it means that more investment projects have a positive NPV that can be carried out by the company. Adding debt can encourage managers to be more disciplined in their investment choices. One way to introduce discipline into the investment process is to force the company to borrow money, because lending creates a commitment to pay interest and principal. In addition, in companies where there is a separation between ownership and management, debt controls the opportunistic behavior of managers to make expenditures in accordance with their authority (discretionary). Therefore, with the existence of debt, managers will later be focused on the activities needed to ensure that debt payments can be met. The debt payment fulfillment is obtained from the return on investment results of the company's fixed assets.

In the pecking order theory hierarchy explains that debt has a positive effect on investment but the sensitivity of debt to investment is smaller than the sensitivity of cash flow to investment, and is greater than equity. Chay et al., (2015) also states that the addition of corporate debt has a positive effect on investment in fixed assets of the company, but the sensitivity of investment to additional debt is smaller than the sensitivity of cash flow to investment, and greater than the sensitivity of equity to investment.

6. Effect of Addition in Equity to Fixed Asset Investment

The addition of equity has a significant positive effect on investment. This shows that the fixed assets investment of manufacturing companies in Indonesia is sensitive to the level of stock equity increase that they do. This positive influence is due to the company when adding the number of shares outstanding usually through SOE will obtain funds so that the higher investment projects that can be positively valued can be carried out by the company.

The company issues or adds shares to obtain funds to carry out company activities, the company conducts additional shares offering carried out by public companies that require additional funds to finance its operational and investment activities. Another reason why a company engages in SEO is to find funds to finance its fixed asset investment activities or repay corporate debt. This stock offering can be done in two ways, first through a rights issue mechanism or selling rights (right) to the old shareholders to buy additional shares at a certain price and at a certain time. Second, through

the mechanism of second offering, third offering, and so on, or selling these additional shares to every investor in the market who wants to buy them, not only to old shareholders.

So it can be concluded that the addition of stock equity has a positive effect on investment but the effect or sensitivity to investment is smaller than the addition of debt and cash flow. In line with the study of Chay et al., (2015) which explains that equity has a positive effect on investment, but the sensitivity is smaller than the addition of debt and cash flow.

RESEARCH METHOD

Population and Sample

The population in this study are all manufacturing companies in the research subjects are non-financial companies listed on the Indonesia Stock Exchange during the period 2010-2014. The sample company has the financial statement data used in this study and also has the accounts needed in its calculations.

Operational Definition and Variable Measurement Dependent Variable

1. Investment in this study is an investment in the company's fixed assets, which shows the addition or reduction in the number of assets owned by the company in a period compared to the previous period, which is measured using the formula :

$$I_{i,t} = \frac{(\text{Tangible fixed asset}_{i,t} - \text{Tangible fixed asset}_{i,t-1}) + \text{Depresiasi}_{i,t}}{\text{Tangible fixed asset}_{i,t-1}}$$

Independent Variable

1. Cash flow, is a potential source of internal funds to be used by companies in order to invest.

$$CF_{i,t} = \frac{\text{Laba bersih}_{i,t} + \text{Depresiasi}_{i,t}}{\text{Tangible Fixed Asset}_{i,t-1}}$$

2. Addition of Debt (DEBTISS), is the amount of debt obtained by the company that the company will use for investment.

$$\text{DEBTISS} = \frac{(\text{LTD}_{i,t} - \text{LTD}_{i,t-1}) + (\text{STD}_{i,t} - \text{STD}_{i,t-1})}{\text{Tangible Fixed Asset}_{i,t-1}}$$

3. Addition in Equity (EQTISS) the amount of equity in the form of shares issued by a company used to fund its investment

$$\text{EQTISS} = \frac{\text{Equity issue}_{i,t} - \text{Repurchase}_{i,t}}{\text{Tangible Fixed Asset}_{i,t-1}}$$

Control Variable

The control variables used in this study are company size, market to book, and leverage

Data analysis method

The analysis technique used in this study is multiple linear regression analysis (multiple regression) to determine the effect of cash flow, additional debt, and added equity. Analysis models in this study are:

$$I_{i,t} = \beta_{CF/K} \left(\frac{CF_{i,t}}{K_{i,t}} \right) + \beta_{DEBT/ISS/K} \left(\frac{DEBT_{i,t}}{K_{i,t}} \right) + \beta_{EQT/ISS/K} \left(\frac{EQT_{i,t}}{K_{i,t}} \right) + \beta_{M/B} \left(\frac{M}{B} \right)_{i,t-1} + \beta_{Lev} Lev_{i,t} + \beta_{Size} Size_{i,t} + \mu_{i,t}$$

Information :

i and t = show company i in year t
 $I_{i,t}$ = Investment in fixed assets of companies i in year t
 $CF_{i,t}$ = Cash flow (measured by net income + depreciation scaled to total assets) of company i in year t
 $DEBT_{i,t}$ = Increase in company debt i in year t $EQT_{i,t}$ = Increase in company equity i in year t
 $M/B_{i,t-1}$ = ratio of market to book value of equity of company i in year t-1
 $Lev_{i,t}$ = Firm leverage ratio i in year t
 $Size_{i,t}$ = Company Size company i in year t
 $K_{i,t-1}$ = company tangible fixed assets of year t-1
 $\mu_{i,t}$ = error
 β = Regression coefficient of each variable

Results and Discussion

Research Analysis Results

Model	Koeficient Regression	Sig.	Conclution
	Unstandardized		
(Constant)	,058	,519	
CF/K	,066	,011	Significant
DEBTISS/K	,032	,039	Significant
EQTISS/K	-,170	,490	Not Significant
M/B	,013	,029	Significant
LEV	-,139	,020	Significant
LOG TA	,029	,044	Significant
R2	0,198		
Dependen Variabel:I			

RESULT AND DISCUSSION

1. The Effect of Cash Flow on Fixed Asset Investment

Cash flow has a significant positive effect on fixed assets investment. This shows that the fixed assets investment of manufacturing companies in Indonesia is sensitive to their cash flow, in other words that manufacturing companies in Indonesia are in accordance with pecking order theory, where companies will take priority over the availability of internal funds in funding their investments. If a company experiences financial financial constraints, the investment in its fixed assets will be sensitive to the availability of internal funds. This happens because of the asymmetry of information between external and internal parties of the company. In this context is company management.

In conditions of limited external funding sources, the company relies on the use of its own funds from cash flow receipts from the company's operations. In line with the research of Chay et al., (2015) which explains that cash flow has a significant positive effect on investment in fixed assets of companies. This happens because of the asymmetry of information between external parties and the company's internal. Due to conditions of limited external funding and expensive external funding costs, companies will rely on the use of their own funds (internal financing) that comes from receiving cash flow from the company's operations.

2. Effect of Addition of Debt to Investment in Fixed Assets

Addition of Debt has a significant positive effect on fixed asset investment. This shows that the fixed assets investment of manufacturing companies in Indonesia is sensitive to the level of debt increment they do. Companies will add debt when they feel that internal funds are insufficient to fund investment activities in the company, this is also because the cash flow owned by the company is usually small, so there is not much fixed asset investment activity that can be done or realized by the company. With more debt obtained by the company, it means that more investment projects have a positive NPV that can be carried out by the company.

Adding debt can encourage managers to be more disciplined in their investment choices. One way to introduce discipline into the investment process is to force the company to borrow money in the form of debt, because lending creates a commitment to pay interest and principal. In addition, in companies where there is a separation between ownership and management, debt controls the opportunistic behavior of managers to make expenditures in accordance with their authority (discretionary). Therefore, with the existence of debt, managers will later be focused on the activities needed to ensure that debt payments can be met. The debt payment fulfillment is obtained from the return on investment results of the company's fixed assets.

Debt in this context is current debt and long-term debt in the form of bond debt and bank debt. In line with Baskin's (1989) research, Allen (1993) states that the addition of debt has a positive effect on corporate investment. Chay et al., (2015) also states that the addition of corporate debt has a positive effect on investment in the company's fixed assets.

3. Effect of Addition in Equity to Investment in Fixed Assets

The addition of stock equity has no significant effect on investment. This shows that the investment in fixed assets of manufacturing companies in Indonesia does not have an influence on the level of stock equity increase that they do. Manufacturing companies in Indonesia tend not to add equity because the cost of issuing high equity and when the company issues shares will be a bad signal for investors, and will represent that the company is experiencing a shortage of funds Myers and Majluf (1984).

4. Comparison of the Effect of Cash Flow, Addition of Debt, and Addition of Equity to Investment in Fixed Assets

Based on the results of the regression coefficient in this study also proved the application of the pecking order theory hierarchy regarding financing preferences in manufacturing companies in Indonesia in the period 2010-2014. Seen from the cash flow variable regression coefficient has the highest regression coefficient of 0.066, this is in line with the first hierarchy of pecking orders which proves that fixed asset investment is more sensitive to cash flow than adding debt or adding stock equity, and debt addition variables are higher than variable addition of equity that has no influence on fixed asset investment, this shows the second hierarchy of pecking.

Order theory. the preference for using this source of funds is due to the information asymmetry and funding costs. Manufacturing companies in Indonesia tend to use cash flow because this variable is free from information asymmetry and the company does not need to pay for funding, the disadvantage of cash flow is that the company has limited funds so that it is not able to meet the funding activities of the company's fixed assets. This will force companies to use external funds in the form of debt, funding using debt becomes a top priority when external funding is needed because the cost to obtain debt is smaller than companies using equity. Then funding uses equity as the last alternative in this hierarchy because of the information asymmetry and also the expensive cost of equity that must be borne by the company, when the company will issue equity to fund its investment activities it will present bad news for investors, because managers assume that the stock price when it is over priced, and investors will assume if the company issues shares, it means that the company is experiencing financial difficulties. So it can be concluded that cash flow, the addition of debt together has a positive effect on investment in fixed assets of the company, and the variable increase in equity has no influence on investment in fixed assets of the company. However, the three variables have different levels of sensitivity, the sensitivity of cash flow is higher compared to the addition of debt and addition of equity, and the sensitivity of additional debt is greater than the addition of equity, this is in line with research by Chay et al., (2015).

CONCLUSIONS

Based on the results of research conducted, the following conclusions are generated:

1. Cash flow has a significant positive effect on investment in fixed assets of the company. This shows that the greater the cash flow the company has, the greater the investment in the company's fixed assets by the company.
2. Addition of debt has a significant positive effect on investment in fixed assets of the company. This shows that the greater the increase in debt made by the company, the greater the investment in fixed assets made by the company.
3. Addition in equity does not have a significant effect on investment in the company's fixed assets. This shows that the size of the addition of equity made by the company, does not affect the size of the investment in fixed assets made by the company.
4. The positive effect of cash flow on fixed asset investment is greater than the effect of adding debt to fixed asset investment, and the effect of adding debt to fixed asset investment is greater than the effect of adding equity to fixed asset investment. These results indicate that the size of fixed asset investment is more sensitive to cash flow (internal funding sources) than debt (external funding sources), and fixed asset investment is more sensitive to external funding sources than

debt compared to external funding sources from shares. Thus, it can be concluded that manufacturing companies in Indonesia follow the pecking order theory in making funding decisions, namely prioritizing internal funding sources first, then using external sources of debt funds.

5. Control variables that have a significant positive effect on investment in fixed assets of the company are the market to book and company size, while the significant negative effect is corporate leverage.

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