Analysis the Effect of Growth Opportunity, Liquidity, Leverage, and Volatility of Cash Flows to Hedging Decisions

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Abstract

Companies operating internationally will surely experience the risk of foreign currency fluctuations. The use of foreign exchange raises an exchange risk profile that must be addressed. One way to overcome the exchange rate risk is to use currency derivatives as hedging tools. research This is a conceptual paper that aims to determine the effect of growth opportunity, liquidity, leverage, and cash flow volatility on hedging decisions. This study uses secondary data in the form of annual financial statements of manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) from 2015 to 2018. Updates in this study are samples and research years and the addition of control variables to control the relationship between the dependent and independent variables.

Keywords: hedging, growth opportunity, liquidity, leverage, cash flow volatility

Introduction

In the era of globalization which is growing as it is now making international trade or trade between countries will also be more extensive. This makes a company will need interaction with other companies both domestic and foreign companies. Therefore, the company will carry out import or export transactions. Every business activity carried out by individuals or companies will certainly not be free from risk, either in whole or even in each line of the business (Wijaya, 2018).

Companies operating internationally will surely experience the risk of fluctuations in foreign currencies. Unexpected foreign exchange fluctuations will affect sales, prices, and also the company's profits in the process of exports and imports. According to PSAK no 50, interest rate risk is the risk of fluctuations in the value of financial instruments caused by changes in market interest rates. This risk is caused by changes in the BI Rate which are set as reference rates (Nuzul and Lautania, 2015).

Companies that actively export will benefit when the local currency depreciates, the depreciation will increase the company's revenue in the form of local currency. Conversely, when the local currency appreciates, the company will suffer losses because its income decreases when it is converted into local currency (Ariana and Sudiartha, 2017). The use of foreign exchange raises an exchange risk profile that must be addressed. One way to overcome the exchange rate risk is to use currency derivatives as hedging tools. According to Guniarti (2014) hedging is a step taken by a company in its efforts to distance or reduce the risk of unexpected exchange rate changes.

Companies that have foreign exchange exposures hedge because of internal and external factors. One of them is a growth opportunity. Growth opportunity is an opportunity for the company's growth in the future. Companies with greater growth opportunities will face greater underinvestment costs, so they are more motivated to implement hedging policies (Goklas and Wahyudi, 2016).

Hedging is also considered influenced by liquidity. Because the more liquid assets of a company, the less likely the company is experiencing short-term liability problems so that the threat of financial difficulties is also small which will have an impact on decreasing activities hedging undertaken by the company (Guniarti, 2014).

The next internal factor is leverage. High ratio leverage shows a high proportion of debt financing compared to equity financing, which indicates that the company is facing risk financial distress (Ariana and Sudiarta, 2017). To deal with the risk of financial distress, the company hedges. According to Goklas and Wahyudi (2016), cash flow volatility indicates that the uncertainty of business income is very high, the uncertainty has the potential to obtain financial risks, such as bankruptcy costs. Thus, the company hedged to deal with these risks.

Issue

Image1. Fluctuations in the Value of the USD against the Rupiah

Source: www.bloomberg.com

In 2015 and 2018, the exchange rate of the rupiah against the US dollar was very weak. In September 2015, the exchange rate of the rupiah against the dollar reached Rp. 14802 and in September 2018 the exchange rate reached Rp. 15,002 (www.msn.com). With the weakening of the rupiah, BI issued Bank Indonesia Regulation PBI No. 21/7 / PBI / 2019 which is a change in Bank Indonesia Regulation No. 20/10 / PBI / 2018 Regarding Domestic Transactions Non-Deliverable Forward. This rule is believed to be effective in stabilizing the rupiah exchange rate, as well as increasing liquidity and efficiency in the foreign exchange market. The DNDF is also believed to be able to help reduce rupiah volatility against foreign currency forward requests because the DNDF settlement uses the rupiah.

As is known, the increasing uncertainty of the current global economic conditions makes capital outflows swiftly from developing countries. As a result, the exchange rate fluctuates, including the rupiah. Moreover, the option that has so far been carried out is to hedge the NDF market abroad. This is said to add to the negative influence on the spot price of the US dollar and rupiah in the domestic market

(www.cnnindonesia.com). The DNDF instrument is a transaction for-forward which transactions are carried out in netting in rupiah on the domestic foreign exchange market. Thus, BI no longer needs to use foreign exchange reserves in carrying out rupiah intervention (www.alinea.id).

Literature Review

Agency Theory

Between principals and agents, there is a relationship that can cause agency problems if both parties maximize their utility, to make agents no longer act in accordance with the principal's interests. Agency problems that arise can be in the form of agency costs, information asymmetry, moral hazards, and adverse selection (Jensen and Meckling, 1976).

According to Zhao (2004), information asymmetry plays an important role in a company's risk management policy. Hedging can reduce information asymmetry between managers and investors about the costs and risks faced by the company. The higher the information asymmetry between managers and investors, the company will reduce hedging to signal the quality of the company's value to investors in line with the increasing volatility of the company despite increasing bankruptcy costs. Companies that do hedging convey information about the benefits of hedging (signaling costs) to reduce bankruptcy costs.

Hedging

According to Brigham and Houston (2011), hedging is carried out by a company or individual to protect against a price change that will have a negative impact on earnings. By doing these activities the targeted profit can be realized, or even if it deviates, the deviation is not too far away. Therefore the process of hedging requires special abilities. Hedging is very useful for companies or countries that have businesses and often do transactions related to interest rates or exchange rates. If companies have debts in foreign exchange and floating interest rates, they will certainly be affected by interest rates that tend to rise and fluctuating exchange rates (Hull, 2008).

The need for hedging is also felt even greater, especially by public companies that often export and import. Hedging can also reduce the possibility of bankruptcy, allow companies to get credit from creditors more easily, establish better cooperation with suppliers, and enable companies to get loans at lower interest rates because of the perceived risk of lower lenders (Hull, 2008).

The effect of Growth Opportunity on Hedging Decisions

High growth opportunities are the desire of investors and company owners to be able to make the company bigger. Companies with greater growth opportunities will face greater under investment costs, so they are more motivated to implement hedging policies. The company's growth opportunities are also high, in financing the growth that is being experienced by the company, the company will be more inclined to use loans from other parties so that it can pose risks faced by the company. Therefore to minimize this risk the company can use hedging to protect the value of its debt (Goklas and Wahyudi, 2016).

H1: Growth Opportunity positive effect on hedging decisions

The Effect of Liquidity on Hedging Decisions

Liquidity refers to the ease and speed of asset can be converted into cash (without loss). The more liquid the assets of a company are, the less likely the company is experiencing short-term liability problems so that the threat of financial difficulties is also small which will have an impact on decreasing hedging activities undertaken by the company. On the other hand, a liquid company will have a greater opportunity to develop its business so that the funds owned tend to be used for other activities besides hedging activities. Thus the higher the liquidity value, the lower the hedging activities carried out because the risks that appear tend to be low and vice versa (Guniarti, 2014).

H_2: Liquidity has a negative effect on hedging decisions.

The Effect of Leverage on Hedging Decisions

Companies can boost company performance by using debt. However, the use of debt that is greater than the quantity of capital owned will cause problems for the company. The higher the leverage charged by the company, the greater the hedging action to be able to minimize risk, this is because the company's debt will be greater than the company's own capital which results in the risk of bankruptcy. The way to overcome this is to do hedging (Astyrianti and Sudiartha, 2017).

H_3: Leverage has a positive effect on hedging decisions

The Effect of Cash Flow Volatility on Hedging Decisions

Hedging is useful to limit the volatility of cash flows. Cash flow volatility indicates that the uncertainty of business income is very high, the uncertainty has the potential to face financial risks, such as bankruptcy costs. Companies that have high levels of cash flow volatility have a greater incentive to take advantage of hedging policies with derivative instruments (Goklas and Wahyudi, 2016).

H_4: Cash flow volatility has a positive effect on hedging decisions

Discussion

High growth opportunities are the desire of investors and company owners to be able to make the company bigger. Companies with greater growth opportunities will face greater under investment costs, so they are more motivated to implement hedging policies. Liquidity refers to the ease and speed with which assets can be converted into cash (without losing value). The more liquid assets of a company, the less likely the company is experiencing short-term liability problems so that the threat of financial difficulties is also small which will have an impact on decreasing hedging activities undertaken by the company (Guniarti, 2014). Companies can boost company performance by using debt. However, the use of debt that is greater than the quantity of capital owned will cause problems for the company. The higher the leverage charged by the company, the greater the hedging action to be able to minimize risk, this is because the company's debt will

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Conclusion

This research is a conceptual paper that discusses the factors that influence hedging decisions. This research will also provide a conceptual framework that forms the basis of information relating to the factors that influence hedging decisions so that it can be used as a material for consideration in the use of derivative instruments, especially foreign exchange derivatives as one of the hedging tools of exchange rate risk. In addition to being taken into consideration, the researchers hope that this research can be an evaluation of the readiness of the world economy in Indonesia in using foreign exchange derivatives as a tool for speculation to get margins. In addition, this research is also to find out the effect of growth opportunity, liquidity, leverage, and cash flow volatility on hedging decisions.

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