CORPORATE CASH HOLDING AND SPEED OF ADJUSTMENT TO THE TARGET OF INDONESIAN FIRMS

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ABSTRACT

Every corporate need cash. Corporate cash holdings always involve a trade-off between benefits and costs. In this This study has some specificity. First, this research analyse determinant of cash holding in Indonesan. The Second this research to identify speed of adjustment to the targeted cash holding of Indonesian firms. The third to identify speed of adjustment to the targeted cash holding of Indonesian firms before and after economic crisis. This research use panel data of Indonesian non-financial listed firms in Indonesian Stock Exchange during the period 2000-2015. Panel regression analysis has been conducted to determine the major factors affecting cash holdings, these variable are Growth, Firm Size Volatility Cash Flow, Leverage, Profitability, Liquid assets as a cash substitute, Dividend, and Asset tangibility.

Keywords: *Cash Holding, Speed Of Adjustment, Target Cash Holding, Determinant of Cash Holding*

Introduction

Every company can not avoid to have cash. Companies must hold cash on hand for different reasons such for the requirement of liquidating current assets to make payments of the companies transactions, compensating balance for loan or service provided, dealing with unpredicted events, and speculation to take advantage of bargain, to take discount and so on (Brigham, 2008).

Corporate liquidity enables firms to invest, thus avoiding transaction costs from debt and equity issuance and associated financing costs. Internal funds also alleviate information asymmetry and agency costs associated with external capital (Opler et al., 1999). Cash holdings enable firms to invest even when they are financially constrained (Almeida, Campello, and Weisbach, 2004) and can guarantee long-term investments such as research and development (Brown and Petersen, 2011). Finally, cash holdings can serve as a defense mechanism against possible takeovers (Faleye, 2004).

On other hand liquidity has high potential costs that will reduce corporate profit. Cash is unproductive asset that have small added value (Brigham, 2004). Cash holdings allow opportunistic managers to invest in negative net present value projects or spend firm resources to their own benefit thus destroying shareholder wealth (Dittmar and Mahrt-Smith 2007; Pinkowitz, Stulz, and Williamson 2006 in Lozano &. Durán, 2016). Opler et al. (1999) states that there are trade-off between the marginal costs and benefits of holding liquid assets determines a firm's optimal cash holdings. This refer on trade off theory suggests that firms set their optimal cash holding level by considering the trade-off between the marginal benefits and the costs of keeping such liquid assets (Al-Najjar and Belghitar, 2011).

In several studies, it is found out that cash provides lower cost of financing for the company because increasing external financing is more expensive due to information asymmetry (Myers & Majluf, 1984), agency problems (Myers, 1984), and asset substitution (Jensen & Meckling, 1976). Therefore, managers are required to maintain adequate internal financial flexibility to reduce the costs related to external financing in imperfect capital markets. Myers and Majluf (1984) on Pecking Order Theory suggests that firms have a tendency to rely on internal sources of funds primarily and external funds secondarily. Cash is used as a buffer between retained earnings and investments (Ferreira and Vilela, 2004). Behavior trade-off and pecking order proved not mutually exclusive. This study refer to Shyam-Sunder and Myers (1999) add model of the pecking order and trade-off theory of in a single specification.

Different studies which analyzed cash holdings and its determinants with reference to target level of cash holdings are consistent with studies on leverage (Jani *et al.*, 2004). By considering transaction costs, agency problems and information asymmetry, the debate on corporate cash holdings features trade off theory and pecking order theory by Meyars (1984) and free cash flow hypothesis by Jensen (1986) very prominently.

On the dynamic trade-off theory of cash holding, corporate are periodically adjusted to the target level. Target level of cash holding is estimated. Target cash holding determined by many factors. Rehman (2015) China Firms determined by firms and industry characteristic. Chang, Deng & Wang (2016) firms characteristic and economic condition. Uyar & Kuzey (2014) add internationalization for factors that determined the cash holding of the firms.

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