Investor Decisions with Pecking Order Theory Method: Strategy of an Investor to Get Right Issue

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Investor Decisions with Pecking Order Theory Method: Strategy of an Investor to Get Right Issue

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Keywords: Investor Decision, Pecking Order, Right Issue, Operating cash flow ratio, debt to equity, Return on Assets, Net Profit Margin, Assets turnover, Price earnings ratio.

Abstract: The purpose of the study is: (1) to tempt and prove empirically Investor strategy on Operating Cash Flow Ratioof company before and after right issue; (2) on Debt to Equity Ratio ; (3) on Return on Asset ; (4) on Net Profit Margin ; (5) on Asset Turnover; (6) to tempt and prove empirically Investor strategy about Price Earning Ratio . This study method implemented purposive sampling. The results showed : (a) there is no difference on Operating Cash Flow Ratio between before and after right issueto performance improvement of Cash Flow Ratio is insignificant; (b) there is no diference onDebt Equity Ratio between before and after right issue to decreasing Debt Equity Ratio performance is insignificant; (c) there is no difference onReturn on Asset between before and after right issue to improvement of Return on Asset performance is insignificant; (d) there is no difference onNet Profit Margin between before and after right issue toinsignificant improved performance; (e) there is a difference onAsset Turnover between before and after right issue to significant decrease.

1 INTRODUCTION

Capital Market Law Number 8 Year 1995 has explained about the mechanism of trading in the capital market. According to the Decision of the Chairman of the Capital Market Supervisory Agency no. KEP-26 / PM / 2003 describes Rights Issue is an additional share capital of a company that has conducted a Public Offering of shares or Public Company. This capital increase activity through Preemptive Rights or Public Offering of Warrants or Conversion Securities. Investors will be more strategic with pecking order theory to gain maximum profit.

Pecking Order Theory states that companies tend to choose funding that comes from internal rather than external companies (Ghosh, 2011) which explains that corporate priorities have a main role in choosing funding. The priority begins with internal funding as the first option, if internal funding is considered less, both companies will propose a debt.For the last option, if the debt is considered less, the company will issue shares. issuing some shares can be done through action one of which is a right issue. The last option is what is the explanation of why the company should issue a stock back or right issue.

Right issue is a right that is purposed to the current shareholders to buy shares which will be reissued by the company (Dewi and Rahyuda, 2014). When investors buy rights issue shares then the company get capital for the issuance of their shares. There are several important dates around the right issue; 1) Cum date is the date the investor can register to earn their right issue, 2) Ex date is the date if an investor is no longer registered, 3) Rec date is the date of recording and 4) Distribution date is the date of the right issue is distributed. This theory can be explained why companies are able to gain high profit with low debt. An investor who gets the rights to a right issue should have several options that must be done. There are three options: (a). Use or exploit the right whereveran investor will buy them which offered in the right issue by filling out the form or purchasing mechanism provided by the securities; (b). Sell right issue rights wherever investors have no more rights to purchase shares which offered by the company; (c). Investors should ignore the right to right issue wherever this action will result loss of rights after the distribution date passes.

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2 RESEARCH PROBLEMS

(Wijaya, 2015) explains the company's financial performance before and after the occurrence of corporate action by issuing a right issue, through observing six company financial performance variables, namely: Operating cash flow ratio (OCR), Debt to equity ratio (DER), Return on Assets (ROA), Net profit margin (NPM), Assets turnover (AT), and Price earnings ratio (PER) on the Indonesia Stock Exchange, are different. Of the 12 companies that issued a rights issue in 2011 on the Indonesia Stock Exchange, if described in a graph of financial performance based on these six variables, it appears that some fluctuated sharply, some experienced changes but were not significant, some were not so influenced by the existence of issue rights issue.

The strategies alternative for investors in responding to the issuance of rights issues for new shares are: (1) using the right issue to buy new shares, or (2) selling rights on the right issue, or (3) ignoring the rights on the rights issue. The choice of an alternative strategy depends on whether or not there is an improvement in the company's financial performance after the issuance of a rights issue. Based on the results of (Wijaya, 2015) research, the writer is interested in conducting further research with the title "Investor Decision with Pecking Order Theory Method: Investor's Strategy to Get Rights on Right Issues"

The problem formulations of this study are as follows: (1) How the Investor's strategy with the company's Operation Cash Flow Ratio performance before and after the rights issue; (2) How the Investor's strategy with the company's Debt to Equity Ratio performance before and after the rights issue; (3) How the Investor's strategy with Return on Asset performance before and after the rights issue; (4) How the Investor's strategy towards the Net Profit Margin before and after the rights issue; (5) How the Investor's strategy with Asset Turnover performance before and after the rights issue; (6) How the Investor's strategy with Price Earning Ratio performance before and after the rights issue.

The purposes of the study are : (1) to tempt and to prove empirically Investor strategy on Operating Cash Flow Ratioof company before and after right isuue; (2) to tempt and to prove empirically Investor strategy on Debt to Equity Ratio of a company before and after right isuue; (3) to tempt and to prove empirically Investor strategy onReturn on Asset before and after right issue; (4) to tempt and to prove empirically Investor strategy on Net Profit Margin before and after right issue; (5) to tempt and to prove empirically Investor strategy on Asset Turnover before and after right issue; (6) to tempt and to prove empirically Investor strategy on Price Earning Ratio before and after right issue.

3 LITERATURE REVIEW

Pecking Order Theory: The Pecking Order Theory was first presented by Modigliani and Miller in 1958 (Sheikh et al., 2012). Pecking Order Theory states that companies tend to choose funding that comes from internal rather than external companies (Ghosh, 2011). In this theory it is explained that there are corporate priorities in choosing funding. The priority begins with internal funding as the first option, then if internal funding is still considered less then the choice of both companies is debt and the last option if the debt is still considered less then the company will issue shares. Issuing shares can be done through corporate action one of which is a right issue. The last option is what explains why the company is issuing a stock back or right issue. Pecking Order Theory: Pecking Order Theory differs from the trade-off theory where in trade-off theory it is explained that companies must achieve their debt targets. Target debt is a balance target which the benefits can be taken and debt should be balanced with the costs incurred in the presence of such debt. One of the benefits of the debt is to disminish taxes. However, this theory simply explains the funding needs based on the priority order only. Therefore, there should be an explanation why companies can have high profitability with low debt.

Company Performance: Performance is the result of work in quality and quantity achieved by an employee in carrying out its duties in accordance with the responsibilities that have been given (Nazaruddin and Basuki, 2015). Quality work can be presented in a narrative or descriptive way. The quantitative work can be mathematically analyzed. Performance can be interpreted as a result or output obtained from the existence of a process. The value of a process can be seen in the performance of the process itself. Performance appraisal requires analysis of a process. Performance is either a result or a process undertaken by the organization. There are three types of performance that are: (a) Strategic performance as the result obtained from the strategy made by corporate managers; (b) Administrative performance relating to the relationships among work units; (c) The operational performance of the company is related to the effectiveness of organization in using the resources. Performance is the result of the quality and quantity achieved by a person or organization in carrying out the responsibility given (Mangkunegara and Hasibuan, 2009). Performance according to the above definition can be interpreted that performance has two types, namely: (a) Financial performance related to the performance of a measurable individual or organization of economic activities that can be quantified. For example comparison of sales level from year to year; (b) Non-financial performance relates to the performance of an individual or organization that can not be measured by numbers. For example, customer satisfaction over services provided by employees. In (Ediningsih and Yacobus, 2009) explained that the performance of the company is an evaluation of how the company is considered successful or not in running its business. In evaluating the financial of company performance required tool called the ratio. Subramanyam and (Subramanyam et al., 2010) explain that there are ratios that can be used to measure the performance of a company such as liquidity ratio, capital structure ratio and leverage, investment rate return ratio, operating performance ratio, asset utilization ratio, and size ratio market. Each ratio has its own usability and interpretation.

4 HYPOTHESIS

4.1 Operating Cash Flow Ratio before and after Right Issue

Operating cash flow is the cash flow generated from the core activities of company (Amuzu, 2010). This ratio shows the cash received by the company from customers. Cash in operating cash flows is the cash flow received from customers from the core activities of company. Each company has different core activities. Debt payments will increase the value of the operating cash flow ratio (Amuzu, 2010). Cash earned from operating cash flows will not be too used to pay off corporate debt. Operation Cash Flow Ratio is derived from total operating cash flows divided by total current liabilities (Subramanyam et al., 2010). The value of the operating cash flow ratio is derived from dividing the operating cash flow to current liabilities. If the cash flow is higher, the value will be higher. (Simanullang and Daljono, 2013) stated that a company uses the funds obtained from the right issue in order to reduce their debt level. If current liabilities are less, the value will be high. The data is used to calculate the cash flow ratio which is obtained in the financial statements. Information on the operating cash flow of the company can be obtained in the financial company statements in the cash flow statement. Meanwhile, information on current liabilities can be obtained in the financial of company statements in the consolidated statements of financial position. If the cash flow from operating activities increases then the operating cash flow ratio will be better with a fixed obligation record. If the right issue is used by the company to settle the obligation, the amount of corporate liabilities is reduced, the ratio will be better with the record of operating cash flow remains. Researchers have conducted international and national online and offline journal surveys, but have not found any research which using the ratio of cash flow operations as a measure of the financial performance of a company doing a right issue. The theory development of these variables uses theories derived from Subramanyam and (Subramanyam et al., 2010), (Amuzu, 2010). Considering the theory described by (Amuzu, 2010) and the logic of thought, hypotheses have one direction. From the description above, it can be derived hypothesis as follows;

H1: Suspected there are differences in operating cash flow ratio before and after right issue

4.2 Differences Debt to Equity Ratio (DERR) before and after Distribution Date Right Issue

Debt to Equity Ratio (DER) is a ratio that measures the capital structure of company derived from total liabilities divided by shareholder equity (Subramanyam et al., 2010). This ratio shows the ratio between liabilities and corporate equity. The assets owned by the company come from their own capital and debt or loans. Given the Debt to Equity Ratio (DER) ratio the proportion between capital and debt will be seen clearly. Another theory mentions the relationship between debt with the right issue. Research conducted by (Simanullang and Daljono, 2013) states that companies tend to use funds obtained from rights issue activities in order to reduce the level of corporate debt. However, in practice the company not only uses the funds from the rights issue to pay off the debt alone, but also to conduct an expansion or buy assets. Research conducted by (Ediningsih and Yacobus, 2009) states that there are differences in Debt to Equity Ratio (DER) before and after the Right Issue. The sample used by the research is as many as 14 companies doing Right Issue. In the research the significant value for the Debt to Equity Ratio (DER) variable is 0.023 or below 0.05 alpha level. Research conducted by (Simanullang and Daljono, 2013) states that there is no significant difference of Debt to Equity Ratio (DER) before and after right issue. The population of the study used a company listed on the Indonesia Stock Exchange 2008-2010. Research conducted by (Ediningsih and Yacobus, 2009) states that there is difference of Debt to Equity Ratio (DER) before and after right issue. This indicates that funds obtained from the rights issue are used to pay off the liabilities of company. Debt repayment by the company will affect the value of Debt to Equity Ratio (DER). Less debt will increase the proportion of capital to debt. Therefore, if the company tends to use the cash earned from the right issue to pay off the debt of company, the Debt to Equity Ratio (DER) value will tend to decrease. From the description above, it can be derived hypothesis as follows;

H2 : Suspected there is difference Debt to Equity Ratio before and after Right Issue

4.3 The Defferences between Return on Assets (ROA) before and after Right Issue

Return on Assets (ROA) is a financial ratios used tomeasure the relationship between profits and asset investment needed to generate profit. Companies use their assets to generate income. They are machines, buildings, and intangible assets such as brands. Return on Assets (ROA) is derived from net income divided by the average total assets of the company (Subramanyam et al., 2010). It will be higher if the value of denominator (net profit) is greater than the value of the numerator (average total assets). The informations are required to calculate the Return on Asset ratio can be found in the Financial Statements. Net income can be found in the Income Statement. The value of the company's assets can be found in the Financial Position Report. Research conducted by (Ediningsih and Yacobus, 2009) states that the value of Return Assets (ROA) is significantly different between before and after the right issue. This study uses the company population listed on the Indonesia Stock Exchange in 2001-2003. From the description above, it can be derived from hypothesis as follows:

H3: Suspected There are difference in Return on Assets before and after Right Issue

4.4 Differences Net Profit Margin before and after Right Issue

Net Profit Margin (NPM) is the ratio used to measure the level of a company's operating performance derived from net income divided by sales (Subramanyam et al., 2010). This ratio reveals how much net profit can be generated from the sales / revenue earned by the company. Research conducted by (Ediningsih and Yacobus, 2009) states that there is no significant difference between Net Profit Margin before and after Right Issue. The population of the research are companies listed on the Indonesia Stock Exchange from 1997 to 2001. Research conducted by (Khajar, 2010) states that there is no significant difference in the ratio of Net Profit Margin before and after the right issue. Research conducted by (Ediningsih and Yacobus, 2009) states that there is a difference Net Profit Margin (NPM) before and after right issue. From the description above, it can be derived hypothesis as follows.

H4: Suspected There Are Difference Between Net Profit Margin before and after Right Isuue

4.5 Defferences in Assets Turnover before and after Right Issue

Asset Turnover (ATO) is the ratio used to measure the efficiency of companies in using their assets (Hofstrand., 2013). It assesses ability of a company in utilizing assett to generate sales. ROA assesses the return on investment on assets viewed from net income. ATO is a ratio that shows the activity of the company obtained from dividing sales by total assets (Khajar, 2010). This ratio is used to measure the level of firms in utilizing their assets. In addition, this ratio explains the ability of firms in utilizing their assets to generate revenue. The research conducted by (Khajar, 2010) states that there is no significant difference in turnover assets before and after the company exercises a right issue. The study examined the differences in the financial performance of firms by using two pre- and postperiods to measure differences. Research conducted by (Ediningsih and Yacobus, 2009) states that there is no difference in Asset Turnover (ATO) before and after the right issue. This is because the funds obtained from the rights issue are not invested to buy assets but are used to pay off the liabilities of company. If the company can effectively utilize its assets to generate sales then the value of Asset Turnover (ATO) will improve. Companies with multiple assets may not necessarily produce decent sales when compared to their asset holdings. From the description above, it can be derived hypothesis as follows.

H5: Suspected there is sifference between Assets Turnover before and after Right Issue

4.6 Differences Price Earnings Ratio (PER) before and after Right Issue

Price Earning Ratio (PER) shows the stock price that the investor is willing to pay for the profit of company. PER is the ratio of the firm's stock price to earnings per share of the company. Price Earning Ratio (PER) is the ratio used to show the stock performance of a company obtained from share price divided by earnings per share (Khajar, 2010). The greater the value of PER then the more expensive the price of a stock. Previous research conducted by (Khajar, 2010) showed a significant difference in Price Earning Ratio (PER) before and after the Right Issue. This shows that there is a difference in the company's stock performance. If the company's stock price is high while earnings per share is low, it will produce a high Price Earning Ratio (PER) value. High Price Earning Ratio (PER) marks the value of an expensive company's stock in other words investors do not like it. If the firm price is low with high earnings per share, it will result in low Price Earning Ratio (PER). From the description above, it can be derived hypothesis as follows:

H6: Suspected there is difference between Price Earnings Ratio (PER) before and after right issue

5 REAEARCH METHOD

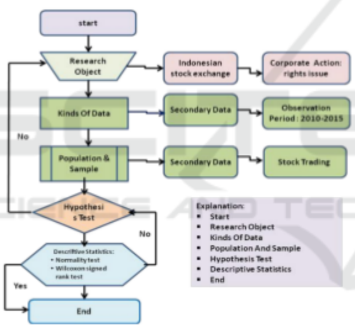

Figure 1: Flowchart Of Research Methods and Processes

The object of this research is all companies listed on the Indonesia Stock Exchange that carry out corporate actions issue a rights issue during the observation period, namely in 2010-2015(Indonesia, 2015). The type of data used is secondary data about the company's financial performance seen from six variables, namely: Operating Cash Flows Ratio, Debt to Equity Ratio, Return on Assets, Net Profit Margin, Assets Turnover, and Price Earnings Ratio. This research is an Event Study that is by looking at the impact of corporate action issuing rights issues on stock trading 25 days before and 25 days after corporate action. The analytical method used to prove the hypothesis proposed in this study is the normality test and the Wilcoxcon signed test. By comparing the value of each variable before and after the company carries out a corporate action issue a rights issue. The conclusions obtained will also be an alternative strategy that should be chosen by investors according to the variables tested.

6 RESEACH RESULTS AND DISCUSSION

6.1 There is No Difference between Operting Cash Flow Ratio before and after Right Issue

Operating Cash Flow Ratio is the ratio used to assess the financial performance of company in paying off current liabilities by using cash obtained from the company's operating activities. Right issue is the issuance of stock returns by the company to increase the company's capital. Wilcoxon Signed Ranks test results show that there is no difference in Operating Cash Flow ratio before and after the right issue with a non-significant performance increase. This shows that there is no change in the company's ability to pay off current liabilities by using cash obtained from operating activities between before and after the right issue. According to Amuzu (2010) states that corporate liability payments will increase the value of Operating Cash Flow Ratio. Therefore, the payment of liabilities has not been done significantly by the company. The lack of performance difference in Operating Cash Flow Ratio is caused when the cash obtained from the right issue has not been used significantly to improve the company's operating performance. In addition, the cash earned from the right issue has not been used significantly by the company to pay its current liabilities. PT Indoritel Makmur International / DNET is one of the samples of this study that has not focused on the right issue proceeds to increase sales. The news reported on the web britama.com explains that DNET or PT Indoritel Makmur International uses the right issue proceeds for investments in several companies

6.2 There is No Difference between Debt to Equity Ratio before and after Right Issue

Debt to Equity Ratio (DER) is a ratio that measures the capital structure of company derived from total liabilities divided by shareholder equity (Subramanyam et al., 2010). This ratio shows the proportion between liabilities and corporate equity. Right issue is the issuance of stock returns by the company to increase the capital of company. Wilcoxon Signed Ranks test results show that there is no difference of Debt to Equity Ratio before and after right issue although there is a significant decrease. This indicates that before and after right issue there is no change of capital structure of company. The comparison between shareholder liabilities and equity did not change significantly. According to Sunarjanto in (Simanullang and Daljono, 2013) stated that the change of Debt to Equity Ratio is not significant due to the proceeding rights issue funds are not used to pay off the debt. The results are not conducted by (Ediningsih and Yacobus, 2009) states that there is difference on Debt Equity Ratio before and after right issue. This makes sense because in research of (Ediningsih and Yacobus, 2009) that companies are more likely to use funds from the rights issue to pay the matured obligations. However, the results of this study should support (Fahmi and Saputra, 2013) states that there is no difference in solvency before and after the right issue. The absence of a Debt to Equity Ratio difference is caused when the company does not significantly use funds from the rights issue to pay corporate liabilities. Therefore, the composition of liabilities does not change significantly compared to equity although the composition of equity changes due to capital increase through right issue.

6.3 There is No Difference between Return on Assets before and after Right Issue

Return on Assets (ROA) is the financial ratios used to measure the asset investment relationship used to generate profit (Lindo in Diminica et al, 2012). Right issue is the issuance of stock returns by the company to increase the company's capital. Wilcoxon Signed Ranks test results show that there is no difference in Return on Assets before and after the right issue and there is no significant increase in performance. This shows that before and after right issue there is no change in the increase in profits resulting from the use of company assets. The results are not supported by research conducted by (Ediningsih and Yacobus, 2009) states that there is no difference in ROA before and after the right issue. This makes sense due to the research (Ediningsih and Yacobus, 2009) , companies are more inclined to invest the proceeds of rights issue to buy company assets such as machinery, buildings and other equipment to increase the company's net profit. The absence of a difference in ROA is caused when the firm does not significantly use data from a rights issue to invest in assets. If the company invests its assets in order to increase the company's productivity, its net profit will increase as it is followed by revenue and production efficiency.

6.4 No Net Profit Margin Differences before and after Right Issue

Net Profit Margin is a ratio that measures the ratio of net income to sales. This ratio measures the effectiveness of the company in generating net income by minimizing the cost. Right issue is the issuance of stock returns by the company to increase the company's capital. Wilcoxon Signed Ranks test results showed no difference Net Profit Margin before and after the right issue significant increase in performance. This shows that before and after the right issue does not change the company's ability to minimize costs. The results of this study supported research conducted by (Ediningsih and Yacobus, 2009) which states that there is no significant difference Net Profit Margin before and after right issue. The results of this study also supported research conducted by (Khajar, 2010) which states that there is no significant difference Net Profit Margin before and after right issue. The absence of a difference in Net Profit Margin is due to the fact that the company does not use the funds obtained from the rights issue to minimize costs. These costs represent costs incurred when the company generates revenue

6.5 Differences in Assets Turnover before and after Right Issue

Asset Turnover is a ratio that shows the level of ability of a company to use assets to generate sales (Hofstrand., 2013). Company assets that are rarely used or even unused but still recognized are called null assets. Right issue is the issuance of stock returns by the company to increase the company's capital. Wilcoxon Signed Ranks test shows that there is a difference in Asset Turnover before and after the right issue and a significant decrease in performance. This shows that before and after the right issue there is a change in the company's ability to use assets to generate sales. The results of this study are not supported by research conducted by (Khajar, 2010) which states that there is no significant difference in asset turnover before and after right issue. The results of this study are also not supported by research conducted by (Ediningsih and Yacobus, 2009) states that there is no difference in asset turnover before and after the right issue. The difference in the decrease in Asset Turnover is because the company has not used the funds from the right issue to increase sales. The company is still focusing funds from the rights issue for other things. PT Indoritel Makmur International is one of the samples of this study that has not focused the right issue proceeds to increase sales. The news reported on the web britama.com explains that DNET or PT Indoritel Makmur International uses the right issue proceeds for investments in several companies.

6.6 No Price Earnings Ratio Differences before and after Right Issue

Price Earning Ratio (PER) is the ratio used to show the stock performance of a company obtained from the share price divided by earnings per share (Khajar, 2010). Investors tend to choose or buy companies with low PER Right issue is issuing of shares re-done by the company to increase the company's capital. Wilcoxon Signed Ranks test shows there is no difference Price Earning Ratio before and after the right issue increase Price Earning Ratio is insignificant. This indicates that right issue is not a good indicator for investors to buy shares of the company. Although the company does a right issue, investors tend to avoid the stock of the company. The results of this study are unsupported by previous research conducted by (Khajar, 2010) states that there is no difference in Price Earning Ratio before and after the right issue. Differences in results are possible due to the use of different time periods. The absence of differences in Price Earning Ratio is because the market does not call the right issue. Therefore investors will tend to avoid companies doing the right issue. PT Lipppo Karawaci is one of the company's samples of research avoided by investors. The news reported in Kontan.co.id by (Taqiyyah, 2010) explains that the related rights issue plan of PT Lippo Karawaci shares decreased by -16.18% to Rp 570 per share.

7 CONCLUSIONS

Based on this data analysis and testing, the conclusions are:

a There is no difference of Operating Cash Flow Ratio between before and after right issue with performance improvement of Operating Cash Flow Ratio is insignificant; Investor's strategy does not use the right to buy shares in a rights issue.

b There is no difference of Debt Equity Ratio between before and after right issue with decreasing Debt Equity Ratio performance is insignificant. Investor's strategy does not use the right to buy shares in a rights issue.

c There is no difference of Return on Asset between before and after right issue with performance increase Return on Asset is insignificant. Investor's strategy does not use the right to buy shares in a rights issue.

d There is no difference in Net Profit Margin between before and after right issue with insignificant performance improvement. Investor's strategy does not use the right to buy shares in a rights issue.

e There is a difference between the Asset Turnover before and after the right issue with a significant decrease. Investor's strategy does not use the right to buy shares in a rights issue.

f There is no difference in Price Earning Ratio between before and after right issue with the increase of Price Earning Ratio is insignificant. Investor's strategy does not use the right to buy shares in a rights issue.

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