

CHAPTER I

INTRODUCTION

A. Background

International trade refers to transactions between countries or national governments and other countries that are subject to commercial relations and carried out by an agreement between the two parties (Ristiyani, 2022). International trade also encourages industrialization and investment by transnational companies, resulting in increased employment and economic growth (Suryanto, 2022). Many things drive international trade, one of which is the desire to meet the need for goods and services, the goal of increasing domestic income and profits, and differences in technology or understanding of how to process available resources.

International trade can increase competition and change market prices, which increases the business risks that companies must bear. International trade can also generate debts and receivables, which can be profitable or detrimental to the Company (Widyagoca, 2016). Companies that rely solely on domestic transactions will not have more complex problems than companies that conduct international transactions. International trade may expose businesses to risks related to interest rates, foreign exchange rates, and commodity prices. These risks can affect cash flow and company value and can threaten business continuity (Situmeang, 2018).

One of the biggest risks of international transactions is changes in foreign exchange rates. Unpredictable changes in exchange rates can impact the prices, sales, and profits of exporters and importers. As a result of trade activities that cannot be separated from the use of foreign exchange in export and import transactions, multinational companies face the risk of changes in foreign currency exchange rates (Wuri, 2018). Every business that carries out international transactions, both imports and exports, will definitely face the risk of foreign exchange exposure.

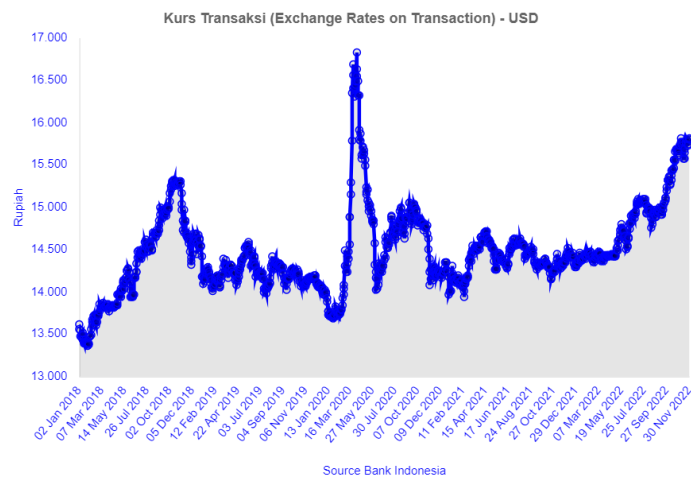


Figure 1.1

American Dollar Foreign Exchange Rates

Source: www.bi.go.id (2023)

Figure 1 shows changes in the US Dollar exchange rate from 2018 to 2022. The USD transaction rate graph shows changes in the USD exchange rate against IDR over the last five years, from January 2 2018 to November 30, 2022. This data shows that businesses are at risk of being exposed to foreign exchange when carrying out foreign exchange transactions, both

import and export. The USD to IDR exchange rate changes every year from 2018 to 2022, as shown in the exchange rate graph. When the indigenous currency, the IDR, depreciates or the USD currency appreciates, businesses that transact internationally and in different foreign currencies must spend more money to purchase goods since the cost of imported items will increase.

Declines in corporate profits, earnings per share, and share price in the market are a direct result of changes in foreign exchange rates. this leads to a decline in sales, product prices, and profit levels. Companies can reduce their risk to reduce the likelihood of profiting from changes in foreign exchange rates.

To prevent significant losses, companies must manage the risk of foreign exchange rate fluctuations in international trade. To manage or optimize the risks faced by companies when carrying out international transactions, companies need risk management (Nisrina, 2023). Furthermore, companies that carry out international trade are expected to use derivative instruments to manage foreign exchange risk (Nabilah, 2023).

Derivative instruments are contracts between the seller and the buyer, which are enforced for certain commodities and securities on a predetermined date, with a compromise price agreed upon by both parties (Wayra, 2023). In terms of their functions, derivative instruments can be helpful in locking in the price of a good or service so that the business can minimize the risk that the asset's value will fluctuate in the future. This technique is known as hedging (Ross et al., 2019).

Hedging helps control risks in the financial sector and reduces financial uncertainty (Shakatreh et al., 2023). The measures taken to protect a business from exchange rate influences are known as hedging (Bodroastuti, 2019). Hedging refers to the practice of using financial instruments to offset or reduce the impact of price fluctuations on a company's revenues and costs.

The hedging policy carried out by the company has several aspects that need to be considered. Financial distress is when an entity experiences a financial decline, usually temporarily before experiencing liquidity. However, this situation can get worse if it is not resolved immediately, which can lead to business bankruptcy (Putri, 2021). Companies can experience financial difficulties for various reasons, but repeated management errors are the main cause of financial problems (Sasmita, 2019). Companies must have effective financial monitoring mechanisms and long-term plans to deal with financial problems that may occur. Hedging decisions are strongly influenced by financial stress (Verawati et al., 2019). According to Yustika et al., (2019), financial crisis does not significantly impact a company's decision to hedge.

Growth opportunities are when a company has the opportunity to invest in profitable things (Harahap, 2019). Growing businesses will require capital in the future, particularly outside capital to finance expansion or meet investment requirements. Companies with high growth opportunities will encourage business expansion, and the funds needed will be a lot. Available internal funds are likely limited, which will influence the company's decisions

about capital structure or funding. Hedging activities are needed to reduce risks that can cause losses to a company as it grows.

Liquidity is an indicator to measure a company's ability to pay all short-term financial obligations at maturity using available liquid assets (Jecia, 2023). Liquidity is positively correlated with the number of assets owned by a company and the company's ability to fulfill its obligations. If estimated correctly, the company will not have difficulty paying back its obligations (Erdiana, 2023). Due to lower financial risk, the amount of hedging carried out by a company will decrease along with the company's liquidity value.

This research chose mining sector companies that have been listed on the Indonesian Stock Exchange because companies in the mining sector are one of the company sectors that are active in exporting and importing goods. The mining industry plays an important role in the global economy by providing essential raw materials for various industries. However, mining companies face many challenges, because the company's higher export growth causes companies to tend to be exposed to more risks so that the possibility of losses incurred by the company is greater compared to companies that do not trade internationally. Companies that actively export and import tend to have a greater foreign exchange exposure. To reduce this risk, mining companies use various strategies, including hedging. This allows mining companies to manage their exposure to commodity price risks, ensuring financial stability and sustainability. Allah Swt commands humans

to always strive for good fortune and avoid actions that can cause harm, as explained in the following Qur'anic verse:

وَالْعَصْرَ (١)

إِنَّ الْإِنْسَانَ لَفِي خُسْرٍ (٢)

إِلَّا الَّذِينَ آمَنُوا وَعَمِلُوا الصَّالِحَاتِ وَتَوَّصُوا بِالحَقِّ^١ وَتَوَّصُوا بِالصَّبْرِ (٣)

"By the time. Verily, mankind is indeed in loss, except those who believe and do righteous deeds and advise others to obey the truth and counsel others to patience." QS. Al 'Ashr: 1-3.

In the verse, Allah Swt commands humans to always advise each other in an effort to practice truth and patience. In this context, hedging transactions can be interpreted as a joint effort of related parties in mitigating potential risks that are feared to arise and can harm one of the parties to the transaction. This agreement in mitigating risk can be interpreted as an effort to advise each other in carrying out the truth. In the Al-Quran Surah Al-Baqarah verse 282 Allah SWT also says:

يَا أَيُّهَا الَّذِينَ آمَنُوا إِذَا تَدَايَنْتُمْ بِدِينٍ إِلَىٰ أَجَلٍ مُّسَمًّى فَاكْتُبُوهُ^٢ وَلْيَكْتُب بَيْنَكُمْ كَاتِبٌ بِالْعَدْلِ وَلَا يَأْب كَاتِبٌ أَنْ يَكْتُبَ كَمَا عَلَّمَهُ اللَّهُ فَلْيَكْتُبْ وَلْيُمْلِلِ الَّذِي عَلَيْهِ الْحَقُّ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا بِيخْسٍ مِنْهُ شَيْئًا فَإِنْ كَانَ الَّذِي عَلَيْهِ الْحَقُّ سَفِيهًا أَوْ ضَعِيفًا أَوْ لَا يَسْتَطِيعُ أَنْ يُمِلَّ هُوَ فَلْيُمْلِلْ وَلِيهِ بِالْعَدْلِ وَاسْتَشْهِدُوا شَهِيدَيْنِ مِنْ رَجَالِكُمْ فَإِنْ لَمْ يَكُونَا رَجُلَيْنِ فَرَجُلٌ وَامْرَأَتٌ مِمَّنْ تَرْضَوْنَ مِنَ الشُّهَدَاءِ أَنْ تَضِلَّ إِحْدَاهُمَا فَتُذَكَّرَ إِحْدَاهُمَا الْأُخْرَىٰ وَلَا يَأْب الشُّهَدَاءُ إِذَا مَا دُعُوا وَلَا تَسْمَعُوا أَنْ تَكْفُرُوا صَغِيرًا أَوْ كَبِيرًا إِلَىٰ أَجَلِهِ^٣ ذَلِكُمْ أَقْسَطُ عِنْدَ اللَّهِ وَأَقْوَمُ لِلشَّهَادَةِ وَأَدْلَىٰ إِلَّا أَنْ تَرَ تَابُوا إِلَّا أَنْ تَكُونَ تِجَارَةً حَاضِرَةً تُدِيرُونَهَا بَيْنَكُمْ فَلَيْسَ عَلَيْكُمْ جُنَاحٌ أَلَّا تَكْتُبُوهَا^٤ وَأَشْهِدُوا إِذَا تَبَايَعْتُمْ^٥ وَلَا يُضَارَّ كَاتِبٌ وَلَا شَهِيدٌ^٦ وَإِنْ تَفَعَّلُوا فَإِنَّهُ

فُسُوْقٌ بِكُمْ وَأَتَّقُوا اللَّهَ وَيُعَلِّمُكُمُ اللَّهُ وَاللَّهُ بِكُلِّ شَيْءٍ عَلِيمٌ

"O you who believe, when you enter into debts for a fixed time, you should record them. Let a recorder among you write it down correctly. Let not the recorder refuse to write it down as Allah has taught him. Let him record(s) it, and let the debtor dictate(s) it. And let him fear Allah, his Lord, and let him not diminish it in the least. If the debtor is of unsound mind, or incapable of dictating, let his guardian dictate it correctly. Seek the testimony of two male witnesses among you. If there are not two men, (it is permissible) one man and two women among those whom you like among the witnesses, so that if one of them forgets, the other may remind him. Let not the witnesses refuse when called. Do not tire of recording it until the due date, whether the debt is small or large. That is fairer in the sight of Allah, more likely to corroborate the testimony, and less likely to leave you in doubt, unless it is a cash trade between you. Then there is no sin on you if you do not record it. Take witnesses when you buy and sell, and do not make it difficult for the recorder, and do not make it difficult for the witnesses. If you do so, it is indeed an unrighteousness on your part. Fear Allah, Allah will teach you, and Allah knows all things."

Surah Al-Baqarah verse 282, knowing about the recommended recording is important so that we know the Islamic provisions regarding the provisions and requirements in the recording. The Quran surah Al-Baqarah verse 282 has explained about recording and the provisions regarding the recorder, and witnesses in recording.

For mining companies, especially those with international transactions that face uncertainties in currency exchange rate fluctuations. Hedging should be used during certain economic conditions to protect the company. Meanwhile, investors who want to invest in mining companies need to pay attention to the growth opportunities variable because this variable affects hedging decisions. So that it can be seen how the company's ability to manage the risks it is and will face. Seeing the importance of the growth opportunities variable, so we must also pay attention to financial distress and liquidity in the company.

Effective hedging decisions are essential for mining companies to avoid errors when recording financial reporting as well as to protect their profitability, secure financing, and maintain their competitive advantage in the market (Moningka, 2022).

The large influence of the mining sector on the global economy makes this sector an interesting research object because in recent years the industry has tended to experience difficulties in various aspects, one of which is the company's financial and operational aspects. This can be seen from funding difficulties because world oil prices rose and coal prices fell, which was caused by management policies that were deemed slow in diversifying in reading the market.

According to the justification given above, the author plans to carry out research entitled, "THE EFFECT OF FINANCIAL DISTRESS, GROWTH OPPORTUNITIES, AND LIQUIDITY ON HEDGING DECISIONS

(Empirical Study on Mining Companies Listed on the Indonesia Stock Exchange for the Period 2018-2022)".

B. Research Questions

Based on the previous situation, it can be formulated as follows:

1. How does financial distress affect the hedging decisions of mining companies?
2. What is the impact of growth opportunities on the hedging decisions of mining companies?
3. How does liquidity influence the hedging decisions of mining companies?

C. Research Objectives

Based on the research formulation above, the research objectives are as follows:

1. To determine the effect of financial distress on hedging decisions in mining companies.
2. To determine the impact of growth opportunities for hedging decisions on mining companies
3. To determine the effect of liquidity on hedging decisions in mining companies

D. Research Benefits

The benefits of this research are as follows:

1. Theoretical Benefits

It is hoped that this research can contribute to decision-making for mining companies, especially those carrying out international transactions to avoid bankruptcy.

2. Practical Benefits

Benefits for writers:

- a. Researchers know how hedging decisions are influenced by liquidity, growth opportunities, and financial distress. This is also a source of learning and experience for writers to gain further knowledge.
- b. It is hoped that this research can contribute to science, especially in the field of financial accounting, and as a comparison for further research.