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We are pleased to inform you that your manuscript entitled “**AGENCY PROBLEMS, CORPORATE HEDGING AND SHAREHOLDER VALUE IN INDONESIA**” has been accepted for presentation at the First Annual Conference of the Indonesian Finance Association co-organized by the Faculty of Economics and Business of Universitas Sebelas Maret and the Indonesian Finance Association. The conference will be held on January 14-15 in Solo, Indonesia.

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## AGENCY PROBLEMS, CORPORATE HEDGING AND SHAREHOLDER VALUE IN INDONESIA

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### **ABSTRACT**

*The purpose of this study is develop models to analyze the influence of agency problems and corporate hedging on shareholder value. This study had applied a new concept that was derived from synthesis of the balancing theory and the contracting theory.*

*This study uses the population of companies listed on the Indonesia Stock Exchange (BEI) in 2009-2012. This study applied panel data regression models. Hypotheses were analyzed with Pooled Ordinary Least Square Model, Fixed Effects Model, and Random Effects Model, then tested with the Hausman Test.*

*The results indicate that financial distress, underinvestment and foreign-debt based hedging had positive influence on shareholder value significantly, while foreign exchange risk had no influence on shareholder value. The findings of this study have theoretical implication that supported contracting and balancing theory. While practical implications for the government is support the discourse of the Ministry of Finance to immediately implement a hedging policy.*

*Keywords : agency problems, foreign-debt based hedging, shareholder value.*

## INTRODUCTION

Growing globalization has encouraged many companies to extend their business, but it has also exposed them to foreign exchange fluctuations. Thus, company management should manage variability of their cash flows from foreign operations due to foreign exchange fluctuations (Bartram 2007). Fluctuations in foreign exchange rates have increased firms' exchange rate exposure and affected the firms' sustainability (Yusgiantoro 2004).

International financial management is based on the perspective that the fundamental purpose of financial management is to maximize shareholder value (Eun et al. 2012). The company's goals can be achieved through the implementation of financial management functions with accurate, considering any financial decisions taken will affect other financial decisions that impact on shareholder value (Fama 1980; Jensen 1986).

The company's goals can be achieved through the implementation of financial management functions accurately since any financial decisions could impact on shareholder value (Fama 1980; Jensen 1986). When the principal delegate the operational of the company to the agent, there is a tendency that agent act for his own sake so that it drive the agency problems (Jensen 1976).

International financial risk management is mainly based on the irrelevant Modigliani-Miller proposition. Further, most of the companies live in market imperfections so that the maximization of shareholder value should take into account agency problems. Financial risk management should applied to manage cash flow fluctuations, which may have an impact on shareholder value fluctuations. The deminishing in cash flow fluctuations will reduce the market imperfections costs, so it will provide more cash flow for shareholders, and will increase the expected shareholder value (Eiteman 2010).

Some empirical research have identified agency problems associated with foreign exchange exposure including financial distress, underinvestment, and foreign exchange risk (Dobson and Soenen 1993); (Froot 1993); (Gay 1998); (Minton 1999), (Clark 2009); (Khediri 2010); (Schiozer 2009); (Ameer 2010); (Aretz 2010); (Gonzales 2010). However, based on previous empirical findings, there is no valid conclusions regarding the influence of agency problems towards shareholder value. This study will explore the influence of agency problems towards shareholder value, and expected to obtain findings that contribute both theoretically and empirically in the study of agency problems.

In the last eight years, the Indonesian economy grow stable and reach an average of over 6% per year. But in 2012, the exchange rate depreciated 6.3% derived from the uncertainty of global economic recovery and external imbalance following the widening current account deficit, so it caused imbalance in the domestic foreign exchange market (Bank Indonesia 2013).

To anticipate the negative impact of foreign exchange rate fluctuation and to protect the shareholders value, then the multinational companies conduct hedging policy. Hedging will ensure that the value of the foreign currency used to pay or the amount of foreign currency that will be received in the future will not be affected by changes in foreign exchange rate fluctuations (Froot et al. 1993; Faisal 2001). Hedging policy can contribute to maximize shareholder value. Public companies in Indonesia are also exposed to foreign currency exposure, but the implementation of

the hedging policy is still relatively limited. Some companies conduct foreign exchange derivatives, while the others conduct foreign debt to hedge their cash flows variability. A synthesis of both of them is expected to perform better than partial hedging policy (Paranita 2014).

This study is based on the following research problems. First, there is a research gap on the influence of agency problems on shareholder value. Secondly, there is a research gap on the influence of hedging policy on shareholder value. Third, business phenomenon in Indonesia on 1) the depreciation of Rupiah rate on foreign exchange rate triggers fluctuation on income and liabilities, and 2) the need to apply hedging as a risk management policy of the company. So the purpose of this study is develop theoretical and empirical model to analyze the influence of agency problems and the foreign-debt based hedging on shareholder value.

Originality of this study is the synthesis of the perspective of agency theory, balancing theory, and the theory of contracting as a basic theoretical framework of the influence of agency problems and foreign-debt based hedging on shareholder value.

## **LITERATURE REVIEW**

**Agency Theory.** Berle (1932) stated about the separation of ownership and control of the company so that the distribution of stock ownership in the company becomes an important matter. However, these conditions could potentially lead to a conflicts between the owner and the manager. Jensen (1976) suggested that the agency relationship occurs when the principal delegates authority to the agent to perform some decision making on behalf of the principal and conceptualized as a series of contracts.

In corporate risk management, agency issues have been shown to influence managerial behavior on risk and hedging (Smith and Stulz 1985). Agency theory also explains the purpose of integration between shareholders, management, and creditors caused by the asymmetry distribution of income, which makes the company is in a very risky condition (Myers and Smith 1987). So the agency theory implies that hedging policy has significant influence on shareholder value (Fite and Pfeiderer 1995).

**Balancing Theory.** The major point in the finding decision is to establish an optimal capital structure. Determination of the optimal capital structure composition of funding will be used to finance its assets. Determination of capital structure policy involves a trade off between risk and return. The higher total debt increase cash flow volatility or company's business risk but at the same time it is also increases the expected return. However, increasing the expected return for issued the optimal debt would raise the stock price. Optimal capital structure is the capital structure that balances risk and return so that it can maximize the stock price (Modigliani and Miller 1963; Myers 1984).

Business owners tend to use debt at a certain level in order to maximize shareholder value. Manager behavior can be controlled through participation in corporate ownership. Ownership of these shares can align the interests of managers and owners of the company. The implication show that the managers act more cautiously in determining the capital structure of the company (Jensen and Meckling 1976; Mao 2003).

**Contracting Theory.** The organization is viewed as a legal entity which has a series of contracts either explicitly or implicitly between individuals within the organization. The series of contracts will provide useful insight for the organization. Organizational behavior is the behavior of the balance of complex contract system, built to maximize agents and have different purposes (Jensen 2000).

Jensen and Meckling (1976) stated that an agency relationship is a series of contracts, in which the principals delegated to several group of agents to decide policy behalf of the pricipals. Conflicts of interest between managers, shareholders, and creditors increase understanding the importance of the implementation of the contract. The contract structure of an organization will limit the risks faced by the agency through the specification of fixed or varied payment based on specific performance. In general, the agent's compensation contract plan reflects the separation of management decision and control decision.

**Hedging Theory.** Hedging is the strategy to protect the value of the company from exposure to foreign exchange rates fluctuations. Multinational company which decides to hedge against their transaction exposure could use the money market instruments. The basic principle of hedging is to perform a balancing commitments in the same foreign currency, which is the second commitment for the same number of initial commitment, but opposite in sign (Eiteman 2010).

Hedging policy with foreign exchange derivatives and foreign debt was applied by multinational companies which had the agency problems related to foreign exchange exposure. Foreign exchange derivatives is used to hedged foreign exchange risk due to the fluctuations in assets and liabilities denominated in foreign currency (Geczy et al., 1997; Fatemi and Luth, 2002; Bartram et al., 2004; Hu and Wang, 2006; Al Shboul and Alison, 2009; Schiozer and Saito, 2009). The foreign debt is used as a natural hedge for companies which has revenues in foreign currency to issued foreign debt to reduce the foreign exchange risk (Allayannis and Ofek, 2001; Keloharju and Niskanen, 2001; Graham and Rogers, 2002; Kedia and Mozumdar , 2003; Nguyen and faff, 2003; Bartram et al. 2003; Davies et al., 2006; Klimczak, 2008; Otero et al., 2008; Gonzalez et al., 2010). Foreign-Debt Based Hedging as a hedging policy synchronization derived from foreign exchange derivatives and foreign debt is expected to affect perform better than partial hedging policy (Paranita 2014).

**Hypotheses Development.** Hypotheses about the implications of agency problems on shareholder value have developed based on the positive theory of risk management, the Capital Asset Pricing Model (CAPM), which analyzes the relationship between risk and return in asset management. For company with great financial performance, high risk capital structure could has stock price appreciation. This could happens because most of the investors avoid the high risk company, so they offering higher returns (Lintner 1965). The shareholder value can be described by the signaling theory. Shareholder value as one of the company's financial performance reflect the market interpretation of signalling information published. The company financed the project with debt or equity in a certain amount, then the market interprets the composition and financial performance in the company's stock price appreciation (Ross 1977).

Based on the contracting theory, financial distress affecting the company contracts with other parties. Financial distress cause contracting costs, which

includes a number of direct costs and indirect costs (Smith and Stulz, 1997). Referring to the theory of Capital Assets Pricing Model (CAPM) and the signaling theory, we developed the hypothesis 1 that the higher financial distress and the higher risk of its business, the higher market expect a high return anyway, so it could drive the increase in stock price and shareholder value.

Based on the contracting theory, projects benefit can be rejected by the management if the projected revenues are not sufficient to cover the cost of debt, leaving a residual cash flow to shareholders. Referring to the theory of Capital Assets Pricing Model (CAPM) and the signaling theory, we developed the hypothesis 2 that the higher underinvestment and the higher risk of its business, the higher market expects a high return, so it could drive the increase in stock price and shareholder value.

Nowadays there are an abundant contracts in foreign currencies denominated, so the management should be focus on the increasing of foreign exchange exposure. Multinational companies would be affected by foreign exchange exposure since they have to manage the cash flows of contractual obligations or receivables (Magee 2009). Referring to the theory of Capital Assets Pricing Model (CAPM) and the signaling theory, we developed the hypothesis 3 that the higher foreign exchange risk and the higher risk of its business, the higher market expects a high return, so it could drive the increase in stock price and shareholder value.

A derivative transaction is a payments contract between the parties, whose value is derived from the value of the asset, reference rate or index. Some research suggests that companies with tight financial constraints and foreign exchange exposures tend to use foreign currency derivative (Geczy et al. 1997; Al-Shboul and Alison 2009). Financing companies using the optimal capital structure that balances the benefits and loss in the use of debt. If the benefits of the use of debt is still large, then the debt can be issued. But if the loss of using debt outweigh the benefits, then the debt is not keeping up (Myers 1984). This concept encourages multinationals companies to issue foreign debt to hedged foreign currency exposure. The foreign debt is used as a natural hedge for companies which has revenues in foreign currency to issued foreign debt to reduce the foreign exchange risk (Kedia and Mozumdar 2003). Based Hedging Foreign Currency Debt as a hedging policy synchronization with foreign exchange derivatives and foreign debt is expected to affect more synergistic than partial hedging policy (Paranita 2014). Hedging policy responded positively by the market because it reflects fluctuations in cash flow stability and sustainability of the company's operations. Interpret market hedging policy as a positive policy and the company's stock price appreciation occurred. Referring hedging theory and signaling theory, we developed the hypothesis 4 that the hedging policy effect on shareholder value.

## **METHODOLOGY**

**Population and Sampling.** Population in this study are all companies listed on the Indonesia Stock Exchange (IDX) in 2009-2012. The sampling method was purposive sampling. Financial companies had been excluded from the sample data since their business activity require derivatives to be used for trading purpose or speculative motive. Disclosure of hedging policy explored by content analysis from the notes to the annual report of each company. Based on the purposive sampling, we

had got 66 companies in 2009-2012 each. Thus, the total number of panels data that meet the criteria are 264 data.

**Variables.** Financial distress proxied by long-term debt, which is reflects a long-term liability to be borne by the company. The higher long-term liabilities, the higher financial distress. It draws on research Geczy, et al. (1997), Pramborg (2005), Davies et al. (2006), Hu and Wang (2006), Klimczak (2008), Afra & Nature (2011).

Underinvestment proxied by capital expenditure, which is reflects expenses to buy or add fixed assets, improve operational efficiency, increase production capacity, extend the economic life of the assets. The higher expenditures for fixed assets, the higher underinvestment. It draws on research Graham & Rogers (2002), Suriawinata (2005), Davies et al. (2006), Hu and Wang (2006), Clark and Judge (2008), Gonzales et al. (2010), Afra & Nature (2011).

Foreign exchange risk proxied by foreign sales to total sales ratio, which is reflects the composition of the foreign revenue to total revenue that contains risk of fluctuations in foreign exchange rates. It draws on research Allayannis and Weston (2001), Al-Shboul and Alison (2009), Clark and Mefteh (2011), as well as Junior Rossi (2011).

Foreign-debt based hedging proxied by foreign debt to total assets ratio, which is the synchronization both foreign exchange derivatives and hedging policy with foreign currency debt. It reflects the effectiveness of hedging compared to the amount of assets of the company. It draws on research Allayannis and Weston (2001), Keloharju & Niskanen (2001), Aabo (2006), Clark and Judge (2008), Klimczak (2008), Otero et al. (2008), Schiozer & Saito (2009), Gonzales (2010), Paranita (2014).

Shareholder value proxied by market-to-book-value of equity ratio, which is reflects the estimated value of a company from the ratio of market capitalization divided by shareholder's equity. It draws on research Allayannis, Ihrig, and Weston (2001), Suriawinata (2004), Eldomiaty (2006).

**Analysis Technique.** In order to observe the interaction between agency problems, hedging policy and shareholder value, panel data regression model is used. According to Gujarati (2009), there are four options in the panel data regression models, i.e. the Pooled Ordinary Least Squares (OLS) model, Cross Section Fixed Effects Model (FEM), Period Fixed Effects Model (FEM), and Random Effects Model (REM). To determine the best models between Pooled OLS Model and Fixed Effects Model, Redundant Test is used. While for determining the best model between the Fixed Effects Model and Random Effects Model, the Hausman test is used (Gujarati, 2009).

The model below depicts that shareholder value is a function of financial distress, underinvestment, foreign exchange risk and foreign-debt based hedging :

$$SV_{it} = \beta_1 FD_{it} + \beta_2 UI_{it} + \beta_3 FER_{it} + \beta_4 HED_{it}$$

where :



- SV = market-to-book value of equity, representing shareholder value.  
 FD = log of long term debt, representing financial distress.  
 UI = log of capital expenditure, representing underinvestment.  
 FER = foreign sales to total sales ratio, representing foreign exchange risk.  
 HED = foreign debt to total assets ratio, representing corporate hedging.

## RESULTS AND DISCUSSION

Empirical results for hypotheses were analyzed under Eviews 8, using four models of data panel. The results of data analysis can be summarized in the following table :

Table 1. Empirical Results

<i>METHODS</i>		FD	UI	FER	HED
<i>Pooled OLS</i>	<i>Coeff.</i>	0,2019	0,1521	-0,1072	-0,1423
	<i>Prob.</i>	(0,0000)	(0,0000)	(0,4654)	(0,7951)
<i>Fixed in Cross</i>	<i>Coeff.</i>	0,1221	0,0726	0,1398	1,4714
	<i>Prob.</i>	(0,0018)	(0,0000)	(0,5676)	(0,0010)
<i>Fixed in Period</i>	<i>Coeff.</i>	0,2050	0,1527	-0,1143	-0,1249
	<i>Prob.</i>	(0,0000)	(0,0000)	(0,4399)	(0,8213)
<i>Random</i>	<i>Coeff.</i>	0,1508	0,0885	0,00336	0,0818
	<i>Prob.</i>	(0,0000)	(0,0000)	(0,8530)	(0,0095)

Source : Results of the data analysis.

Then we conduct the Redundant Test and Hausman Test on the data panel method as follows:

Table 2. Redundant and Hausman Test

<i>Redundant Test</i>	<i>F-statistic</i>	12,7298
<i>Cross Section Fixed Effect Model</i>		(0,0000)
<i>Redundant Test</i>	<i>F-statistic</i>	0,2039
<i>Period Fixed Effect Model</i>		(0,8936)
<i>Hausman Test</i>	<i>Chi-squared</i>	14,0155
<i>Cross Section Random Effect Model</i>		(0,0072)

Source : Results of the data analysis.

Redundant Test on Cross Section Fixed Effect model is used to test the null hypothesis that the estimator Cross Section Fixed Effect Model has no difference with the Pooled OLS model. F-statistic value of 12.7298 with a probability of 0.0000 is significant at  $\alpha$  0.05 indicates that the null hypothesis is rejected, or in other words the Cross Section Fixed Effect model is better than Pooled OLS model.

Redundant test on Period Fixed Effect Model is used to test the null hypothesis that the estimator Period Fixed Effect Model has no difference with the Pooled OLS model. F-statistic value of 0.2039 to 0.8936 probability is not significant at  $\alpha$  0.05 indicates that the null hypothesis can not be rejected, or in other words Period Fixed Effect Model no difference and no better than Pooled OLS model.

The Hausman test on Cross Section Random Effect Model is used to test the null hypothesis that the estimator Cross Section Fixed Effect Model has no difference with the Cross Section Random Effect Model. The statistical test was developed Hausman  $\chi^2$  distribution asimtosis. If the null hypothesis is rejected, then the meaning of Cross Section Random Effect Model is not appropriate because the random-effect correlated with the possibility of one or more independent variables. X2 value of 14.0155 with a probability of 0.0072 is significant at  $\alpha$  0.05 indicates that the null hypothesis can be rejected, or in other words the Cross Section Fixed Effect model is more appropriate than the Cross Section Random Effect Model.

Based on Redundant Test and the Hausman test, it can be stated that in this regression model, the most appropriate model is Cross Section Fixed Effect Model (FEM). Thus, the results of the data analysis regression model can be expressed as follows :

$$SV_{it} = 0,122 FD_{it} + 0,0726 UI_{it} + 0,1398 FR_{it} + 1,4714 HED_{it}$$

<i>t-stat.</i>	(3,1733)	(5,5760)	(0,0572)	(3,3329)
<i>prob.</i>	(0,0018)	(0,0000)	(0,5676)	(0,0010)

Cross Section Fixed Effect Model incorporates all observations but still accommodating each unit cross section to have intercept dummy variables. This model accommodates the heterogeneity of inter-unit cross section with its own intercept value. If the cross section of this study unit is a company registered in the Indonesia Stock Exchange this model assumes that each company will have a different intercept. These differences reflect the characteristic of each company, such as economies of scale, managerial styles, types of markets served, and so on.

**Hypothesis 1.** Hypothesis 1 testing results states that the effect of financial distress on shareholder value indicated by the coefficient of 0.122 in the direction of a positive relationship. The test results of this causal relationship is evidence to be able to accept the hypothesis 1 for the results of the analysis showed the value of the standard error of 0.0377 with a significance value of t at 3.1733 and probability value of 0.0000, which means a significant influence on  $\alpha = 1\%$ . Based on the results of empirical testing, the first hypothesis is declared acceptable. Thus, the results of this study empirically find sufficient evidence that the financial distress significant positive effect on shareholder value. So the amount of financial distress of companies in the sample of this study is able to increase shareholder value. This indicates that the increase in long-term debt will increase the shareholder value of the company.

Higher long-term debt reflects the high risk, but also reflects the company's operational expansive and management signals to investors that the financial performance of the company is in great condition. Thus, the market appreciates the positive long-term debt which is reflected in an increase in the market capitalization of the company. This supports the theory that an increase in the debt contracting will increase shareholder value, because it can better control the debt agency costs. The

results of the empirical test of this hypothesis is consistent with research by Geczy et al. (1997); Graham and Rogers (1999); Allayannis and Weston (2001); and Haushalter et al. (2002).

**Hypothesis 2.** Hypothesis 2 testing results states that the effect of underinvestment on shareholder value indicated by the coefficient of 0.0726 in the direction of a positive relationship. The test results of this causal relationship is enough evidence to be able to accept the hypothesis 2 because the results of the analysis showed the value of the standard error of 0.0126 with a significance value of  $t$  at 5.5760 and probability value of 0.0000, which means a significant influence on  $\alpha = 1\%$ . Based on the results of empirical testing, the second hypothesis stated acceptable. Thus, the results of this study empirically found enough evidence that underinvestment significant positive effect on shareholder value. So the amount of capital expenditure in the sample company is able to increase shareholder value. This indicates that shareholder value will increase if the company has a high capital expenditure.

Capital expenditure as a proxy for underinvestment in this study, reflects expenses used to purchase fixed assets, increase the value of fixed assets, increasing its production capacity, or improving operational efficiency. Companies with high capital expenditure reflects the company has investment opportunities and stable growth. Companies with great investment opportunities and growth, tends to increase shareholder value. The market appreciates the high capital expenditure with high market capitalization, thus increasing shareholder value companies. The results of this empirical test supports research by Geczy et al. (1997); Allayannis and Weston (2001); Graham and Rogers (2002); Davies et al. (2006); Hu and Wang (2006); and Clark and Judge (2008) who obtained the finding that capital expenditure positive effect on shareholder value.

**Hypothesis 3.** Hypothesis 3 testing results states that the effect of foreign exchange risk on shareholder value indicated by the coefficient of 0.1398 in the direction of a positive relationship. The test results of the causality is not enough evidence to be able to accept the hypothesis 3 as the result of the analysis shows the value of the standard error of 0.1801 with a significance value of  $t$  at 0.0572 and probability value of 0.5676 which means that the effect is not significant at  $\alpha = 5\%$ . Based on the results of empirical testing, the third hypothesis can be rejected or unacceptable.

Foreign exchange risk is measured with the foreign sales to total sales ratio, which reflects the composition of income from international transactions compared to total sales. In this study, it had been proven that there is no influence of foreign sales to total sales ratio on shareholder value of the company. In our samples, most companies had foreign revenue which is not dominant than the total revenue, so this variable was not significantly affect shareholder value companies. This empirical test results do not support the research findings by Geczy et al. (1997); Graham and Rogers (1999); Allayannis and Weston (2001); Haushalter et al. (2002); Suriawinata (2004); Pramborg (2005); Berry (2006); Eldomiaty et al. (2006); and Clark and Judge (2008) in significance.

**Hypothesis 4.** The hypothesis 4 testing result states that the effect of foreign-debt based hedging on shareholder value indicated by the coefficient of 1.4714 in the direction of a positive relationship. The test results of this causal relationship is

evidence to be able to accept the hypothesis 4 for the results of the analysis showed the value of the standard error of 0.4414 with a significance value of t at 3.3329 and probability value of 0.0000, which means a significant influence on  $\alpha = 1\%$ . Based on the results of empirical testing, then the hypothesis 4 is declared acceptable. Thus, the results of this study empirically find sufficient evidence that the foreign-debt based hedging significantly have positive effect on shareholder value. Foreign-debt based hedging proxied by foreign debt to total assets ratio, which is indicates the effectiveness of the use of foreign currency-denominated debt to total assets of the company. The increase in foreign debt to total assets ratio can increase shareholder value.

In this study, foreign-debt based hedging proxied by the interactions between hedge ratio and the foreign debt ratio, which reflects the foreign debt to total assets ratio. The high debt-based currency hedging contributed to the increase in shareholder value of the company. The results support the findings of empirical test by Haushalter (2000); Allayannis and Ofek (2001); Keloharju and Niskanen (2001); Allayannis and Weston (2001); Kedia and Mozumdar (2003); Clark and Judge (2008); Eldomiaty et al. (2006); Aabo (2006); Magee (2009); ARETZ and Bartram (2010).

## **CONCLUSION**

Based on a literature review and analysis of data, our study concluded that:

1. Agency problems that proxied by financial distress and underinvestment significantly have positive effect on shareholder value; while foreign sales to total sales ratio is not proven significantly effect on shareholder value.
2. Foreign-debt based hedging significantly have positive effect on shareholder value.

The conclusion of this study support the agency theory which states that the related separation of ownership and control of the company, the distribution of share ownership in the company becomes an important thing (Berle, 1932). However, these conditions may cause potential conflicts between the owner and the manager, who called the agency problems. Agency relationship is described as a relationship that arises because of the contract agreed between the principals who use agents to provide services for the benefit of the principal (Jensen 1976). Agency problems related to the risk of fluctuations in foreign currency tends to lead to conflicts between agents with the principal.

The concept of foreign-debt based hedging support contracting theory and balancing theory. The concept of hedging policy with foreign currency derivative supports contracting theory which states that the conflict of interest between managers, shareholders, and creditors increase understanding of the importance of the contract (Jensen and Meckling, 1976). Hedging contracts with foreign currency derivative is a means to limit the risk of fluctuations in cash flows encountered agents, as well as potentially detrimental to shareholders. The concept of hedging policy using foreign debt supports balancing theory, which states that the funding company uses an optimal capital structure that balances the benefits and pengobanan on the use of debt (Modigliani and Miller, 1963; Myers, 1984).

The findings of this study also support the hedging theory which states that multinational companies to hedge against exposure to the transaction, can use the

money market instruments. The basic principle of hedging is to perform a balancing commitments in the same foreign currency, which is the second commitment for the same number of initial commitment, but opposite in sign (Eitman, 2010). Empirically, the findings of this study concluded that the foreign-debt based hedging and agency problems significantly have an influence on the maximization of shareholder value.

This study uses all companies listed in Indonesia Stock Exchange in all sectors, except for the financial sector from 2009 until 2012. As such, the findings of this study can be used as a reference for investors. Factors that proved empirically contribute to shareholder value is financial distress, underinvestment, and foreign-debt based hedging. Thus, the investor can make such factors as one of the benchmarks prospective because of the potential to maximize shareholder value.

The findings of this study have practical implications for the government to support the discourse of the Ministry of Finance to immediately implement a hedging policy, especially for SOEs (State Owned Enterprises). Therefore, we need a collective effort from all stakeholders to promote the benefits, uses, and the importance of hedging policies that will arise awareness of the importance of hedging policy for sustaining businesses in Indonesia Stock Exchange.

Basic theoretical models are built and empirical research model developed in this study contains some of the following limitations:

1. The empirical model used in this study only agency problems mechanism because agency theory highlighted the internal aspect. Limitations of this study provide opportunities for future studies to consider the external aspects.
2. The model of data analysis in this study assumes that the relationship between the variables independent and dependent causality is linear so it is possible to bias the analysis results. Limitations of this study is expected to open up opportunities for future studies to consider models that are nonlinear data analysis in an effort to get the results more accurate data analysis.

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