



Trends in Free Cash Flow Company of The Issuer Stock Exchange

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Abstract: This study aims to examine the tendency of prioritizing management companies listed on Indonesia Stock Exchange (IDX) allocate free cash flow. Respondents there were 23 companies listed on IDX who has a wealth of at least the IDR 1.2 trillions. Questionnaires were sent based on four economic situation, namely: the situation is stable or normal, getting better, getting worse, and the uncertain economic situation. The fourth economic situation is faced with five options for allocating free cash flow, namely: payment of cash dividends, buy back stock, make acquisitions, purchase of financial assets, and distribute it to other areas of investment, such as option's Mutual Funds. Incidentally Indonesia's economic situation was observed 2015 - 2016 is the worsening situation in which the rupiah exchange rate against the USD around IDR 14,500. Similar to the economic situation in 1997/ 1998. The results show that the worsening economic situation the management of companies listed on IDX prefers: the purchase of shares and investments in other business fields, followed by The purchase of financial assets and acquisitions, and payment of cash dividends in the final choice

Keywords: Dividend, Financial Assets, Buy Back Stock, Acquisitions, Hedging.

JEL Classification: G34, M12.



1. Introduction

Based on the results of verification the data processing and mapping the results of research, it is known that in normal economic conditions and tend to improve the management of the issuer in Indonesia Stock Exchange (IDX) prefer to allocate their free cash flow into the acquisition activities. In a normal economic situation, the acquisition followed by dividing free cash flow in the form of cash dividends and make investments to other sectors. After that, buy back shares and the last option is the purchase of financial assets. Bararuallo (1997) indicates that all of the listed companies in IDX more selective in developing the company's business activities. Expansion efforts to convince shareholders through dividend payments and less paid attention to the share buyback (Achim., Borlea,. & Gaban, ; 2016). Price of shares outstanding is seen as a measure the company's value in eyes of society so less attractive to repurchase the same as investing into other sectors (Simakova, & Stavárek; 2015). All this shows that aspects of existing theories in economic situation, strategies, and objectives of management companies must take precedence in profit.

Bararuallo, (2011) This is caused by the stock price tends to go down and open the opportunity for business expansion into other business sectors. Purchases of financial assets and acquisition occupied the second option for consideration market and the slowness of return on investment. Finally, because of benefits achieved little, then the payment of cash dividends into consideration the last (Copeland, 1988; Damodaran, 1994; Denison, 2002; Fama, 1998).

2. Model Research

So the concept of free cash flow stated that market pressures would encourage managers to distribute free cash flow to shareholders because there is the risk of losing control of the company. According to Jensen (1986: 137), free cash flow is the excess cash to fund all the projects that have a net present value positive net of dividends (Fernandez and Pablo, 2004; Kieso, 2011; Marshall, et al, 1993; Myers, 1984; Ohlson and James, 1995). Free cash flow is the excess required to fund all the projects that have a positive net present value. But indeed if free cash flow is large enough, then it not only to pay dividends but also to buy back shares, purchased the assets of financial, acquisitions, or more components of the value (Park, et al; 2000; Redhead and Keith, 1997; Weston, et al, 1993).

Free cash flow is calculated using the following formula:

$$\text{FCF} = \text{AKOP} - \text{PMP} - \text{NWC} \dots\dots\dots (1)$$

Where:

- FCF = Free Cash Flow
- AKOP = Operating cash flow of the company.
- PMP = The company's capital expenditure.
- NWC = Net working capital

Investors may be looking to the purchase of shares is an indication that companies do not have a good new project. However, if the company does not have a good investment opportunity, then it should be cash available in large quantities redistributed to shareholders. However worthy to be aware that after a stock repurchase, there is a concern that the company's risk increases so that a decline in stock prices on the market. That is, the company can distribute income to shareholders by buying back shares to the company that are outstanding. Price of the stock repurchase at equilibrium can be calculated with the following formula:

$$(\text{S} \times \text{Pc}) \text{P}^* = (\text{S} \text{ n}) \dots\dots\dots (2)$$

Where:

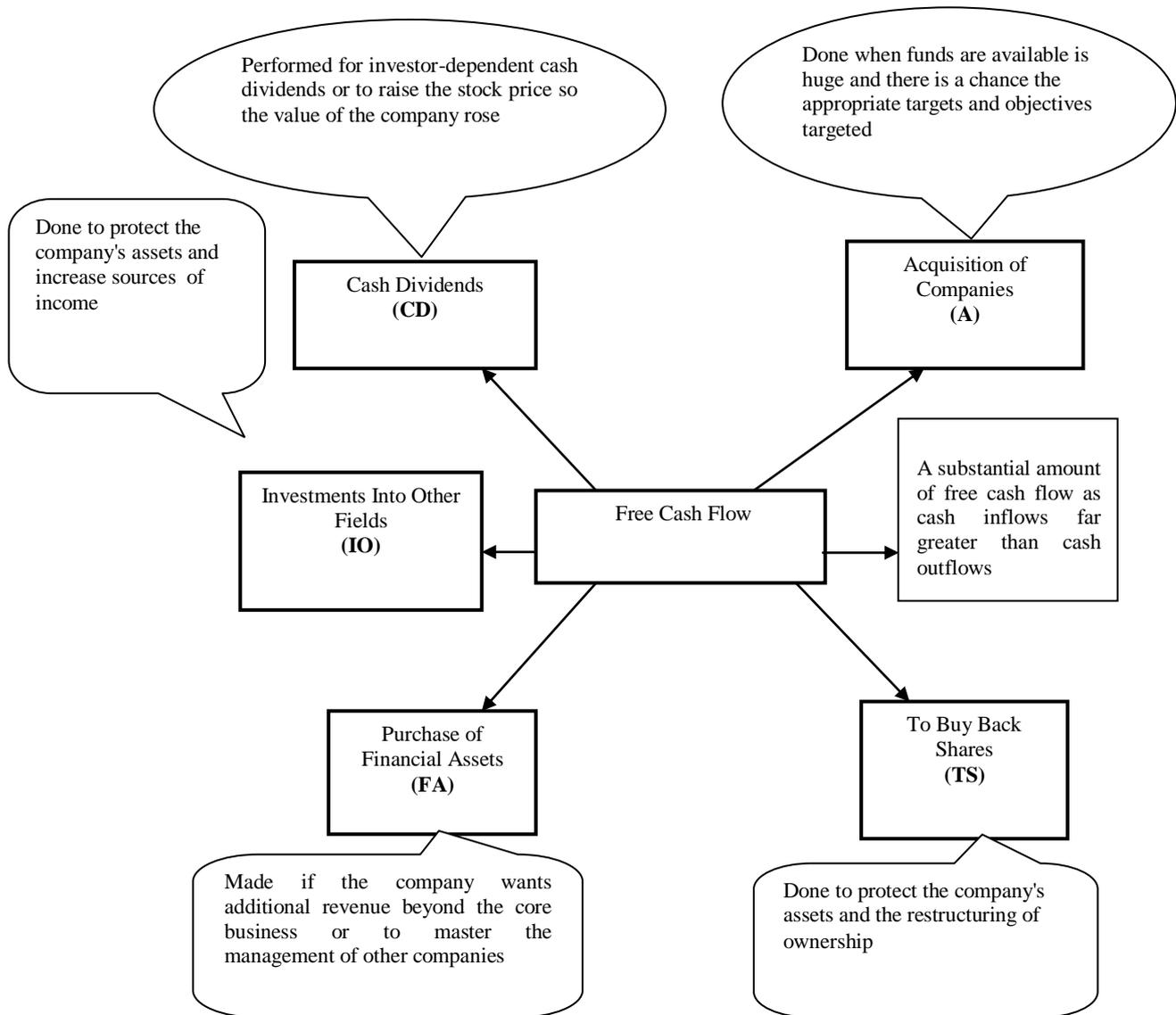
- P * : The price of the stock repurchase equilibrium
- S : Number of outstanding shares before the stock repurchase
- N : Number of shares to be bought back by the company
- Pc : The current stock price before the stock repurchase

If you had to choose between stock repurchase and dividend payments in cash, in perfect market conditions, the market is not perfect, the investor may have a preference for one of two alternatives to it. If the choice falls to the repurchase of shares, then there are three methods that can be used, namely: (1). Shares purchased on the open market; (2). Companies making a formal offer to buy the company's shares in an amount and a specified price; (3). The company bought back a number of shares ones or several large shareholders.

As a result, there are two possibilities for shareholders and the company that is detrimental or beneficial. From the aspect of profits for shareholders, repurchase stock consists of: (1). Stock repurchase often seen as a positive sign for investors because the stock repurchase generally done if the company feels that the stock is undervalued; (2). Stock repurchase reduces the number of shares outstanding in the market, so that after the stock repurchase, there is the possibility of the stock price rises. While aspects of loss for shareholders can be: (1). Companies buy back shares at a price too high to the detriment of shareholders did not sell back its shares; (2). Repurchase stock profits in the form of capital gains, whereas some investors like dividend.

On the economic situation, is volatile and uncertain management company in IDX more likely to choose the policies below a certain order, such as: dividing the dividend in cash (DT), to buy financial assets (FA), to buy the company's shares (TS), does the acquisition of another company (A); or make investments to other sectors (OI), which is a component of certain financial derivatives (option), parked in the Fund (fixed income), or in the form of for ex.

Based on the theoretical framework and trends above, then this research model is constructed as follows:



Figure(1): A Research Model

3. Results

In the uncertain economic conditions, almost every targets-free cash flow focused on the division of dividend and the expansion of investment into the sector. The consideration, tried to be not divert capital to other businesses, and they are confident that the company is still quite reliable with their business expansion into other business fields. Here acquisitions became the second as a result of market IDX and venture companies that have business links could doubt to make a profit because of cost pressures remain in large enough quantities. Subsequent impact is the purchase of financial assets, and the company's shares are considered less profitable because the company is facing a difficult situation. Small profits, increased financial burden, and difficult to make long-term

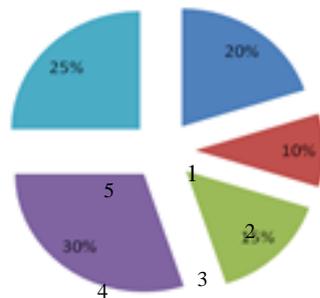
cooperation's for almost all companies are facing considerable problems pressing business; the fixed costs are quite large and born regularly and sustainable.

Thus it can be stated that from the standpoint of management companies in IDX cash dividend policy priority in uncertain economic circumstances. Another interesting point of this study is that investment into other areas, and share purchases re-occupy the first choice in a bad economic situation and uncertain. This trend can be believed by reason stock prices down, and many companies are experiencing financial difficulties and thus potentially more illiquid.

As with the acquisition of which tend to occupy the first position in the normal state of economy and is getting better as well as being the second choice in the bad economic situation and uncertain. It seems that the acquisition does require substantial funding from the management company that will acquire in a bad situation and increasingly uncertain of the acquired company. Unlike the purchase of hard assets become the primary choice. It seems quite difficult for the management of the issuer in IDX to be a broker that requires a lot of time and extra thought rigorous and disciplined time. The above description requires further research in the economic situation of other countries in which the strategy and decision making styles are slightly or completely different with entrepreneurs in Indonesia, especially that go public in IDX.

3.1. Economic Situation Normal

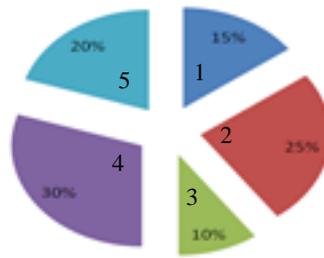
In a relatively stable economic situation or normal management of the company is more likely: the acquisition (30%) and then dividing the cash dividend (25%) or more shall infuse cash into areas more promising. For example, in the financial derivatives sector (25%) such as options and future's transactions (swap) in the form of interest rate swaps or commodity swaps. Firms in this study, less. please share buyback (15%) or purchase-sale of shares and bonds (10%) in the IDX. If ordered by the mapping of the trend, then the order is: 4 (A) = 30%, 1 (DT) = 25% and 5 (OI) = 25%, 3 (TS) = 15%, and 2 (FA) = 10% in the final selection. So the order is: 4 (A = 30%), 1 (DT = 25%) and 5 (OI = 25%), 3 (TS = 15%), and the last is 2 (FA = 10%).



Figure(2) : The Results of The Mapping 1: The Economic Situation is Normal

3.2. Improved Economic Situation

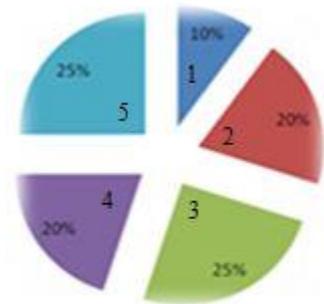
In the economic, situation is relatively improved; the management company is more likely to: acquisitions 4 (A) = 30%, then actively invest in securities in IDX 2 (FA) = 25%, then followed by investments into other areas (5 (OI) = 20%. However, interest dividends only 1 (DT) = 15% and buy back stock only 3 (TS) = 10%. If ordered by the mapping of the trend, then the order is: 4 (A = 30%), 2 (FA = 25%) and 5 (OI = 20%), 1 (DT = 15%), and 3 (TS = 10%) in the final selection.



Figure(3): The Results of the Mapping 2: The Economic Situation is Getting Better

3.3. Economy Worsens Situation

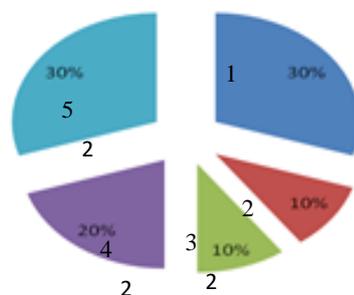
In the relative economic situation, worsening turns management companies in IDX more likely: buying shares back 3 (TS) = 25% and investments into other sectors 5 (OI) = 25%. This activity was followed neatly by acquisition activities 4 (A) = 20% and active in the IDX. But less the dividend distribution for his tendency to think only one (DT) = 10%. If ordered by the mapping of the trend, then the order is: 3 (TS = 25%) and 5 (OI = 25%) and 2 (FA = 20%) and 4 (A = 20%) and 1 (DT = 10%) in the final sequence.



Figure(4): The Results of the Mapping 3: The Economic Situation is Worsening

3.4. Economic Situation Uncertain

In a situation of uncertain economic management of companies in IDX more likely to do: dividend of 1 (DT) = 30% while actively investing in other sectors 5 (OI) = 30%, followed by the acquisition of 4 (A) but less thinking of buying shares returns 3 (TS) = 10%, including playing in IDX 2 (FA) = 10%. They are less please the purchase-sale of stocks and bonds in the IDX. If ordered by the mapping of the trend, then the order is: 1 (DT = 30%) and (OI = 30%), and 4 (A = 20%), and the last is 2 (FA = 10%) and 3 (TS = 10%).



Figure(5): Results of Mapping 4: The Economic Situation is Uncertain

If the sequence above tendency solidified and tabulated the end result looks like below.

Table: Final Results and Ranking

Economic Situation	Priority Target The Use Of Free Cash Flow					Information
	1	2	3	4	5	
Stable / Normal	4(A)	1(DT) & 5(OI)	3(TS)	2(FA)		The results are sorted in priority order of allocating free cash flow
Improved	4(A)	2(FA)	5(OI)	1(DT)	3(TS)	
Worsens	3(TS) & 5(OI)	2(FA) & 4(A)	1(DT)			
Uncertain	1(DT) & 5(OI)	4(A)	2(FA) & 3(TS)			

Note: Sorted and Tabulated According to The Results of Data Processing

Tabulation of the results in Table 1 above shows that aspects of company policy, especially policies on the distribution of free cash flow, greatly depends upon the decision of the company management meetings. As if all can be arranged as carried interest. But the results from this research thrust a number of things that need to be studied more theoretically; among other things, the policy of dividend distribution in cash just be the first choice in the economic situation uncertain, and dividend is not relevant is more visible in the economic situation is improving or deteriorating since economic situation. So even the act of buying back shares: less is best done in a normal economic situation, getting better, or the uncertain economic situation but in the economic situation worsened. Acquisition should be done in a normal economic situation and improved; investment into the business field is more appropriate in a deteriorating economic situation and uncertain. As a result, companies can lose money or profit. The advantages for companies are: (1). Avoid the dividend increase; (2). Strategy disrupted the expropriation of businesses; (3). Approach tender offer and negotiated basis. Companies may make a formal offer to buy the company's shares to an amount and a specified price, including the number of shares bought back from one or a few large shareholders.

4. Discussion

Free cash flow (FCF) represents the excess of the cash required to fund all the projects that have a Net Present Value (NPV) after deduction of dividends (Barclay and Smith, 2001). FCF could theoretically be used to pay dividends, buy back shares, purchase of financial assets, or acquire another company. However, the issuer's management in adding custom IDX, they allocate their free cash flow into other sectors in the form of financial derivatives such as options, future's transactions, in the form of parked in the Fund with fixed income (Bararuallo, 2012). However, in certain situations the economic situation is stable, getting better, worse, or the uncertain economic situation tends to allocate free cash flow to more promising option in the judgment?

5. Conclusions and Recommendations

Based on the results of above observations, the bad economic situation and increasingly erratic to IDX in 2015, it can be concluded that the management of companies listed on IDX tended to pay dividends and invested in other areas such as options, or in parking in the Fixed Income Fund in uncertain economic situation; while the acquisition occupies the second option and the share buyback and financial assets occupy the last option.

In a deteriorating economic situation, the management of companies listed on IDX priority to the share buyback and investment into other business fields; while the acquisition and purchase of financial assets are in the second prioritization. Payment of cash dividends be the last option. So the

theory bird in the hand is not quite right in the deteriorating economic situation. The management company listed on the IDX in 2015 is likely to make acquisitions in a normal economic situation and getting better. However, the payments of cash dividends and investments into other business fields are in the second preferential treatment in normal economic situation. The next option is the share buyback and the last position by purchasing financial assets.

Different in the economic situation is getting better. Purchases of financial assets are in prioritizing second, followed by investment in the business, and the payment of cash dividends in the next selection. Precisely the share buyback is in the final selection. The reason is needed for expansion because the funds provided quite a lot. Although looks like the above, but still advised to make the same observations on the stock exchanges of other countries in similar economic situations.

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