

CHAPTER I

INTRODUCTION

1.1 Background

The importance of Cash Holding in corporate finance cannot be overstated, as sufficient cash is often the ultimate determinant of a firm's survival. Numerous corporate failures, despite varied origins, have been attributed to a lack of sufficient funds (Ye, 2018). This issue is especially critical for Indonesian manufacturing companies, which operate within the unpredictable economic environment of an emerging market. Adequate cash reserves therefore serve a dual purpose: they provide a defensive buffer against economic shocks and operational disruptions, while also offering the strategic flexibility to invest in new opportunities and maintain a competitive advantage.

The determination of an optimal level of corporate Cash Holding is a central issue in corporate finance. An excessive accumulation of cash can indicate operational inefficiency, as such funds represent a non-productive allocation of capital that could otherwise be invested in value-generating projects. Conversely, insufficient cash reserves may trigger a liquidity crisis, impairing a firm's capacity to meet its short-term obligations and capitalize on strategic investment opportunities. Trade-off theory and pecking order theory offer frameworks in understanding this issue. The trade-off theory suggest that firms actively seek an optimal cash balance by weighing the benefits of liquidity against the opportunity costs of holding cash (Opler et al, 1999). In contrast, the pecking order theory proposes that firms follow a distinct financing hierarchy to mitigate costs

from information asymmetry, prioritizing the use of internal funds before issuing debt or new equity (Myers & Majluf, 1984). These theoretical perspectives highlight the complex considerations critical for ensuring financial stability and fostering sustainable growth.

In the Indonesian manufacturing sector, where economic conditions can be unpredictable, managing Cash Holding becomes even more critical. This sector faces unique challenges such as fluctuating raw material costs, changes in demand, and competition from both domestic and international players, such as the influx of cheap imported goods from countries like China. According to Tempo, the textile manufacturing industry has faced significant impacts from this high competition, resulting in substantial job losses and factory closures. These factors add complexity to cash management in manufacturing companies. Additionally, the sector's capital-intensive nature requires substantial investments in machinery, technology, and human resources, making efficient cash management essential for maintaining operational stability. The dynamic economic environment in Indonesia further compounds these challenges, as companies must be prepared to respond quickly to economic shifts and market fluctuations, making effective cash management the difference between thriving and struggling in this highly competitive sector.

According to data from Badan Pusat Statistik for the 2019–2023 period, the Indonesian manufacturing sector contributed an average of 19.16% to the national Gross Domestic Product (GDP) and grew at an average annual rate of 5.84%. This substantial contribution and consistent growth highlight the sector's role as a major

contributor to the national economy, making the financial stability of its firms important for the nation's overall economy. Given this economic significance, studying on the impact of Cash Holding on Indonesian manufacturing companies is valuable for generating insights that can inform more effective capital allocation and liquidity management strategies for stakeholders and individuals that operates in this sector.

The critical importance of Cash Holding management is evident in several notable corporate cases in Indonesia, where poor cash management have led to severe consequences. For instance, the bankruptcy of PT Sri Rejeki Isman Tbk (Sritex) highlights the risks of ineffective Cash Holding, as the textile giant struggled to meet its obligations (CNBC Indonesia, 2024). Another significant case involves PT Indofarma, where substantial cash reserves were allegedly misused by executives for personal gain, demonstrating the need for transparency and oversight (CNN Indonesia, 2024). Furthermore, the Indonesia Eximbank fraud case, involving Rp 2.5 trillion in mismanaged funds, emphasizes the critical role of robust corporate governance in preventing such financial misconduct (CNBC Indonesia, 2024). These incidents demonstrate that while adequate cash is essential, its responsible and transparent management is crucial for mitigating risks and ensuring overall financial health.

Recent studies have explored the implications of Cash Holding in various contexts, emphasizing their crucial role in financial performance. Yilmaz and Samour (2024) discovered significant linear and non-linear relationships between Cash Holding and profitability measures like ROA and ROE in North African and

Middle Eastern countries. Their findings suggest that maintaining optimal cash levels can enhance profitability and support financial stability. Ahmed and Tahir (2024) revealed that in Pakistani firms, larger board sizes and CEO duality strengthen the association between corporate Cash Holding and financial performance, indicating that diverse and robust governance structures can better manage cash reserves.

Alnori (2020) investigated the impact of Cash Holding on the performance of non-financial firms listed in Saudi Arabia, finding that Cash Holding can either enhance or diminish firm performance. The study highlights the importance of maintaining optimal levels of cash to maximize benefits and minimize potential drawbacks. Similarly, Doan (2020) examined the effect of Cash Holding on firm performance among Vietnamese publicly listed firms, revealing that companies with larger cash reserves tend to perform better. This suggests that substantial Cash Holding can act as a buffer against financial distress and improve operational flexibility.

These studies collectively highlight the significance of understanding the dynamics of Cash Holding and their broader impact on firm performance. Given these insights, this study aims to explore the relationship between Cash Holding and financial performance in Indonesian manufacturing companies. By examining these relationships, the research seeks to provide insights into how companies can optimize their cash management practices to enhance financial performance and shareholder value. Specifically, the study will investigate how different levels of Cash Holding influence operating performance (ROA) and financial performance

(ROE). To provide a comprehensive understanding, the study will also consider control variables such as firm age, firm size, and leverage. Through this study, the researcher seeks to provide insights into how companies can optimize their cash management practices to enhance firm performance.

1.2 Research Problem

The existing literature on corporate Cash Holding has extensively covered various aspects of cash management and its implications. However, there is a noticeable gap in research specifically focusing on the Indonesian manufacturing sector. The unique economic and regulatory environment in Indonesia presents distinct challenges and opportunities for companies, making it essential to understand how Cash Holding impact firm performance in this context.

While there has been substantial research on the general relationships between Cash Holding and performance metrics such as “The Effect of Cash Holdings on Financial Performance: Evidence from Middle Eastern and North African Countries” by Yilmaz and Samour that discovered significant linear and non-linear relationships between cash holdings and profitability measures like ROA and ROE in North African and Middle Eastern countries, specific studies focusing on the Indonesian manufacturing sector remain limited.

Addressing this research gap will provide valuable insights for managers, investors, and policymakers, helping them to develop more effective cash management strategies and governance practices tailored to the Indonesian manufacturing sector. Therefore, a comprehensive study that investigates the relationship between Cash Holding, various dimensions of firm performance.

Based on the following description, the research question formulated for this study is:

1. Do Cash Holding have an impact on firm performance?

1.3 Research Objectives

This study aims to provide empirical evidence on the influence of corporate Cash Holding on firm performance in Indonesian manufacturing companies. By examining the influence of corporate Cash Holding, the research seeks to offer insights into how companies can optimize their cash management practices to enhance financial performance and shareholder value. Additionally, the study will investigate how Cash Holding impact various dimensions of firm performance, including operating performance (measured by ROA) and financial performance (measured by ROE).

1.4 Research Contribution

1. Theoretical Contributions

This study aims to provide new insights into the relationship between corporate Cash Holding and firm performance in Indonesian manufacturing companies. The findings will serve as a reference for future research in similar contexts.

2. Practical Contributions

The results are expected to help managers in the Indonesian manufacturing sector develop better cash management strategies and provide investors with valuable information for making informed decisions regarding a company's financial health.

1.5 Writing Systematic

CHAPTER I INTRODUCTION

This chapter includes the research background, research problem, research objectives, research contributions, and writing systematics.

CHAPTER II LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

This chapter covers the theoretical basis and the development of hypotheses.

CHAPTER III RESEARCH METHODOLOGY

This chapter describes the data and data sources, population and sample, sampling techniques, operational definitions of variables and their measurements, and the data analysis methods used in the research.

CHAPTER IV ANALYSIS AND DISCUSSION

This chapter presents the data analysis and the results of the discussion.

CHAPTER V CONCLUSION AND LIMITATION

This chapter provides the conclusions of the research, discusses the research limitations, and offers suggestions for future research.

