CHAPTER I

INTRODUCTION

1.1 Background

The rapid economic development in Indonesia encourages companies to follow this development globally. This development led to very tight competition, so the company must be able to maintain the company business so that the company goals can be achieved. To support the company's business, the company requires a source of funding. This funding source has a function to expedite the company's operational activities so that they can run well. Sources of funding can come from internal or external companies. Internal funding sources, such as retained earnings, come from within the company generated itself. Meanwhile, external funding sources, such as debt, come from outside the company.

One source of funding is debt by issuing bonds that will be purchased by creditors. Bonds can be described as transferable medium-long-term notes, which contain a promise from the issuing party (companies) to pay compensation in the form of interest for a certain period and pay off the principal at a predetermined time to the creditors. Every company that has debt provides interest to creditors for the compensation that the company must give. Therefore, this interest rate will be the cost of the company's debt (Fabozzi, 2007).

The cost of debt arises from using company debt in the past. This debt requires the company to pay interest expenses at a later date. In addition to getting returns in the form of interest, creditors must pay attention to the risks of purchasing a company's bonds. The risks that arise can be in the form of risks related to the characteristics and way management manages the company. Return and risk a trade-off means that the higher the creditor's assessment of existing risks, the higher the company's interest expense.

Therefore, the company must grow to be able to pay debts and interest to creditors. However, if the company cannot pay debts and interest later, the company will go bankrupt. In Indonesia, an example of a bankrupt company is PT Sariwangi Agricultural Estate Agency. This company was declared bankrupt in 2018. PT Sariwangi Agricultural Estate Agency went bankrupt because it could not pay debt repayments to its creditor, Bank ICBC Indonesia, worth Rp317 billion (exchange rate Rp15.471) (Brilian, https://finance.detik.com/, 2022). Based on the case above, an agency problem occurs between management and creditors. Management is obliged to repay debts and interest to creditors who have claims on company assets. However, management could not pay the company's debts and interest, resulting in a transfer of ownership of assets to creditors.

On the other hand, the company will benefit from the cost of debt. The existence of the cost of debt can make the company save on taxes and reduce the tax burden to be paid. Efforts made by companies to reduce the tax burden can be through tax management. Tax management is one way to fulfil tax obligations, but the amount to be paid can be minimized to obtain the expected profit and liquidity (Pohan, 2013). One form of tax management is tax planning. According to Pohan (2013) and Darussalam (2009), tax planning is an effort by taxpayers to minimize the tax burden so that the taxes paid by companies can be as efficient as possible based on the scheme regulated in the law and does not cause disputes between taxpayers and tax authorities. Companies can carry out tax planning in various ways, which is through tax avoidance (Mgammal, 2019).

Tax avoidance is an activity that affects tax obligations, both allowed or special activities to reduce taxes (Dyreng et al., 2008). Most companies are involved in tax avoidance. This tax avoidance aims to reduce the company's income tax because the tax burden will certainly reduce the company's profits (Noor et al., 2010). As a result, the tax avoidance that occurred became the main focus of the government. The implementation of tax avoidance usually takes advantage of tax law loopholes and does not violate tax law. In addition to avoiding taxes by taking advantage of tax law loopholes, companies can take advantage of deductible expenses to reduce taxes. One way to take advantage of deductible expenses is to use the cost of debt or known as interest expenses. In Indonesia, interest expense which is recognized as a deductible expense is regulated in PMK NO.169/PMK.010/2015.

Research conducted by Lim (2011) explains that there is a relationship between tax avoidance and the cost of debt. Based on this research, tax avoidance is a substitute for using debt, which means companies use less debt when engaging in tax avoidance. Tax avoidance can reduce the tendency of companies to go into debt to increase financial slack and reduce the possibility of bankruptcy. This tax avoidance activity will lead to a decrease in the use of company debt. In general, tax avoidance can help companies reduce the cost of debt by taking advantage of the savings paid to the state (Ha et al., 2022). Thus, if the tax avoidance is greater, the cost of debt will be smaller.

However, it differs from research conducted by Masri dan Martini (2012), which shows that creditors view tax avoidance as a risk. For example, suppose tax avoidance activities result in a decrease in the value of the company. In that case, likely, creditors will not get back payments of principal and interest expenses (Shina & Woob, 2017). Based on research conducted by Li et al. (2018), accounting transparency and the quality of financial reports will be disrupted if there is tax avoidance. Therefore, if a company doing tax avoidance gets an unsatisfactory evaluation result, the creditor will demand a higher rate of return. Thus, tax avoidance activities increase the cost of debt. In addition, creditors do not always see tax avoidance as an indicator of creditworthiness, so it is not related to a decrease or increase in the cost of debt, and companies focus more on business results and management efficiency in lending decisions (Ha et al., 2022; Zamifa et al., 2022).

In debt contracts, a mechanism is needed to increase the trust of a third party (the creditor). Creditors must ensure that the funds lent will be used as well and efficiently as possible. Information asymmetry occurs when creditors have limitations in obtaining information related to company performance. Thus, a mechanism is needed to assist the interests of all stakeholders, which is corporate governance (Chatterjee et al., 2019). Corporate governance is one way to control and improve company performance. This corporate governance regulates the division of tasks and obligations toward companies, including shareholders, managers, commissioners, and stakeholders (Sarbah & Xiao, 2015). Corporate governance can be proxied by several indicators, one of which is institutional ownership.

Institutional ownership is the amount of company ownership owned by institutional investors, such as investment companies, banks, insurance companies, or other institutional owners. According to Lim (2011), there is a relationship between institutional ownership and the cost of debt. Institutional ownership can reduce agency problems between shareholders and managers. The existence of institutional ownership can monitor management performance, which encourages management to improve company performance. The monitoring carried out by institutional parties can reduce the company risk that will arise, so the cost of debt charged by creditors is lower (Roberts & Yuan, 2010). That means the higher the level of share ownership owned by the institution, the more control over management performance is increasing, which impacts the cost of debt borne by the company. However, research conducted by Yunita (2012) explains that institutional owner, as the dominant shareholder, prefers to finance companies with debt because it does not reduce their voting rights. That is, institutional ownership cannot monitor company management's performance, so institutional ownership cannot be able to resolve agency problems between managers and shareholders. In addition, there is a possibility that the institutional parties do not take control because these actions require a high cost, and there is no evidence that the control taken by institutional investors cannot limit management behavior. This is because this control does not encourage management to focus its attention on the company's performance, so institutional ownership cannot reduce the self-interested behavior of management (Ha et al., 2022; Adam et al., 2015).

In addition, creditors can also see the company's state from leverage. Leverage is seen as a source of financing used by companies. Leverage explains how much debt is used in company activities (Siswanto, 2021; Alkhatib, 2012). Leverage also indicates the risks the company will face.

Research conducted by Lim (2011) explains that there is a relationship between leverage and the cost of debt. If the company's leverage is high, it means that the source of funding used by the company comes from debt. The use of high debt as a source of funding carries a risk of non-payment of the debt, so companies need to pay attention to their ability to generate profits. One of them is to expand and innovate products that will ultimately increase company profits.

On the other hand, this risk will be a concern or strict monitoring by creditors to provide company loans. The level of attention or strict monitoring by creditors for high risk will also affect the high cost of company debt. Therefore, the higher the company's risk, the higher the company's obligation to pay debts and interest expenses, and vice versa. (Elyasiania et al., 2010). However, research conducted by Swissia & Purba (2018) explained that leverage does not determine the amount of cost of debt to be paid by the company. When the company makes a loan to a creditor, the creditor will see the company's ability to pay its obligations based on the assets it owns. Loans made by companies will incur the cost of debt, which is the effective interest rate that must be paid by the company.

There are several conflicting research results related to the cost of debt. First, Kovermann (2018), Cen et al. (2017), Masri & Martini (2012), and Lim (2011) explain the relationship between tax avoidance and the cost of debt. Kovermann (2018), Cen et al. (2017), and Lim (2011) found that tax avoidance has a negative relationship with the cost of debt. Masri & Martini (2012) found that tax avoidance has a positive relationship with the cost of debt. However, Ha et al. (2022) and

Zamifa et al. (2022) explain that there is no relationship between tax avoidance and the cost of debt. Second, Chatterjee et al. (2019), Swissia & Purba (2018), Yunita (2012), Lim (2011), and Roberts & Yuan (2010) explain the relationship between institutional ownership and the cost of debt. Chatterjee et al. (2019), Swissia & Purba (2018), Lim (2011), and Roberts & Yuan (2010) found that institutional ownership has a negative relationship with the cost of debt. Yunita (2012) found that institutional ownership has a positive relationship with the cost of debt. However, Ha et al. (2022) and Adam et al. (2015) explain that there is no relationship between institutional ownership and the cost of debt. Third, Dirman (2020), Spiceland et al. (2016), Lim (2011), and Elyasiania et al. (2010) found that leverage has a positive relationship with the cost of debt. However, Swissia & Purba (2018) explain that there is no relationship between leverage and the cost of debt. These conflicting research results indicate that further research is still needed. Therefore, the author is interested in analyzing the relationship between tax avoidance, institutional ownership, and leverage on the cost of debt. This research was conducted on non-financial companies listed on the Indonesia Stock Exchange during 2012-2021.

1.2 Research Problem

Based on the background of the research problems described earlier, the research problems to be discussed in this study are formulated as follows:

1. What is the relationship between tax avoidance and the cost of debt?
2. What is the relationship between institutional ownership and the cost of debt?
3. What is the relationship between leverage and the cost of debt?

1.3 Research Purposes

Based on the formulation of the research problem described earlier, the purposes of this study are as follows:

1. To obtain empirical evidence regarding the relationship between tax avoidance on the cost of debt
2. To obtain empirical evidence regarding the relationship between institutional ownership on the cost of debt
3. To obtain empirical evidence regarding the relationship between leverage on the cost of debt

1.4 Research Benefits

This research is expected to provide the following benefits:

1. Theoretical Uses

   This research is expected to add insight and knowledge, especially regarding the relationship of tax avoidance, institutional ownership, and leverage on the cost of debt. In addition, this research is expected to contribute ideas for further research and provide ideas as a consideration in providing information about tax avoidance, institutional ownership, and leverage on the cost of debt in a company.

2. Practical Uses

   This research is expected to provide information to non-financial companies regarding the relationship of tax avoidance, institutional ownership, and leverage to the cost of debt. This research is also expected to be a consideration for investors and potential investors to determine a company's performance by paying attention to tax avoidance, institutional ownership, leverage and the cost of debt as a form of consideration for deciding to invest in the company.

1.5 Writing Systematic

CHAPTER I	**INTRODUCTION**
	This chapter is an opening chapter that outlines the background, research problem, research objectives, research benefits, and writing systematics.
CHAPTER II	**LITERATURE REVIEW**
	This chapter describes some of the theories and basic concepts related to this research, reviews the previous literature, and directions regarding developing the hypothesis.
CHAPTER III	**RESEARCH METHODS**
	This chapter contains the research design, population, sample, data collection methods, data sources, operational definitions and measurement of research variables, and data analysis method.
CHAPTER IV	**RESULTS AND DISCUSSION**
	This chapter will describe the results of hypothesis testing, the interpretation of the results, and arguments for the research results.

CHAPTER V CONCLUSION

This chapter contains the conclusions and limitations of the research. This chapter will also contain suggestions for future researchers to overcome the limitations of existing research.