

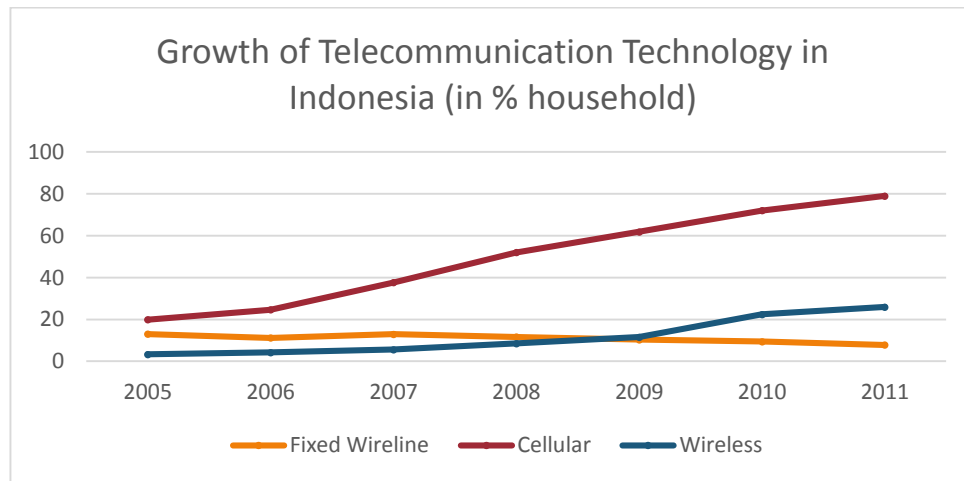
# CHAPTER I

## INTRODUCTION

### 1.1 Research Overview

Based on the Act no. 52 year 2000 regarding the telecommunication procurement, the system of telecommunication procurement in Indonesia, including the network, service, and particular telecommunication, on the article 9 of the government policy, there was stated that the procurement of the telecommunication network is divided into a fixed network (*cable and wireless*) and mobile network (*cellular*). During the milestone of the development of telecommunication in Indonesia, the needs of Indonesia's society had been shifted and impacted on the change of the level of development from every segment of telecommunication network. It was then proven by the phenomena that is happened in the cable-based (*fixed wireline*) telecommunication network provider.

Since the first time cellular technology (*GSM*) introduced by the end of the year 1996, the prepaid card technology in 1998 and the more competitive used of CDMA technology in 2002, the society was started to change to use cellular phone and wireless because of its flexibility and could fulfill their high needs of mobility. As the result, the domination of the fixed wireline towards the procurement of new connection was shifted to the mobile phone and wireless. As the consequences, the growth of conventional telecommunication technology that has been used by Indonesia since a long time ago was falling year by year as shown in the figure below:



**Figure 1.1** The growth of telecommunication technology in Indonesia

Source: [www.bps.go.id](http://www.bps.go.id)

\*Data collected on September 13, 2013

Based on the above figure, we can conclude that the cellular phone has been substituting the fixed wireline in Indonesia. This might be different with the phenomena that happened in the developed country where the cellular phone is only become a complementary of the fixed phone. There is one

factor that was influencing this issue which was the culture of the society in the developed country was valuing the privacy more and also the government policy which was simultaneously with the development of ICT by focusing on the domestic telecommunication industry. That was why the fixed and mobile phone could grow side by side.

The high mobility and needs of fast and accurate information is also becoming one factor that shifts the preference of society on how they are choosing the telecommunication mode. It is also indirectly triggered by the development of ICT in the world that pushes the fast growth of cellular phone and wireless in Indonesia.

The government expected to be able to formulate the regulation which ensures the telecommunication access which covers the entire Indonesia archipelago and also optimize the growth of fixed wireline network industry which is getting slower. The slow growth in the fixed wireline industry is actually can be optimized by referring to the tele-density of Indonesia which is categorized as low compared to several other countries in ASEAN such as Malaysia, Singapore, and Thailand.

To formulate the policy which ensures the telecommunication access which covers the entire Indonesia archipelago and also optimize the growth of fixed wireline network industry which is getting slower, the particular and comprehensive review is needed to measure the performance and profitability of this industry.

Therefore, a review regarding the telecommunication fixed wireline telecommunication industry, wireless, and cellular in Indonesia should be comprehensively taken into account, either quantitative or qualitatively, by using the secondary data from big dominant companies on the industry which will be representative to represent these industries.

Speaking of telecommunication industry in Indonesia, there are several telecommunication provider companies which engages the business in Indonesia, PT Indosat Tbk, PT Telekomunikasi Indonesia Tbk, Telkomsel, PT XL Axiata Tbk, PT Hutchison Charoen Pokphand Telecom (HCPT), Bakrie Telecom, and PT Smartfren Telecom Tbk.

## **A. Indosat**

### **i. Indosat at Glance**

PT Indosat Tbk is one leading telecommunication service provider in Indonesia that provide prepaid and postpaid cellular service. Indosat is the pioneer that introduce the wireless broadband service with the 3.5G and HSDPA technology in Indonesia. Indosat also provides the telecommunication service including the international direct connection, wireless connection, and also fixed phone.

In addition, along with its subsidiaries such as PT Indosat Mega Media (IM2) and PT Aplikasinusa Lintasarta, Indosat is providing a data connection services or media, internet, and data communication (MIDI) like IPVPN, channel rental and internet service. The company stated its stock in form of dual listing in 1994.

Recently the common stock of the company is stated on Bursa Efek Indonesia (BEI: ISAT) and American Receipt (ADR) also stated on New York Stock Exchange (NYSE: IIT).

**ii. Indosat Logo**



*Figure 1.2 Indosat Logo*

*Source: [www.indosat.com](http://www.indosat.com)*

**iii. Vision Statement**

*“To be the first choice of the customer for the whole information and communication needs”*

**iv. Mission Statement**

1. Providing and developing the products, services, and innovative solutions and high quality that offer the best value to our customers.
2. Continuously increasing the value of all shareholders.
3. Manifesting the better quality of life of all stakeholders

**v. Products and Services**

**Table 1.1** Indosat Personal Product

Personal		
1	IM3	A GSM multimedia prepaid service for young generation that offers a telephone, SMS, and data services with an interesting price.
2	INDOSAT MENTARI	A prepaid GSM cellular service for adult customer that is designed to operate on Android, Blackberry, Apple iOS, and Windows to communicate well.
3	MATRIX	A postpaid GSM cellular service for professional users and corporate that is equipped with ability to have additional corporate based services.
4	INDOSAT SUPER 3G	A super-fast service up-to 7.2 Mbps for all of the prepaid and postpaid subscriber with a quota-based or unlimited option.

5	STARONE	A fixed wireless connection that offers a fixed connection, mobile voice, and data using CDMA 2000 1x technology.
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Source: *Indosat Annual Report 2012*

**Table 1.2** Indosat Business Product

Business		
1	INDOSAT SOLUSI UKM	A comprehensive telecommunication solution to improve the productivity cooperatives and small medium enterprises in Indonesia through CUG, I-Customer relationship Management (I-CRM), I-Koperasi, Indosat Phone.
2	INDOSAT CORPORATE SOLUTIONS (ICS)	An integrated telecommunication solution for business covering the voice, mobile data, connection, value added service, and hosting through Mobile and Convergence, Connectivity and Internet, Satellite, and information technology services.
3	INDOSAT CLOUD	Indosat Cloud Infrastructure-as-a-Service (IaaS) from Indosat is an enterprise class service which is designed and built using the best and leading software and hardware infrastructure. Indosat Cloud is offered through internet connection or through a leased private line. The Indosat Cloud Platform is built to support the automatic transmission and whole settings and also supported by the server devices, storage, network element that is included in a virtualized application system.

Source: *Indosat Annual Report 2012*

**Table 1.3** Indosat Personal Product

International Services		
1	INDOSAT INTERNATIONAL ROAMING (OUTBOUND)	Indosat International Roaming gives the Indosat subscriber an easiness on a simple and reasonable telecommunication cost whenever they travel across nations through the IDD 001.
2	INDOSAT FLATCALL	The international flatcall allows the Indosat subscriber to call international number through Indosat 01016.

3	TRAVELING CONNECT	This is a program that allows the listed subscriber to get a mileage plane or hotel point whenever they made an international call using the mobile operator which were participated on this program.
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*Source: Indosat Annual Report 2012*

**B. Telkom Indonesia** (Source: Telkom Indonesia Annual Report 2012)

**i. Telkom Indonesia at Glance**

PT Telekomunikasi Indonesia, Tbk or commonly called “Telkom” is a state-owned company that is the biggest telecommunication and network services in Indonesia. Telkom provides the info-com, fixed wireline, and wireless, cellular phone, data and internet, and also the network and interconnection, directly or by utilizing its subsidiaries.

As a state-owned company, the government of Indonesian is the major shareholder that owned most of the common stock of the company, while the rest is owned by public. The stock of the company is traded on the Bursa Efek Indonesia (BEI) or Indonesia capital market, New York Stock Exchange (NYSE), London Stock Exchange (LSE) and Tokyo Stock Exchange (without listings).

To answer the challenge that is continuously developed in the domestic or global telecommunication industry, Telkom is willing to transform fundamentally towards all of its business line that covers the business transformation and portfolio, infrastructure transformation and system, organization transformation and human resource, and also cultural transformation. These transformations are carried on to support the TELKOM business diversification efforts from the dependency towards the *Legacy* portfolio business which is related to telecommunication such as fixed wireline, cellular phone, and Multimedia into TIME portfolio.

(Source: Telkom Indonesia Annual Report 2012)

ii. **Telkom Indonesia Logo**



*Figure 1.3 Telkom Indonesia Logo*

*Source: [www.telkomsel.com](http://www.telkomsel.com)*

iii. **Vision Statement**

*“To be a leading company on Telecommunication, Information, Media, and Edutainment (TIME) service in regional area.”*

iv. **Mission Statement**

1. Serving a high quality TIME service with a competitive price
2. Organizing the best corporation in Indonesia.

v. **Products and Services**

**Table 1.4** Telkom Core Products and Services

Core Products & Services		
1	TELKOMLokal	It is a service for a local call among customer in a limit of less than 30 km range coverage or inside a certain area.
2	TELKOMSLJJ	It is a long range direct connection inside the area of Indonesia.
3	TELKOMSLI-007	A telecommunication service to overseas by using the 007 access code.
4	TELKOMSpeedy	Is a broadband internet connection service using ADSL technology with a high speed up to 3 Mbps.
5	TELKOMFlexi	A cellular voice and data services using CDMA 2000-1X technology
6	TELKOMGlobal-01017	Is a premium VoIP international call that is utilizing the internet access by using 01017 access code to over 232 codes of destination country.

7	TELKOMSave	Is a long range call and international VoIP call almost same as Telkom Global but using a two-steps dialing method.
8	TELKOMNet INstan	It is a dial-up internet access service without a subscription needed and is designed with an easy and simple concept to fulfil the needs of accessibility.
9	plasa.com	It is a web portal to serve the information and internet community service in Bahasa Indonesia by focusing the service to the national education community.
10	Kartu i-VAS	To support the internet users by issuing an internet value added service which is a tool to do the prepaid payment (micropayment) and to access various content or internet service.
	Telkomitercarrier	Is an interconnection service and wholesale for the service providers and other network that is known as Other Licensed Operator (OLO).
	TELKOMVision	It is a TELKOM subsidiary that provides a paid cable TV service.

*Source: Telkom Annual Report 2012*

### **C. Bakrie Telecom** (source: Bakrie Telecom annual report 2012)

#### **i. Bakrie Telecom at Glance**

PT Bakrie Telecom Tbk is a fixed wireline and wireless network service provider using technology CDMA 1x. the company was established in 1993 called PT Radio Telepon Indonesia. In 2003, the company changed its name to Bakrie Telecom and was stated on the Bursa Efek Indonesia. In 2007, the communication and informatics department issuing license for BTEL to operate nationally followed by the license to provide a international direct connection.

In 2010, BTEL started its transformation from only focusing on the voice and sms to be a broadband wireless access provider by using CDMA EVDO technology. This data service hopefully can be the stimulus for the development of the company in the future. In the same year, BTEL was also transformed from one company that previously was only prioritizing the growth and profit of business become a company that is fully concern towards the environmental conservation.

ii. **Bakrie Telecom Logo**

The logo for Bakrie Telecom features the company name in a bold, green, sans-serif font. The word "Bakrie" is positioned above "Telecom", and both are centered within a light gray rectangular background.

**Figure 1.4** *Bakrie Telecom Logo*

*Source:* [www.bakrietelecom.com](http://www.bakrietelecom.com)

iii. **Vision Statement**

*“To give a better life for Indonesian society by providing information connectivity”*

iv. **Mission Statement**

Providing a high quality with a reasonable price of information connectivity.

**D. XL Axiata** (source: XL Axiata annual report 2012)

i. **XL Axiata at Glance**

PT XL Axiata Tbk (hereinafter referred to as XL or the Company) is one of the leading cellular service provider company in Indonesia, offering various types of telecommunication products and services such as Voice, SMS, data, and other value-added mobile telecommunication services to more than 90 percent of the 240million people of population of the country.

Established in October 6, 1989 under the name of PT Grahame Metropolitan Lestari, XL commenced operations as a trading and general service company. In 1996, XL entered the telecommunications field after obtaining a GSM 900 operating license and officially launching its GSM services, becoming the first private company in Indonesia to provide cellular mobile telephony services. The company changed its name to PT Excelcomindo Pratama, pursuant to a company cooperation agreement with the Rajawali Group and three foreign investors (NYNEX, AIF, and Mitsui).

Currently, the majority shares of XL are owned by Axiata through Axiata investments (Indonesia) Sdn. Bhd. (66.65 percent) and the remaining is held by the public (33.45 percent). XL has developed from a small company offering basic telephony services into one of the largest telecommunication company in the country with extensive network infrastructure and services around the country. XL provides services for retail customers and offers business solutions to corporate customers.

As one of the leading cellular telecommunication company in Indonesia XL strives to enhance its service end-to-end and innovatively delivering the customers' needs. XL is dynamic in managing and operating the business, eager in learning and fast in adapting for



any changes in the industry or market landscape to be able to deliver excellent quality service to customer.

**ii. XL Axiata Logo**



*Picture 1.5 XL Axiata Logo*

*Source: [www.xl.co.id](http://www.xl.co.id)*

**iii. Vision Statement**

*“To be the Indonesia’s cellular champion”*

**iv. Mission Statement**

- Delighting customer
- Delighting shareholders
- Delighting employees

These four companies are the example of the telecommunication companies that operate the telecommunication service business in Indonesia. These four companies are fiercely compete one another to maintain and improve the quality of service and race to grab the market share of Indonesia society.

## **1.2 Research Background**

To be able to serve the Indonesian society with a decent communication service and also to always innovate to be the number one telecommunication provider company in Indonesia, a large investment to support the company operating activities is needed to generate and improve the value of the company. That is why the large number of investment should be decided carefully so that the invested capital would effectively maximizes the value of the company and also satisfies all of the stakeholder of the company.

In maximizing its value, the manager should make a lot of critical decisions in order to make every single activity could add the value to the company. The decision making for capital structure is also have a significant role in financial management of the company, because of its impacts towards the risk and the level of rate of return for the shareholder. Deciding to choose more funding from the debt will causing a heavy interest cost, decreasing profit, and pushing the income per capita, and the most important is it puts the company into a danger of bankruptcy. On the other hand, the conservative policy by using a lot of owner is equity could decrease the profit which is earned by the company on improving the rate of return to the shareholder where the higher component of equity causing a lower share per piece. A company should decide which one is the most suitable source of funding for every of its activity to maximize the value of the company.

The funding decision of a company could be explained by the capital structure theory. In a company, a capital structure is the amount of specific mixed between debt and equity of a company to fund its operational activities. The theory about capital structure was firstly introduced by Modigliani and Miller (1958 and 1963), the basic theory is that the value of a company is not influenced of the capital structure of the company (assuming that there is no tax, no bankruptcy cost, no asymmetric information, and is running on an efficient market). Moreover, on the next period, there are some prove that appear and state that the theory is not relevant to explain the capital structure from the company which is on the real market structure (Watson and Wilson, 2002). There are three theories that are usually being used to explain the capital structure of the company, *pecking order* theory, *market timing model*, and *static trade off*.

The first one is *pecking order theory*, was introduced by Myers and Majluf (1984), this theory explains that a company will prefer to fund the needs of investment with the source of fund from the internal of the company, or usually called by *retained earnings*. This theory predicts that external equity is used as the last resort.

The second one is the market timing model. Market timing model posits that corporate executives issue securities depending on the time-varying relative costs of equity and debt, and these issuance decisions have long lasting effects on capital structure because the observed capital structure at date-t is the outcome of prior period-by-period securities issuance decisions (Huang and Ritter, 2009). According to the market timing theory, when the cost of equity is low, the company will choose to use the funding from equity, otherwise it chooses debt.

The third one is the static trade off theory. The static trade off model stated that a company or a firm in its way on finding its capital structure will consider the tradeoff between the benefit of using debt in form of tax shield and reducing the agency cost from the shareholder, but it may generate some problems by the existence of bankruptcy cost and agency cost.

Those three theories are the theories that commonly used to measure the capital structure of one company. The pecking order theory predicts that the external equity is based as the last funding

resource. Under the market timing theory, equity issuance are not necessarily more expensive than debt issue, and in the previous empirical capital structure literature the dynamic trade-off theory has found strong support and argues that firms do have a target which balances the costs and benefits leverage.

Previous research had been conducted regarding the topic of the speed of adjustment. For example the research from Rongbing Huang and Jay R. Ritter (2009) discussing about testing the theories of capital structure and estimating the speed of adjustment in the publicly traded U.S. firms. The research entitled “Testing Theories of Capital Structure and Estimating the Speed of Adjustment” examines time series patterns of external financing decisions and its relationship with the cost of equity capital. In this research the author breaks down the capital structure into three, pecking order theory, market timing model, and static trade off. The pecking order theory explains that the external funds are more expensive than internal funds, and external equity is more expensive than external debt. It predicts that external equity is used as the last resort. The market timing posits that corporate executives issue securities depending on the time-varying relative costs of equity and debt, and these issuance decisions have a long-lasting effects on capital structure because the observed capital structure at date  $t$  is the outcome of prior period-by-period securities issuance decisions. Under the market timing theory, equity issues are not necessarily more expensive than debt issues when equity risk premium is low. Furthermore, firms may want to raise funds when the cost of equity is low in order to build a stockpile of internal funds. Consistent with the market timing theory, they find that firms fund a larger proportion of their financing deficit with net external equity when the expected equity risk premium is lower. This output of this research found out that the speed of adjustment in US publicly traded firm adjusts in a moderate speed and the firms tend to fund a larger proportion of their financing deficit with net external equity when the expected equity risk premium is lower.

Another research studying the adjustment speed of capital structure is from Akinleye Gideon Tayo. The research entitled “Speed of Adjustment towards the Target Capital Structure by Nigerian Listed Firms” is explaining about the ongoing adjustment and reform efforts of Nigeria, and the recent crisis in the nation’s capital market that have brought to the fore the importance of finding optimal adjustment path that will maximize the inter-temporal social welfare function of the country, subject to capital structure constraints. The research examines speed of adjustment of Nigeria Listed Firms to target capital structure. This study made use of panel data from secondary sources collated mainly from annual financial statements and reports of sampled companies quoted on the Nigerian Stock Exchange (NSE) over a study period of 10 years covering 2000-2009. Samples of 85 non-financial manufacturing listed companies were purposively selected for analysis. The findings of the study show that firms adjust toward target leverage at a moderate speed, with a half-life of 3.9 years for book leverage, even after controlling for the determinants of capital structure and firm fixed effects. However, if projects appear with much higher frequency, and if they need to be financed quickly, even this adjustment seems slow.

Based on the research background above, the author is encouraged to conduct a research with the title, “*Analysis of Speed of Adjustment towards the Capital Structure of Telecommunication Industry in Indonesia*” to explore the capital structure and speed of adjustment phenomena in the telecommunication company in Indonesia.

### **1.3 Problem Formulation**

In this recent situation where the banks are setting a relatively low interest over a loan of debt or a credit to get an external funding facility, especially to fund a telecommunication company’s operating activities that require a large number of fund, the author would like to formulate the problems into:

- 1.3.1 Do telecommunication companies in Indonesia prefer to use long term debt or using equity in making a financing decision on their capital structure?**
- 1.3.2 Analyzing how does the speed of adjustment towards the capital structure on telecommunication companies in Indonesia?**

### **1.4 Research Objectives**

The objectives of this research are as follows:

- 1.4.1 Explaining whether the funding for the deficit of telecommunication companies operational activities in Indonesia tend to use a long term debt or use the equity issuance.**
- 1.4.2 Analyzing the speed of adjustment towards the capital structure on telecommunication companies in Indonesia.**

### **1.5 Research Benefits**

This research hopefully might be beneficial to the company, bank, investors, academician, and those who are intended. By understanding the speed of adjustment towards the capital structure, the benefits that might be obtained are:

#### **1.5.1 Investors**

The output of this research will provide the information about whether or not a company could provide a sufficient funding for its investing activities. It would bring a positive signal to the investors that the company will be able to increase the wealth of the investor. It is also can be correlated with a *signaling theory* where a company which uses a retained earnings and debt will give a more positive signal to the investors rather than a company issues equity or bonds.

#### **1.5.2 Academician**

Could be used as a figure of analysis of speed of adjustment towards the capital structure of a company.

### **1.5.3 Creditor / banks**

The output of this research will provide the information about the ability of the company to do the funding internally, so that the creditor can analyze the ability to pay over the debt that has been proposed by the creditor.

## **1.6 Scope of Reasearch**

### **1.6.1 Variable and Data Gathering Period**

The data being used was a secondary data from the annual report of telecommunication company and also taken from the annual report and also from the historical value of the capital market of telecommunication companies in Indonesia, started from August 31<sup>st</sup>, 2006 until August 31<sup>st</sup>, 2012.

### **1.6.2 Research Objects and Area**

The object of this research is the companies who run in the telecommunication industry in Indonesia.

## **1.7 Writing Structure**

The writing structure in this report will be given in form of a consecutive description of chapter by chapter to make a better flow of discussion. The systematics are as follows:

### **CHAPTER I INTRODUCTION**

This chapter descres the sequence of background about the selection of topic to be discussed, the problem formulation, objectives that want to be achieved by conducting the research, benefits of the research, problem definition, and assumptions, and also the writing systematics for this research.

### **CHAPTER II LITERATURE REVIEW**

This chapter elaborates the basic theory and literature study which are becoming the explanation in detail about the theories regarding the problem solving and also explains the outline of the method used by the author as the framework of problem solving.

### **CHAPTER III RESEARCH METHODOLOGY**

This chapter is a structured overview of the research implementation step by step which is illustrated in form of flowchart and a description will be given on each step in conducting the research.

#### **CHAPTER IV RESULT AND ANALYSIS**

This chapter elaborates the methods of data collection which is gathered from the company and the way how to process the data in accordance with the basic theory being used, and also the result of the model and its analysis.

#### **CHAPTER V CONCLUSION AND SUGGESTION**

This chapter contains the conclusion and summary of the problem being discussed and also suggestion that are related to the existing problem during the research.