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COST OF CAPITAL DERIVED FROM LONG TERM DEBT

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Abstract

Long-term debt is a policy that is often taken by companies in order to develop their business or invest in the form of fixed assets or non-fixed assets that are used as capital, because a company may not use all of its own capital to invest so that through long-term debt this is how the company can invest and from the results of that investment the company can repay its debts. The decision to take long-term debt requires careful calculation, how much the company's ability to invest and run its business operations, so that long-term debt is not a problem but makes the company grow and develop.

Keywords: ***Cost of Capital, Long term debt***

INTRODUCTION

In facing business competition, a company must really be able to pay attention to a very important thing, namely with regard to capital. In certain situations a company can meet its funding needs by prioritizing internal sources of funds, but due to company growth, the need for funds is getting bigger, so to meet these funding sources, companies can use sources of funds from outside the company, namely debt. However, the use of debt here, there needs to be caution over the risks involved resulting from the use of the debt. This is because the use of debt has a high risk, however, with a source of funding originating from long-term debt, the company can finance its business needs when it requires large enough funds and takes a long time for the company to obtain results or profits from the business. then used to fulfill its long-term obligations, one of which is the company's business needs, namely business expansion or expansion. When a company decides to use debt, debt costs will arise. The cost of this debt is categorized as a financial risk, because even though the company is in financial trouble, the company is still obliged to pay these costs. If the company decides not to use debt or the financing is done internally, the company has no obligation to pay these costs. Although not all companies use their own capital, it does not rule out the possibility of these companies borrowing from outside. The decision to finance through debt has a limit to how much funds can be explored on the basis of the benefits that can be obtained from the debt. Companies that use more debt will increase the interest expense and loan principal that must be paid close the opportunity to gain profits than expected.

DEBT DEFINITION THEORETICAL FRAMEWORK

According to Drs. S. Munawir in the book Analysis of Financial Statements (2004: 18) argues regarding debt as follows "Debt is a company's financial obligations to other parties that have not been fulfilled, where this debt is a source of funds or company capital originating from creditors"

DEFINITION OF LONG TERM DEBT

According to Prof. Dr. Zaki Baridwan in his book entitled Intermediate Accounting (2010: 363) argues regarding long-term debt as follows: "Long-term debt is used to show debts whose repayment will be made in more than one year or will be repaid from sources that are not from the current assets group. Long-term debt is debt with a long term, generally more than 10 years. According to Sartono (2008: 216), long-term debt or long-term debt is a form of agreement between the borrower and the creditor where the creditor is willing to lend a certain amount. and the borrower is willing to pay periodically which includes interest and principal. According to Munawir (2004:19), long-term debt is a financial obligation whose payment period (maturity) is still long-term (more than one year from the balance sheet date). This long-term debt is generally used to finance company expansion (expansion) or modernization of the company because the capital requirements for these purposes include large amounts. (Zefri Maulana and Ayang Fhonna Safa. 2017).

The longer the life of the credit drawn, the better, because the longer the opportunity to obtain cash inflows, which means the greater the ability to repay debts. Meanwhile, the shorter the credit life, the greater the risk of not being able to pay back the debt because the smaller the opportunity to raise funds to repay the debt (Riyanto, 2001: 143). However, it should also be considered that the longer the credit period, the interest expense will be borne by the bank the company is also getting bigger. The use of long-term debt must really be considered, so that the effectiveness of the use of long-term debt can be achieved. The use of long-term debt that is not/is less effective will affect the company's profitability.

Guidelines for dealing with this are as follows (Riyanto, 2001: 145):

1) For current assets, it should be financed with short-term credit that has a term or age that is not shorter than the bound funds in these current assets;
2) For non-revolving fixed assets (eg land), in principle financed with own capital. Because for this type of asset there is no depreciation;
3) For fixed assets that do not rotate gradually (buildings, machinery, vehicles and so on) can be financed with long-term credit or own capital.

Types of Long Term Debt

1) Mortgage Notes Payable Mortgage notes are a token debt with a term of payment exceeding one year, where the payment is guaranteed by certain assets such as buildings, land or furniture.
2) Bonds Payable Bonds payable are debentures issued under a seal stamp, which contain the ability to pay the principal on the maturity date and pay the interest regularly at certain agreed time intervals.
3) Long-term notes payable (Notes Payable- Long Term) Long-term notes payable are notes payable where the term of payment exceeds one year or exceeds the normal operating period.

LONG TERM DEBT RISK

Generally, long-term debt is an option as a solution for companies that need large amounts of funds, which are intended to buy new machines, assets or factories, and others. Even though this long-term debt is more of an option for attracting loans, it's a good idea to first identify the risks and benefits.

The following are the risks of long-term debt:

1. There is a Risk of Decrease in Share Value.
   Risk of decline in share value This will usually apply to companies on a large scale that have sold their shares on the stock market. The amount of debt can affect the selling price of shares in the market, where a large amount of debt will likely make the value of shares decrease. Obviously, this is a very big risk for the company, because it could make the company suffer huge losses.
2. Debt Repayment Risk
   The company's ability to pay off debt will certainly depend on its performance. The risk is always therein progress performancethe company, even though the company has received a number of injections of funds in the form of long-term debt. This long loan deadline, it will be very risky for the company to be able to pay off its debts if the performance is not as good as expected.
3. Can Burden Finances.
   All types of debt are certainly a burden. This long-term debt too will be a financial burden in the future. Not only the principal of the debt, the burden of fees and interest will also burden the finances, especially if the company does not perform well.
4. Monthly Expense Expenses Become High.
   Even though it has a long enough deadline, it is possible that the amount of long-term installments will burden expenses every month. This large amount of debt will be directly proportional to the amount of installments that are quite large and last a long time.
   With a number of risks that follow the decision to take long-term debt, this can still be handled properly, especially if the company's management has good ability to manage these debts.

ADVANTAGES OF LONG TERM DEBT

If there is such a thing as risk, there will be a number of advantages to be gained from this long-term debt, namely:

1. Debt Doesn't Affect Company Management
   In procuring long-term debt, the source of the debt or commonly known as the bondholder (debt) will not have voting rights in the continuation of the company. This is very good for the company, because the company does not need to make changes inside management and operations company for procuring long-term debt.
2. Can Take Advantage of Lower Interest
   Long-term debt will be applied at an amount of interest which will then become a burden for the company's management. But this thing still light and Enough profitable compared to the amount of dividends paid to shareholders in the company.
3. It can also reduce taxes
   By carrying out long-term debt, the benefits to be gained are being able to reduce the existing tax burden. Because if the dividends given to shareholders are not charged as a cost and creates a tax burden for the company, the interest on the loan is actually included in the cost and does not cause tax for the company.

DISCUSSION

In developing its business or expansion company generally requires sizable funds as business capital, apart from personal funds owned can also be obtained from investors and debt. The limited funds owned by the company are the reason for deciding on debt as a source of capital so that it cannot be avoided. Based on the time period, debt consists of short-term debt, medium-term debt and long-term debt. The company's decision in determining debt in terms of the time period usually depends on the need or utilization of the debt, but what is currently being discussed is long-term debt. The decision of the company or manager in taking action to increase business capital through debt The long term certainly has risks and benefits, but the company is unable to predict the impact that will arise, whether it will pose a risk or make a profit. These two things are important for analysis so that strategies and planning capabilities can be developed through good formula calculations. Things that can minimize the risk of long-term debt, namely first, managers are not reckless in making long-term debt decisions, maturity through calculations is needed to finance projects that have long-term prospect values and have profitable values. Second, taking action to pursue short-term profits through long-term debt, in this case creating a large number of trending or seasonal products without ever thinking about the emergence of competitors. while to create these products come from specially created machines, and the funds used to buy machines and raw materials come from long-term loans. Third, when the company is experiencing difficulties in paying off obligations to pay debts that are due, The company uses a long-term allocation of funds.

CONCLUSION

Long-term debt or Long Term Debt is needed for capital costs in order to set up a company or to expand due to company growth. Me Fulfilling the need for funds can be pursued by prioritizing sources of funds that come from within, but companies need large funds so that to meet these sources of funds, companies can use sources of funds from outside the company, namely debt. Hal most companies are run and managed by withdrawing debt to increase their capital because the lack of capital is often an obstacle to financial circulation to drive company. Own Debt in large amounts will certainly bring a big risk for the company. But that doesn't mean companies can't be in debt. Managing company debt takes hard work. But if you are able to manage the company's debt well, the opportunity for the company to continue to grow will also be higher. company must capable take into account its current condition and how it will develop in the future. Calculate and plan carefully if you want to make a decision to have long-term debt. Even though it is for good and business development, procuring long-term debt must still be carried out with full consideration. Make sure this debt will have a positive impact on the company, so that you can be sure of the ability to pay it off and avoid any risks that may be faced.

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