ABSTRACT

The field of finance is broad and dynamic. It directly affects the lives of every person and every organization. There is a financial aspect to almost every decision a person/business makes. Defining corporate finance much more broadly is to include any decisions made by a business that affects its finance.

The corporate finance has only one objective : to maximize the value of the firm. In its activities to achieve the objective, corporate finance decisions that have to be managed can be classified into three major groups—investment decisions, financing decisions, and dividend decisions.

In the most general terms, financing decisions in corporate finance deal with the right-hand side of the firm's balance sheet and involves two main areas :

1. The most appropriate financing mix of debt and equity must be established from time to time to give an optimal cost of capital for maximizing the value of the firm.
2. The most suitable ways to move toward the optimal.

Considering the financing decisions that have to be taken in order to achieve the firm's objective, the writer conduct the such study at PT Riau Andalan Pulp & Paper.

Generally, the firm is still a very new operated firm, since it has just commenced production and sales in 1995. The firm has been suffering lossses in 1996 and 1997 for higher interest expenses and being under capacity managed, whereas the economic crisis that hit Indonesia is not indeed threatening the firm owing to its overseas market and using the US Dollar as its monetary unit.

By implementing the cost of capital approach in estimating the firm's cost of capital and its leverage, the firm has been found out significantly overlevered. It is obviously able to be seen from the ability of the firm to make operating profit, however the operating profit finally cannot cover the interest expenses. The such negative cash flows make the firm in a lower rating and forsakes some firm's value, because the firm operates with debt ratio that significantly different from its optimal. If the firm's cash flows is kept constant, the value of the firm will be maximized when the cost of capital is minimized at its optimal debt ratio.

In closing the study, the writer come up with several summaries :

1. The firm need to analyze and evaluate its optimal leverage periodically in order to always measure the perfomance of management in fulfilling the firm's objective—maximizing the value of the firm.

2. The current significantly overlevered firm should move toward to its optimal cost of capital gradually by paying off debt with Retained Earnings, reducing or eliminating dividends, and issuing new equity and paying off debt.
3. The cost of capital is estimated at a given point in time. Further changes, data, and information will have a different result, therefore the cost of capital approach is subject to changes in order to always provide the most suitable clues for management in their effort to maximize the firm's value.