CHAPTER I

INTRODUCTION

1.1   Background of the Study

A financial instrument, specifically stocks, has gained popularity in Indonesia. Owning stocks has become a common way to save up money with high return. According to Melicher and Norton (2017), a share of common stock "represents an ownership interest in a corporation." It is a common method for companies to raise funds to expand their businesses. People who buy the "ownership of the shares from the companies" are called as investors. Investors buy stocks to maximize their savings because stocks owners are entitled to receive annual or quarterly dividends, which can amount to 10% of stock return on average. Also, saving stocks are more profitable as, investors can sell their stock ownership and can earn a huge amount of profit in return when the companies are thriving.

Commonly, people will reach out to brokerage firms, who have the license to trade directly in the stock exchange, to purchase common stocks. This is because stocks are traded in the stock exchange. The stock exchange in Indonesia is located in Jakarta, Indonesia. It is called Indonesia Stock Exchange (IDX). Companies listed in the stock exchange are classified in IDX Composite Index *(Indeks Harga Saham Gabungan)*. This index tracks the performance of the whole stock market. To narrow down their search for profitable with steady risk stocks, investors seek out blue-chips stocks as a mean of stock investment.

Large companies with steadily thriving performance who delivers high stock return are considered as blue-chip companies. Blue-chips stocks have years of reputation nation-wide for their high quality and performance. They are usually the market leaders in their industry. Due to its high performing and reliable quality, blue chips stocks attract all kind of investors. It is commonly popular amongst new investors because its risk is more stable and easier to bear with. In 2019, CNBC Indonesia announces famous blue-chip stocks in Indonesia, which are PT Bank BCA (BBCA), PT Bukit Asam Tbk (PTBA), PT Gudang Garam Tbk (GGRM), and PT Unilever Indonesia Tbk (UNVR).

Due to the interest towards high performing blue-chip stocks, IDX creates several official indexes to categorize all company stocks based on various criteria set by IDX. Famous prestigious indexes that usually track the high performing companies with high market capitalization and high liquidity, such as LQ45 and IDX30. These indexes are used by most mutual funds and investors to invest their money. LQ45 index consists of the top 45 companies. IDX30 consists of the top 30 companies. In order too narrow down their search for the right stocks, or also known as "stock screening", investors usually use the indexes issued by IDX as one of their benchmarks.

As IDX30 applies the most selective criteria compared to the other indexes, the researcher considers it is challenging to do research on IDX30. Normally, stocks classified within this index are the top 30 companies in Indonesia with excellent performance. Surviving in this index is difficult, especially for three consecutive

years. Obviously, stocks in IDX30 indexes are very eye-catching as they are considered as the less-risky investment for investors.

Despite having prestigious reputations, numerous of sensational cases relating to indexes fund made by IDX catches the researcher's attention. The first case is, since 2016, a company called PT Hanson International Tbk (MYRX) has been included in LQ45 index. In 2020, MYRX is suspended from Indonesia Stock Exchange due to their involvement in PT Asuransi Jiwasraya (Persero) financial problem. In fact, according to a news in October 2019 by CNBC Indonesia, MYRX also issued inaccurate financial statements in 2016, which overstating their performance and making this company qualified to be listed in LQ45 index.

The next case that makes the researcher even more curious is the suspected insider trading case within PT Matahari Department Store Tbk (LPPF) in 2010. This company is included in IDX30 as well. Many investors are led to believe that the company is performing well, when in fact, the stocks are suspected to be traded illegally using the pump-and-dump schemes.

According to United States Securities Exchange (SEC), pump-and-dump scheme is a type of security fraud made usually by companies or third party acting as promoter, who deliberately buys all their stocks through third party to boost a company stocks price. This practice will mislead investors who are considering to do investment. Then, once the stock price has gone up, the fraudster will dump the shares into the market to seek profit, and the investors will lose money because they are misled. Other companies that are once included in prestigious indexes are also suspected to be involved pump-and-dump schemes, such as PT Trada Alam Mineral

(TRAM), PT PP Properti Tbk (PPRO), PT Bumi Resources Tbk (BUMI) and so on (Bisnis.com, 2020).

From the cases above, the researcher has a preliminary presumption that not every companies listed in official indexes are in fact promising for public to invest, even though the indexes are made by the trustworthy IDX. There is a possibility that stocks of companies are in fact mispriced and misleading due to the illegal trading practice and fraud which are not critically evaluate before listing them into official indexes. According to a news from Bisnis.com (2020), Mirza Adityaswara, a senior economist, also feels the same way towards the stocks in the official indexes. Adityaswara says "the stock index is formed by the IDX to provide a reference to the public for shares that are worthy of investment." He also regrets how pump-and-dump stocks could be included in the IDX's prestigious index. That, he says, "harmed the public who made the index as a reference for investment."

Aside from the malpractice of trading of stocks, the demand and supply of stocks can influence the share price. Since not everyone can do a thorough fundamental analysis like professional investors and financial analysts do, people will just follow whatever trusted benchmark, such as IDX30, to buy stocks. Buying stocks without analyzing the fundamentals critically can raise up the price as it hints that the demand for that stock is increasing. This is also called as supply and demand model. According to Schroeder, Clark and Cathey (2016), the availability of the product (or known as supply) and the desire to purchase the product (or known as demand) are influencing the price of the product. Hence, the price of a stock is the equilibrium point of supply and demand.
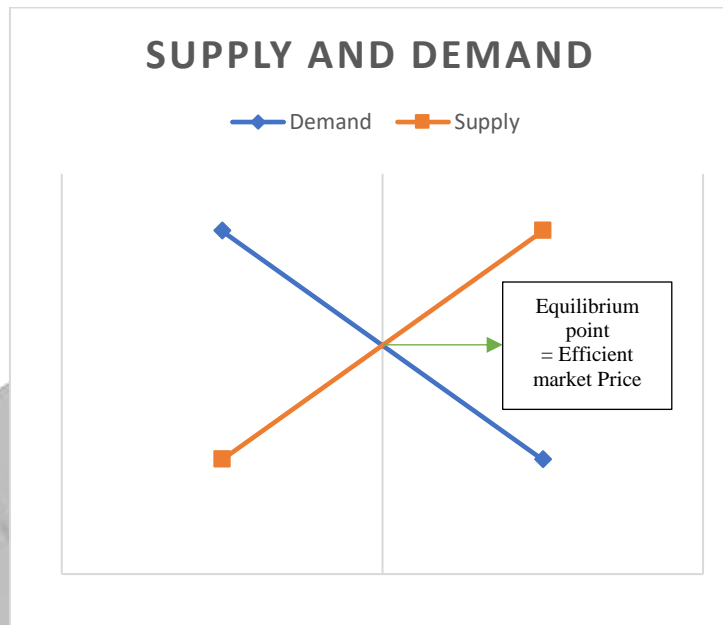
Figure 1.1. Supply and Demand

Source: Prepared by the researcher (2020)

The extension of supply and demand model is efficient market hypothesis, which emphasizes that the stock price reflects whatever information available in the public (Sonkin and Johnson, 2017; Schroeder, Clark and Cathey, 2016). The information such as historical data, financial statements and other publicly available data of the company, will influence the share price. Hence, if people solely follow the trend of purchasing a stock without scrutinizing the company fundamentals thoroughly, the demand for the stock increases, then, the price of the stock will be more expensive, which can lead to overvaluing the stock. Whereas, if the public is panic and deciding to sell their stock without considering the fundamentals carefully, the demand for the stock decreases, then, the stock will be cheaper in the market, which can lead to undervalue of the stock. This is how the mispricing works.

To resolve the malpractice of stock trading and the effect of supply and demand model like efficient market hypothesis, investors should have analyzed the stocks and companies thoroughly before investing by doing fundamental analysis. Fundamental analysis is a method of stock analysis that is widely accepted and applied by many investors. It is used to avoid mispriced stocks, so investors can properly determine the intrinsic value of the stocks. Thus, fundamental analysis is required to know the true worth of the company (Damodaran, 2012).

There are reasons why fundamental analysis is preferred. Bentes and Navas (2013) claim that famous billionaire investors such as Warren Buffet has used fundamental analysis to exploit the bear markets and cheap stocks. This method provides the base for Buffet to gain money from investing in stocks. Another reason is because fundamental analysis is widely accepted by fund managers when they are forming their portfolios. This is proven by a research conducted by A. C. F. Moube and J. M. Jannach in 2003. It also allows investor to find undervalued stocks when creating their portfolio. Hence, the researcher chooses fundamental analysis for this research.

Fundamental analysis can be categorized into top-down analysis and bottom-up analysis. As the commonly used fundamental analysis, top-down analysis will start by analyzing the economics, industry, financial statements, and lastly valuation (Subramanyam, 2014).

In the industry analysis, there is an important sector, which is the consumer goods sector. This sector is one of the sectors that directly interact with the public society, due to its nature to produce goods that cater directly to the public society

and bring good public welfare to the people. This consumer goods sector provides all the daily necessities for everyone.

In order to avoid making reckless investing decision by following the crowd, investors are suggested to conduct a fundamental analysis, which then follow by a stock valuation to know the real worth of the stock based on the company's earnings and market value of the assets (Nasdaq, 2018). Doing a proper stock valuation is important for investing decision making. First, investors need to select a valuation model in order to discover the intrinsic value of the stock. Next, investors will calculate the valuation based on the model they have selected. One of the most widely used valuation models by securities analysts and investors are price to earning multiplier model or (Price-Earnings ratio). Price-earnings ratio takes the stock price and earning per share (EPS) into account. The underlying valuation is based on discounted cash flow (DCF) valuation model, which means this model rejects growth will forever be in a steady rate (Sonkin and Johnson, 2017). Price-earnings ratio is one of many multiplier valuation models. Then, after calculating the intrinsic value of a stock using Price-earnings ratio, investors will compare the calculated value with the stock price. Lastly, they will make an investment decision based on what Schroeder, Clark and Cathey (2016) has claimed. Investors will choose whether to buy (if undervalued) or sell (if overvalued).

The Indonesian Financial Services Authority or known as, OJK (*Otoritas Jasa Keuangan*) has been doing an on-going trend and movement by asking the public to start investing in publicly listed stocks in IDX. Obviously, with the promising return rate, this movement has successfully attracted people across

Indonesia to start in investing, especially those stocks listed in prestigious index such as IDX30. However, the ongoing malpractice trading cases revolving around companies in IDX which are deemed as promising, seems to worry the public. Moreover, the supply and demand of the stocks has affected the true worth of the stocks, which results into mispricing of the stocks in the market. To invest wisely, investors should conduct a thorough fundamental analysis in the company they plan to invest. From analyzing the economics, to the industry (specifically in this case the consumer goods sector), and also to the company itself by examining its financial statements and all relevant data. Also, complete it with calculating the value of stock by using a stock valuation model. All this process will help investors to make the right investing decision.

Based on all the background stated, this research will cover the performance of companies listed in Index IDX30 under consumer goods sector, by examining the economics condition, investigating the industry performance, analyzing the financial statements using financial ratios. Without forgetting to value the stock price of the 5 companies by utilizing a stock valuation model. Hence, the researcher decides that this research title is "**A Fundamental Analysis on Determining Intrinsic Value of Consumer Goods Companies Listed in IDX30 Index.**"

1.2 Problem Formulation

Based on the background above, the researcher identifies the following problems:

1. How does the macroeconomics analysis affect the intrinsic value of the stocks under IDX 30 index?

2. How does the industry analysis affect the intrinsic value of the stocks under IDX 30 index?

3. How does the financial statement analysis of the stocks under IDX 30 index demonstrate the performance of the companies?

4. Using P-E Multiples, which stocks under IDX 30 index in the consumer goods sectors are overvalued, fair valued and undervalued?

1.3 Research Focus

This research focuses on companies under index IDX30, specifically those under consumer goods industry for the duration of 3 years (2016-2018). Launched by Indonesia Stock Exchange in 23 April 2012, IDX30 is the headline index that measures the performance of the top 30 stocks with qualities, such as "large market capitalization, high liquidity, and good fundamentals" (IDX, 2020). The five consumer goods sector companies that are included in IDX30 for 3 consecutive years are PT. Gudang Garam Tbk (GGRM), PT. Indofood CBP Sukses Makmur Tbk (ICBP), PT. Indofood Sukses Makmur Tbk (INDF), PT. Kalbe Farma Tbk (KLBF), and PT. Unilever Indonesia Tbk (UNVR).

Stocks movement are always fluctuating, including the five companies listed above. The stock price can be observed in Indonesia Stock Exchange daily during working hours. In this research, top-down fundamental analysis will be applied. The data that are needed to conduct a fundamental analysis on Gudang

Garam Tbk (GGRM), Indofood CBP Sukses Makmur Tbk (ICBP), Indofood Sukses Makmur Tbk (INDF), Kalbe Farma Tbk (KLBF), and Unilever Indonesia Tbk (UNVR) are global and Indonesia macroeconomic data from 2016 – 2018, consumer goods industry data from 2016-2018, financial statements from 2016-2018, and other supporting and reliable data during the period of 2016-2018.

1.4 Objective of the Research

Here are some objectives of the research that you can make to solve the problem that've been found, which are:

1. To analyze company performance through economic analysis
2. To examine competitive advantage of the five companies under the consumer goods industry
3. To study how the companies perform using financial statement analysis
4. To determine whether stocks under IDX30 index are overvalued, fair valued, or undervalued, using price-earnings ratio.

1.5 Benefit of the Research

This research is expected to bring two kinds of benefits, which are:

1.5.1 Theoretical Benefit

This research will hopefully bring theoretical benefits, as follows:

1. This research is expected to make an advancement academically.

2. This research may inspire fellow researchers out there to conduct research around the capital market in Indonesia.

1.5.2 Practical Benefit

This research will hopefully bring practical benefits, as follows:

1. For investors, this research is particularly helpful for them to make investment decisions in the future.

2. This research may also guide people on how to value a particular stock using PER multiple before making a financial decision.

3. This research might benefit most companies to be aware of current macroeconomics conditions when their stock price goes up or down.