CHAPTER I
INTRODUCTION

1.1 Background of Study

Nowadays, investment gives an opportunity for investors to earn a return in both short term and long term by investing in the actively traded share of companies. Market refers to an institution or arrangements that facilitate the purchases and sales of goods and services. Capital market is one of the markets for securities where the issue of securities provides opportunities for both investors or companies to increase their funds. Capital market is a market that allow people to do their investment activities by investing in stocks, bonds, mutual funds and so on. (Muritala & Ogunji, 2017)

The development of a growing capital market will provide greater investment opportunities for investors who consider that capital markets are able to provide benefits as a means of allocating productive funds for the long term. Protection of investor interest is of utmost importance to ensure that there is a continuous flow of investments to the capital market.

The main reason for investors to invest in the capital market is to earn income or return. Dividend or capital gains are the form of return obtained from stock investments. Dividends are the profit that will be distributed to the shareholders based on the percentage of shares in the company, while the capital gain is the gain when the investment is sold for a higher price than the original price. (Carlo, 2014)

Stock return is used to measure the performance of company stock. The financial objective of the firm is maximizing investment returns which is reflected by the change in the company stock prices (Acheampong, Agalega, & Shibu, 2014). In addition, the performance of the company by using fundamental analysis will give huge opportunities for company to be success. When investors decide to invest in certain shares, investors need to investigate the financial performance of the company because there are certain companies grow well and look promising but

there are many companies have a bad financial performance. Thus investors require careful considerations, so accurate information is needed for investment decision making. Investors must be able to utilize all of the information through a fundamental approach in order to analyze the market and its investment in the hope of gaining significant profits or return. The fundamental approach usually results in longer-term investment. A financial ratio is calculated based on the publicly published and audited financial statement. (Rawal, 2015)

Financial fundamental has brought many benefits to both internal and external users over a long period of time. Investors are able to use information obtained through financial ratio in order to make a better investment decision and the information also allow investors to assess different companies and compare their standing over the years. Furthermore, strengths and weaknesses of different companies from profitability, liquidity, solvency (capital structure), market measures, value-added and growth perspectives are the summary of information obtained from financial ratio analysis. Therefore, when measuring the performance of a company, the most common fundamental approach is related to returns. (Muhammad & Scrimgeour, 2014)

There are several researchers emphasized that stock return is indeed influenced by several fundamental factors. According to Rahayu & Utiyati, 2017 and Muhammad & Ali, 2018, there are several fundamental factors that affect stock return includes micro factors are earnings per share (EPS), book value per share (BV), debt to equity ratio (DER), price to earnings ratio (PER), dividend payout ratio (DPR) and other financial ratios. While for the macro factors are the interest rate, inflation rate, foreign exchange rate, and international economic conditions. By calculating return on equity (ROE), return on asset (ROA), current ratio (CR), total asset turnover (TATO), both investors and companies can see the relationship between financial fundamental of a company and stock return (Azis, Pahlevi, & Toaha, 2018). Kusuma & Topowijono (2018) mention that there are several value-added factors that affect the stock return. Both economic value added (EVA) and market value added (MVA) are the other method in measuring the financial performance of a company that affects the stock return.

Table 1.1.1 :ROE, PER, DER, MVA, and Stock Return in the Year 2013-2017

Company	Year	ROE	PER	DER	MVA	Stock Return
PT Kalbe Farma Tbk	2013	23%	29.736	33%	1068.668	18%
PT Kalbe Farma Tbk	2014	22%	40.442	27%	1620.561	46%
PT Kalbe Farma Tbk	2015	19%	30.070	25%	1086.651	-28%
PT Kalbe Farma Tbk	2016	19%	30.208	22%	1249.105	15%
PT Kalbe Farma Tbk	2017	18%	32.291	20%	1393.595	12%
PT Bukit Asam Tbk	2013	25%	11.959	55%	6726.632	-32%
PT Bukit Asam Tbk	2014	23%	13.459	71%	8511.819	23%
PT Bukit Asam Tbk	2015	22%	4.683	82%	119.300	-64%
PT Bukit Asam Tbk	2016	19%	13.017	76%	7494.294	176%
PT Bukit Asam Tbk	2017	33%	5.192	59%	4653.751	-10%
PT Semen Indonesia Tbk	2013	25%	15.675	41%	10474.049	-11%
PT Semen Indonesia Tbk	2014	22%	17.240	37%	11984.815	14%
PT Semen Indonesia Tbk	2015	16%	14.942	39%	6773.732	-30%
PT Semen Indonesia Tbk	2016	15%	12.000	45%	4020.437	-20%
PT Semen Indonesia Tbk	2017	7%	28.743	61%	4768.254	8%

Source: Prepared by Writer (2019)

Kalbe has been active in the pharmaceutical industry for more than fifty years ago in 1966 and now the company has become the most reputable national pharmaceutical company in the international market. Based on the data obtained from financial statement of Kalbe company, the stock price has experienced a sharp decline in 2015 around Rp. 1,320 compared to 2014 around Rp. 1,830 and stock return was drop around 28% from 2014 to 2015 due to the challenging macro-economy in Indonesia with significantly lower spending power as well as affected by profit, asset, lower sales growth and increase in cost in which later on will affect stock return to drop because decrease in sales and profit will slow down the movement of stock price and stock return received by investors. Moreover, there is a serious case regarding the sales of Kalbe in 2015 which affect the stock price to decrease. The net sales of prescription pharmaceuticals division have experienced a decline by 0.8% (from Rp. 4,329 to Rp. 4,293) due to the impact of the product recall and injection production line suspension, following a complaint regarding one of the anesthetic injectable product. Therefore, a huge decrease of stock price

and stock return were occurred due to the serious case above and also it will decrease the level of confidence from investors to invest as well as it will decrease the spending power of consumers. In addition, the stock price of Kalbe is also influenced by the Rupiah depreciation (inflation rate increase) (PT Kalbe Farma Tbk, 2015).

PT Bukit Asam Tbk, better known as Bukit Asam, is a Mining Company owned by the Government of Indonesia which was founded in 1950. The stock price of PT. Bukit Asam (Persero) Tbk. has experienced a sharp decline in 2015 around Rp. 4,525 compared to 2014 around Rp. 12,500 and stock return was drop around 64% from 2014 to 2015. In 2015, both stock price and stock return dropped steeply in PT Bukit Asam Tbk due to external challenges experienced by all investors in the national coal industry, such as the decline of coal demand, oversupply in the coal market, the downward trend of coal prices, and increasingly fierce competition in the market. The declining of stock price and stock return caused by slowing global economic growth (recession) which has affected the price of national coal. The downward trend in coal prices continued to get worse because a major consumer of Indonesia's coal, China has been reducing its coal demand due to its weakening economic growth and the reduced of price coal also caused by a huge collapse of world mining commodity prices driven by weakening oil and gas prices. Then, many investors have withdrawn their investment funds because the return received by investors were lower or did not get any return (loss). Therefore, the case above is the reason for the stock price and stock return to decrease (PT Bukit Asam Tbk, 2015).

PT Semen Indonesia Tbk, is a company that operates in the building material sector. There was a steep drop in the stock price in 2015 amounted to Rp. 11,400 compared to 2014 amounted to Rp. 16,200 and the stock return was decreased by 30%. The cause for both stock price and stock return to decline, there was a decrease in the selling price of cement due to the intervention from the government in 2015. With the intervention, many investors responded to this announcement by withdrawing their investment funds in the market, especially foreign investors. Investors prefer that selling prices should be controlled by market

mechanisms rather than regulated by the government. The impact that PT Semen Indonesia Tbk felt from the decline in cement demand growth was the selling price, which experienced tremendous pressure caused by the price war. This resulted in the profitability target of PT Semen Indonesia Tbk for 2015 not being reached and investors have withdrawn their funds because the low selling price means the margin of the company is getting smaller and the return that the investors got is lower. Furthermore, with unstable national economic conditions in 2015, which was marked by the weak purchasing power of the consumer (weakening of the exchange rate, which reduced people's purchasing power) and reduced the growth rate of the property business, thereby it reduced the demand for cement in the Indonesian market. The decline in selling prices also made the price of cement products nationally not increase (PT Semen Indonesia (Persero) Tbk, 2015).

This research paper is aimed to do a research for companies listed in Indonesia stock exchange and registered in LQ 45 Index for period 2013 to 2017 by analyzing the factors (variables) that affect the stock return which are Return On Equity (ROE), Price to earnings ratio (PER), Debt to equity ratio (DER), and Market value added (MVA).

From the consideration above, the researcher is interested in conducting research with the title "**The Effect of Return On Equity, Price To Earnings ratio, Debt To Equity ratio, and Market Value Added toward Stock Return for companies registered in the LQ45 and listed in IDX".**

1.2   Problem Limitation

The problem limitation aims in this research is to analyze or investigate the variables that affect the stock return by using fundamental analysis for companies that is financial statement listed in LQ 45 Index for the period 2013 to 2017. The fundamental variables are return on equity (ROE), price to earnings ratio (PER), debt to equity ratio (DER), and market value added (MVA). Moreover, the reason for choosing the sample in the LQ 45 index because it reflects the movement of the price of shares that are actively traded and also affect the state of the market. The LQ 45 index consists of stocks of companies that have high liquidity and have better financial condition, so it is expected to provide the real condition of the company

and also one of the areas of investment that has a high demand from both foreign and domestic investors.

1.3 Problem Formulation

Based on the background that has been described, then the problems can be discussed are:

1. Does Return on Equity (ROE) affect the stock return partially?
2. Does Price to Earnings Ratio (PER) affect the stock return partially?
3. Does Debt to Equity Ratio (DER) affect the stock return partially?
4. Does Market Value Added (MVA) affect the stock return partially?
5. Do ROE, PER, DER, and MVA affect the stock return simultaneously?

1.4 Research Object

The objectives of the research to answer the above problem formulation, which are:

1. To analyze the effect of Return on equity towards stock return partially
2. To analyze the effect of Price to earnings ratio towards stock return partially
3. To analyze the effect of debt to equity ratio towards stock return partially
4. To analyze the effect of market value added towards stock return partially
5. To analyze the effect of ROE, PER, DER, and MVA toward stock return simultaneously

1.5 Benefit of Research

1.5.1 Theoritical Benefit

1. This research paper gives benefit for students as a reference to enrich and improve their knowledge about the effect of fundamental analysis toward stock return.
2. This research paper gives benefit for the next researchers as a basic reference of the research and improvement of the knowledge regarding fundamental analysis toward stock return.

1.5.2   Practical Benefit

1. This research paper is to provide insight for investors regarding the relationship between stock return and fundamental analysis.

2. This research paper gives the benefit for the management of the company to provide insight about the stock return in order to improve the performance of the company and create a better competitive edge strategy.

1.6   System of Writing

Chapter I – Introduction

It is a summary of the overall content of the research and an overview of the issues regarding the relationship of fundamental analysis toward stock return discussed in this research paper. This chapter describes the background of the study, problem limitation, problem formulation, research objectives, the benefit of research and systems of writing.

Chapter II – Literature review and hypothesis development

This chapter consists of the theoretical background that will discuss signaling theory, understanding of the capital market, the function of the capital market, financial instruments, understanding of stock return and financial performance, components of financial statement, understanding of fundamental analysis and financial ratio. Furthermore, previous research, hypothesis development, research model and framework of thinking will also be discussed as the basic reference of theory and analysis.

Chapter III – Research methodology

This chapter will discuss the research design used in this research paper is a quantitative method, population and sample, and explanation from the sample size and sample type, data collections method, operational variable definition, variable measurement, and data analysis method

Chapter IV – Data analysis and discussion

This chapter will mainly discuss data analysis and show how the data is processed. The research paper also discusses the general overview of "Research Object", data analysis (the result of data quality testing, the result of hypothesis

testing) and discussion

Chapter V – Conclusion

This chapter discusses conclusion after research, implication and recommendation. This chapter will also let the readers to understand the result of the research and can be proper guidance for every reader and other researchers for future research and benefit.