

CHAPTER I

INTRODUCTION

The fundamental notion and research of the issue will be discussed in the introductory chapter. This will provide an overview of the study as well as a broad understanding of why this concept emerges in the market. This chapter will also go through the paper's key issues. The research questions that will be explored throughout the paper will be derived from this. Following that, this chapter explains the use and contribution of the study and briefly list down the chapter outline.

1.1 Background of Study

During the worldwide subprime mortgage financial crisis in the United States in 2008, business and household uncertainty about the government's future regulatory framework, spending, taxation, monetary policy, and health insurance policies reached its peak (Baker et al., 2016). Many firms and families postpone their investment and consumption due to policy uncertainty. Policy uncertainty appears to have long-term consequences to firms, especially Stated-Owned Enterprise (SOE) and private firms. This is because SOE firms are directly exposed to these unpredictable conditions as a result of government policy uncertainty. Private firms, as well as SOEs, are sensitive to Economic Policy Uncertainty (EPU) because they have an incentive to establish political ties in order to receive fair treatment from the government (Faccio et al., 2006).

Economic policy changes made by the government issues are a major source of uncertainty, and they have a significant impact on financial markets. The government sector has the capacity to make changes to fiscal and monetary policies such as changes in interest rates, increases in currency values, changes tax rules, etc. Those changes can have a big impact in the business world, on company performance, and can even affect the stock price of a company. Many studies of uncertainty have focused on the effects of uncertainty on a wide range of macroeconomic variables, including inflation and unemployment (Fernández-Villaverde et al., 2015), firm level investment (Bernanke, 2014; Y. Wang et al., 2014), durable goods demand (Eberly, 1994), and even output growth (Colombo, 2013).

In various previous studies, it was found that heterogeneous type of uncertainty has a substantial and significant effect on social issues. (Caggiano et al., 2017) conclude that political uncertainty increase the unemployment rate and even will be higher in economic recession. Another study shows Policy Uncertainty influence on economic issues as well, such as international business (Handley, 2014), corporate risk-taking incentives and performance of policy-sensitive firms (Akey & Lewellen, 2016) and even decrease of investment expenditure (Gulen & Ion, 2016; Julio & Yook, 2012; Kang et al., 2014). Firms diverse exposure to EPU discover that changes in EPU have no impact on cash flow and there is a negative relationship between EPU exposure and equity premium (Brogaard & Detzel, 2015; Li, 2017). Exposure to EPU has also found to affect cost of debt (Francis et al., 2014), stock liquidity (Nagar et al., 2003),

merger and acquisition decisions (Bonaime et al., 2018), etc. While (Francis et al., 2014) agree that companies with more exposure to political risk have higher loan costs. Furthermore, it also demonstrates that lenders would demand higher lending rates if they were exposed to more uncertainty.

Theoretical and empirical literatures, on the other hand, disagree on how EPU affects a company's value. (Bulan, 2005) argue that businesses should be careful about doing irreversible investments in the uncertainty conditions since the risk of doing so enhances the possibility of delaying the investment. The impacts of uncertainty on investment are more pronounced for companies with bigger irreversible investments and a greater reliance on government expenditure (Gulen & Ion, 2016). In the meanwhile, when there is a lot of ambiguity, managers' risk aversion rises, the uncertainty also make the company's worth decreases (Bernanke, 2014; McDonald & Siegel, 1986). Nevertheless, others argue that in a competitive market, waiting for uncertainty to be resolved is pointless because businesses will raise their investment and company value (Abel, 1983; Abel et al., 2013; Hartman, 1972). Ambiguity in economic policy has a substantial influence, generally speaking, macro and micro variables. The impact of this uncertainty on company value is one of them. Whereas, if the value of the company experiences shocks it will certainly have an impact on market value, because market value was calculated based on the price current stock. In which market rate of return and stock prices will decrease further under conditions of political uncertainty (Chen et al., 2017; Liu et al., 2017).

The Indonesian capital market itself is a strategic place in examining whether uncertainty can destroy or increase the market value of a company. Indonesia has a background of emerging market countryⁱ, which has a low level of GDP and medium-level of economy but has a high GDP growth rate (> 5%) over the last 15 years. Uncertainty in economic policy can affect the Indonesian economy. This is due to the open nature of the Indonesian economy so that the Indonesian economy is very reactive to shocks from macroeconomic factors, that is one of them is EPU. Open economies countries are also more prone to global and advanced business cycle fluctuations. Changes in government policies can have a very large and crucial impact which in turn will result in greater policy uncertainty which in turn often causes quite volatile volatility for stock prices, where changes in stock prices will have an impact on market value. Policy uncertainty is one of the macroeconomic factors that causes market reactions and has an impact on stock price movements and market values. In addition, many issuers which are State-Owned Enterprises (SEO) are very reactive to changes in government policies. As well as issuer companies that have been listed in Indonesia Stock Exchange (IDX), where government policies have an influence on performance shares in the market.

In Southeast Asia, Indonesia has the largest economy and ranked 16th largest economy in the world. Indonesian economy has had tremendous development since the East Asian financial crisis in which the biggest driver in its expansion has been fueled mostly by exportsⁱⁱ. Indonesia has clearly been impacted by the crisis like many other countries have experienced economic

collapse as a result of the uncertainty in the global economic crisis, since its export growth has slowed and its exchange rates have fallen. Despite the fact that the crisis has had a minor impact on Indonesia's economy compared to other Southeast Asian countries such as Singapore and Malaysia (Rahardja, 2015). The increasing global uncertainty in the past year has had an impact on the Indonesian economic growth (Hutama et al., 2020). On the fiscal side, the performance of tax revenues, most prominently in the mining industry, reflects the uncertainty and downturn in the global economy. In which Indonesian government is attempting to promote expenditure, particularly among the lower middle class, in order to maintain growth.

The preceding study findings shows that different firms' exposures to EPU will result in varied company features, company decisions, and external perceptions of company values. Meanwhile, in terms of the impact of a firm's heterogeneous EPU exposure, the results in different markets are varying. However, this result happens in highly developed mixed economy such as United States and one of the largest developing countries such as China. The result in an emerging country and open economy such as Indonesia could be different.

The influence of dynamic economic policies implemented by major country has led to the creation of the phenomenon of global uncertainty. These circumstances have an influence on the economic instability of emerging market countries, the bulk of which have open economies and trade ties with these large nations. Small country often said to face a variety of risks as a result of global uncertainty, including deterioration in economic performance, with the worst-case

scenario being the onset of an economic disaster. This study aims to test the relationship between EPU and market value in listed firms in Indonesia. Uncertainty in economic policy might have an important implication for Indonesia's market value. Furthermore, due to the open structure of the Indonesian economy, the country is extremely sensitive to external shocks, such as uncertainties in foreign economic policy. Also, this study wants to further examine firm's competitive status using Herfindahl-Hirschman (HHI) index as a market concentration indicator.

1.2 Statement of Problem

Based on the background of the study that has been described previously, the problem in this research is as follows:

1. Does uncertainty in economic policy influence market value in Indonesia Stock Exchange (IDX)?

1.3 Objectives of Research

Based on the formulation of the problem described above, the objectives of research are as follows:

1. To test whether exposure to EPU have an impact on market value.

1.4 Use of the Study

This research is hopefully useful for:

1. Investor

As one of the external macroeconomic uncertainty factor that can keep coming back anytime, this paper can provide knowledge for the investor

how the impact of policy uncertainty affects the valuations of firms and which competitive level of firms have greater exposure, this is because market values reflect the functioning of the market system and serve as a basic price index for various financial products.

2. Companies

Provide insight and knowledge to the open economy and developing country like Indonesia to survive and sustain in conditions of macro uncertainty such as EPU. This insight is hopefully useful to help companies to better recognize uncertainty in policy economy, because it is a systematic risk that is not diversified.

3. Academic

With all hope, this study can provide new understanding and knowledge both for the public and for further researchers in knowing what the impact of uncertainty in economic policy toward market value in Indonesia is. This study can be used as a reference for further research.

1.5 Systematic of the Study

An overview description with sub- and sub-chapters organized in a logical order to help readers comprehend and follow the flow of this thesis proposal's writing. In addition, the author employs an APA citation style to make it easier for readers to find the references. The systematics of the study is as follows:

Chapter I: Introduction

This chapter discusses the background of why uncertainty occurs in economic policy and what effects it has on market values in Indonesia. After

that, it also discusses the problems faced and the scope of these problems. The objectives, benefits of research, and the research methodology that will be used will also be discussed in this chapter. The last section also discusses the systematics of research writing.

Chapter II: Literature Review

This chapter discusses the basic theoretical foundation, supporting theories, relevant literature for developing hypotheses, and developing hypotheses.

Chapter III: Methodological Research

This chapter will discuss the data, empirical models, conceptual and operational definitions of research variables, and the data processing/classical assumption test.

Chapter IV: Empirical Result

Forth chapter will discuss the statistical description, the results of the data processing / the results of the classical empirical assumption test, discussion and analysis of the data results, implication and interpretation of the result with the given formulated hypothesis.

Chapter V: Conclusion

Last chapter will discuss the conclusions of the research. It also discusses about the limitations and suggestions obtained from this study.