CHAPTER I

INDTRODUCTION

1.1 Background

The stock market is the heart of any economy whether if it's developing or a developed one. Among the various function of stock exchange, the provision for liquidity of capital and continues market for securities are acknowledged as leading functions from the point of view from investors. In other words, the stock exchange is to give sellers a place to "liquidate" their shareholdings. From the point of view in economic general, a healthy stock market has been considered remarkably required for company economic growth whether if it's developing or a developed one. Also, the stock market is expected to contribute to company improvements in productivity especially for the indicators of stock market operations such as capitalization, liquidity, asset pricing and turnover.

In the last decade, there has been great concern among investors and regarding the behavior of stock market prices; the investors are interested in researcher earning a higher return on their investments. Emerging stock markets have caused a massive impact to the society. In recent years, the stock market has recently been of great importance to the worldwide investment community. As a result, there are many stock exchange in the entire world such as New York Stock Exchange (USA), NASDAQ (USA), Euronext (Europe), National Stock Exchange (India), Tokyo Stock Exchange (Japan), Indonesia Stock Exchange (Indonesia), etc.

The issue about seasonality in the stock market has successfully engaged the attention of researchers for a long time due to its potential for producing abnormal returns during a certain period of the year. Seasonality here refers to the repetitive fluctuation in a time series which caused over a range less than a year. This issue not only interest researchers in developing country yet, this issue also engaged the attention of researchers from a developed country, one of them is Indonesia.

Historically, the stock exchange in Indonesia has been established long before Indonesia became independent. Precisely, since Dutch colonial times in the year 1912 at Batavia. The government of Dutch East Indies established the stock market that day for the purpose of Dutch

East India Company or Vereenigde Oostindische Compagnie (VOC). Even though the stock market in Indonesia has been established since 1912 the improvement and the expansion stock exchange in Indonesia not running as Dutch government expected. Moreover, the stock market in Indonesia stopped due to world war I, World war 2, and the displacement of government from Dutch to Indonesia that causes the stock exchange can't run properly. Indonesia government reactivated the stock exchange in the year 1977, and a few years later the stock exchange improved along with various incentive and regulation issued by the Indonesia government. (http://www.idx.co.id/id-id/beranda/tentangbei/sejarah.aspx)

Briefly, this is the table that shows the history of stock exchange in Indonesia.

[December 1912]	▪ First stock exchange in Indonesia was established at Batavia by the government of Dutch East Indies
[1914 – 1918]	▪ Stock exchange in Batavia vacuum due to World war I
[1925 – 1942]	▪ Stock Exchange in Jakarta reopened along with Stock exchange in Semarang and Surabaya
[1939]	▪ Because of political issue (World war II) Stock exchange in Semarang and Surabaya vacuumed
[1942 – 1952]	▪ Stock Exchange in Jakarta vacuumed during world war II
[1956]	▪ Because of Dutch nationalization program stock exchange became less active
[1956 – 1977]	▪ Stock Exchange vaccumed
[10 August 1977]	▪ Stock exchange unveiled again by President Soeharto. Jakarta Stock Exchange (BEJ) was running under BAPEPAM (Badan

	Pelaksana Pasar Modal). This reactivation of stock exchange also marked by go public PT Semen Cibinong as the first public companies
[1977 – 1987]	▪ Trading on stock exchanges is very lethargic, the number of public companies until 1987 is still 24. The society prefer banking instruments compared to capital market instruments.
[1987]	▪ With the presence of the Paket Desember 1987 (PAKDES 87) which provides easier accessibility for the company to do public offerings and foreign investors to invest in Indonesia
[1988 – 1990]	▪ Deregulation package in banking and stock exchange sector launched. For the first time, Jakarta Stock Exchange has open for foreign investors. The activity inside market increased
[2 June 1988]	▪ Bursa Paralel Indonesia (BPI) start operating and manager by Persatuan Perdagangan Uang dan Efek (PPUE). However, the organization itself consists of broker and dealer
[December 1988]	▪ The government released Paket Desember 88 (PAKDES 88) that provides companies easy acces to go public and several positive policy for capital market growth
[16 June 1989]	▪ Surabaya Stock Exchange (BES) start operating and managed by private company PT Bursa Efek Surabaya
[13 July 1992]	▪ BAPEPAM changed to Badan Pengawas Pasar Modal. This date was commemorated as Jakarta Stock Exchange (BEJ) Anniversary
[22 May 1995]	▪ Trading automation system in BEJ was implemented with Jakarta Automated Trading Systems (JATS)
[10 November 1995]	▪ Indonesia government issued law no. 8 Tahun 1995 about Capital market which came into effect on January 1996

[1995]	▪ Bursa Paralel Indonesia merger with Bursa Efek Surabaya
[2000]	▪ Trading system scripless trading began to applied in Indonesia Capital market
[2002]	▪ Bursa Efek Jakarta (BEJ) began to applied remote trading system
[2007]	▪ Bursa Efek Surabaya (BES) merge with Bursa Efek Jakarta (BEJ) and change its name to Bursa Efek Indonesia (BEI)
[02 March 2009]	The inaugural launch of a new trading system PT Bursa Efek Indonesia: JATS-NextG

Table 1 1.1. Indonesia Stock Exchange History

(http://www.idx.co.id/id-id/beranda/tentangbei/sejarah.aspx)

Indonesia is a country that contains excellent economic potential. Potential that has not gone unnoticed as part of the global community. Indonesia the largest economy in Southeast Asia and one of the emerging market economies in the world. Indonesia also classified as a newly Industrialized country and Indonesia is a member of G-20 major economies or a group of twenty which aims to discuss policy that relates to the promotion of international financial stability. Right now, Indonesia is at the ranked sixteenth on largest economy in the world by nominal Gross Domestic Product (GPD), and also Indonesia is the seventh largest regarding Purchasing Power Parity (PPP). After the crisis in the late 1990s halted a booming economy fostered by the Suharto Government, Indonesian macroeconomic indicators started to come back on track in mid-2000s. Although the Asian Financial crisis had disastrous consequences especially on the more unfortunate urban segments of society. The prudent financial, macroeconomic policy is one of the reasons why Indonesia was resilient to the global financial crisis of 2008 – 2009. Both public and private debt have fallen sharply (as a percentage of GDP), international reserves have grown fast, and inflation has been under control. In combination with relative political stability and certain favorable demographic trends, it provides opportunities for strong economic performance over the medium term. Regarding the long-term plan, the Indonesia government aims to be in the top six of largest global economies by the year 2030. With the help of every sector right now Indonesia is experiencing remarkable economic growth. Indonesia was often mentioned as an appropriate candidate to be included in the BRIC countries (Brazil, Russia, India, and China). (https://www.indonesia-investments.com/culture/economy/general-economic-outline/item251?)

Indonesia's fast-growing economy could become the world's 7th largest by 2030, up from 16th today, but only if it can further boost productivity to meet growth targets. Most international businesses and investors know that modern Indonesia boasts a substantial population and a wealth of natural resources. But far fewer understand how rapidly the nation is growing. Home to the world's 16th-largest economy, Indonesia is booming thanks mainly to a combination of domestic consumption and productivity growth. By 2030, Indonesia could have the world's 7th-largest economy, overtaking Germany and the United Kingdom. But to meet its ambitious growth targets and attract international investment, it must do more. Indonesia has an attractive value proposition. Over the past 20 years, labor productivity improvements, mainly from specific sectors rather than a general shift out of agriculture, have accounted for more than 60 percent of the country economic growth. Unlike typical Asian economies, Indonesia's has grown as a result of consumption, not exports and manufacturing. The archipelago nation is also urbanizing rapidly, boosting incomes. By 2030, Indonesia will have added 90 million people to its consuming class more than any other country except India and China. There are a lot of investments product which offered to the society such as money market, futures exchange, and capital market. Due to Indonesia high potential Indonesia stock exchange (IDX) established a program especially for educating the community about the stock market. With the mission to become an actual Information and education. Also, to increase social awareness about the stock market. Indonesia stock exchange (IDX) hope that with this program IDX can become a tool for the society which is still blind about capital market. In capital market itself, there is a part that we will learn about a stock split. (https://www.mckinsey.com/global-themes/asia-pacific/the-archipelago-economy)

In today's competitive business world, a stock split has become very common phenomena. A stock split is a corporate action in which a company divides its existing shares into multiple shares to boost the liquidity of the shares. Although, the number of shares outstanding increases by a specific multiple, the total value of the shares remains the same compared to pre-split amounts, because the split does not add any real value. Since stock does not add value to company's capital, but why do firm continue to engage in such financial manoeuvers when the costs of splitting the stocks are not trivial. A stock split appears to be an exciting corporate event to analyze. Since the publication of the seminal study by Fama et al. (1969), two primary hypothesis has emerged in the finance literature as the leading explanations of stock split signaling hypothesis and trading range hypothesis. According to the signaling hypothesis, managers might make financial decisions, such as stock splits and stock dividend distribution, to convey favorable private information to investors about the current value of a firm. While stock splits do not affect firm financial fundamentals, the market tends to react to them positively. The literature suggest that stock splits are to improve the liquidity of trading by realigning stock prices to an optimal trading range (Copeland (1979); Baker and Gallagrher.1980), to draw attention to the stock (Grinblatt et al. (1984)), or to signal management private information about the firm's future performance (Brennan and Copeland (1988)). Surveys of corporate managers by Baker and Gallagher (1980) reveal that manager use stock splits to bring the share price into an optimal trading range and to enhance the liquidity of their firm shares. Baker and Gallagher survey also suggest that management interested in a broad and heterogeneous stockholder base or broader marketability tends to adjust stock price to such an optimal rate by splitting the stock. Indeed, the great explanations for stock split all imply an improvement in liquidity. The survey conducted by Baker and Powell (1992) also reports that firms undertake stock splits mainly to move stock prices to the desired trading range and to improve the stock liquidity.

The investors and researchers which experienced on played stock exchange with the purpose of to get a dividend from the company will find the right time and the perfect price to invest in that company stocks. Most of the big company can distribute their profit to their shareholders through a stock split. Whereas, the shareholders didn't need to pay more to acquire the stock. The stock split is just to attract more investors to invest in the company itself although, the stock split didn't affect company wealth.

Different studies on stock split have emphasized various aspects. Some have concentrated on liquidity hypothesis and some on trading range hypothesis. These studies highlighted the fact that trading volume actually increases after split announcement. (Lakonishok and Lev, 1987; Dubofsky, 1991). There are various other studies also which have emphasized broader markets created by splits. Other studies explain stock splits as a result of signaling hypothesis. The stock split announcement gives a signal to the outsiders that company is confident about its internal operations and split indicates company's confidence (Copeland, 1979; Angel, 1997; Nayyar and Rozeff, 2001) There are various studies that prove that companies prefer specific clientele (uninformed and small investors) and lower stock price that is comparable to other firms in the same industry. (Mcnicholas and Dravid, 1989; Lukose and Rao, 2002).

According to Brigham & Houston (2006), a stock split is just an action taken by the company in order to increase the number of shares of the company in the market. Like, double the number of shares by giving two new shares to the shareholders for every one share that the investors have before. For example, the number shares outstanding is 10 million shares with the price of Rp 1000 per share. So, company equity value is 10 million x Rp 1000 = 1 Billion. In a stock split the firm splitting their stock into 2. Which caused the value of shares divided into 2, Rp 1000/2 = 500. However, it did not affect company equity value 20 million x Rp 500 = 1 billion. So, due to changes in outstanding shares along with changes in stock price it didn't affect company's capital. The main purpose of a stock split is to increase the liquidity of the stock distribution and keep the stock price at optimal price for trading. Liquidity here means the scale of the stock can be quickly bought or sold in the market. The liquidity can be calculated through its trading volume activities (TVA). If the trading is higher than stock listing then the more liquid the stock which caused the volume of stock trading increased. According to Reilly and Brown (1997), the factor of stock liquidity is in connection with securities which reflected on trading market data, and the determinant factor from liquidity is the amount of money from the number of shares traded. We can calculate the liquidity using bid-ask spread whereabouts the smaller the bid-ask spread is, the less liquid the stock and vice versa. If the stock price of the company too high the demand of the stock will reduce due to purchasing power which caused the stock is not liquid. However, if the stock price is low or at the optimal range, the demand will increase.

Throughout January until December 1996 stock split become popular among the big company. From January to July 1996 there are four companies that conduct a stock split. However, from August to December the number of the company that does a stock split become double. At least, eight companies that conduct a stock split every month. (Statistika BEI 1996)

Based on the background, the writer is interested to conduct a research about the relation between Stock Split towards stock liquidity.

1.2 Research Limitations

Although this research was fully prepared, there was an unavoidable limitation that the writer needs to faces. Because of the limited object that the writer use. There is more than hundred company that implement stock split in the last few years. However, the writer only uses 41 objects in the written thesis.

1.3 Research Problems

1. Does stock split affect liquidity as measured using bid-ask spread?
2. Does stock split affect liquidity as measured using trading volume?

1.4 Research Objectives

1. To examine the effect of a stock split to liquidity using bid-ask spread
2. To examine the effect of a stock split to liquidity using trading volume

1.5 Research Contributions

1. For the writer, to improve writer knowledge regarding stock split and to increase the writer ability of the Stock market which will certainly be beneficial to the writer future.
2. For company, to increase manager awareness about the stock split and hope that this thesis could be beneficial for the manager reference materials before carrying through a stock split
3. For stock exchange investors, could be the investors reference materials before invest in any Indonesia company's especially to give information about the result of a company that wants to implement stock split in Indonesia Stock Exchange.
4. For current and future research, to help current and future researchers to get a better understanding about capital market especially in a Stock split. Also, to become the reference materials for the future research with added or change the variable.

1.6 Research Outline

Chapter 1: Introduction

In this chapter, the writer sets up the research problem for the reader which contain background, research limitations, research problems, research objectives, research contributions, and research outline. This chapter also specifies the research objectives explored in greater detail to contribute to understanding the research problem.

Chapter 2: Literature Review

This chapter contains several theories that support the writer thesis, an explanation why its relevant, and how the modeling efforts address the hypothesis to be tested. Also, this chapter summarises the major studies and findings that have been published on the research topic, and this study contributes or adds to what has been already studied.

Chapter 3: Research Methods

This chapter explains the detailed technical and scientific activities, which include the research design, sampling plan, instrumentation, statistic tools, and treatment of data.

Chapter 4: Data and Analysis

This chapter contains the explanation of the object of the study, organizing the findings that address the research questions, and explain on how these data collected are related to the theory and prior researchers presented at the beginning of the study.

Chapter 5: Conclusion

This chapter consists of the summary of the research, conclusions, and recommendation that can be used for the advanced study of the research topic by its theoretical, methodological, substantive contributions that may be necessary to overcome the limitations of existing facts in the future.