

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Currently, investment is one of the most essential factors for a country's economic growth. Investment is broadly categorized into two, namely financial investment such as deposits, stocks, and bonds and real investment such as gold or property. Since technology becomes more and more advanced, investment media that are popular today is financial investment as it is considered practical and easy. The advantages that investors get from investing in financial investment are funds invested is quite liquid compared to real investment and can be withdrawn anytime. In financial investment, investors can choose either to invest in capital market or financial market.

The capital market is a marketplace where corporations in need of funds can sell their stock ownership to other parties who want to invest in stocks. The capital market provides an alternative for investors to do short-term or long-term investment. Based on data published by Kustodian Sentral Efek Indonesia (KSEI), investor in Indonesia capital market has increase rapidly by 33.53% from year 2020 to 2021. It implies that more investors are interested to invest in Indonesia capital market. In the capital market, stocks are one of the most popular instruments. Stock investment offers a high rate of return to investment; however, it also has a high

risk. The main reason that investors are interested in investing in stock is to get profit from their investment which is capital gain and dividend. Hence, understanding stock prices and factors that influence stock prices are very important to investors in making investments.

Stock price is the market value of a company, it can be different from the company intrinsic value. Analyzing the stock price of the company will tell us if the company is undervalued, overvalued, or has a fair value. When a company's stock price is undervalued, the demand for stock will increase. But when stock prices are overvalued demand for stock will decrease. Stock prices are usually driven by market forces, which means the stock price depends on the power of demand and supply. Higher demand for buy orders and lower supply of buy orders will increase the stock price, whereas lower demand for buy orders and high supply of buy orders will depress the stock price (Liu & Park, 2015). The fluctuation of stock price will determine the return on the investment, whether the investors gain profit or loss from their investment.

Besides demand and supply, stock prices are also influenced by other factors. Before making an investment in a company, investors usually conduct technical or fundamental analysis. Technical analysis is done based on the historical price of the stock. Technical analysis is done by analyzing the graph or candle stick, which is the record of the stock price movement. Fundamental analysis is analysis based on companies' fundamental factors which include companies' financial performance, micro and macro environment of companies. Fundamental analysis is

done by analyzing the financial statement, investors can determine the financial performance and conditions of company and whether it is worth investing in. One of the most used financial statement analyses is ratio analysis. Ratio analysis is divided into liquidity ratio, profitability ratio, solvency ratio, turnover ratio, and earnings ratio. In this research, the writer will use debt to equity ratio (DER) which represents solvency ratio and earnings per share (EPS) which represents market value ratio.

The debt-to-equity ratio (DER) is used to assess the capital structure of a company. DER measures how much debt a firm has compared to its total equity to finance the company's asset. A large debt is a risk to a company as a company might not be able to pay its debt if it liquidates and a large debt could reduce company net income due to higher interest expenses that company must bear. Earnings per share (EPS) is a ratio that investors frequently use to measure the profitability of a company before buying its shares since it measures the profit earned per share of common stock. It is one of the most important aspects that investors consider measuring the company's success. The higher the EPS, the more attractive it is for investor to own the shares.

This research was conducted at the company LQ 45 Index on the Indonesia Stock Exchange period 2017-2021. According to IDX (<https://www.idx.co.id/>), LQ 45 Index is an index that measures the price performance of 45 stocks that have high liquidity and large market capitalization and are supported by strong company fundamentals. The stock classified as liquid means it has high buying and selling

activities on the Indonesia Stock Exchange influences stock price changes. In addition to liquidity, these companies are also chosen based on market capitalization. Other criteria for entering the LQ 45 Index is include listed on the IDX for at least three months, having regular transaction in activity in the market, such as value, volume and frequency of transaction and having a regular number of trading days in the regular market (Rate et al., 2017). From the description of LQ 45 we conclude that investors are really interested in the stock.

Table 1.1 Table of Phenomenon

COMPANY	YEAR	DEBT TO EQUITY RATIO	EARNINGS PER SHARE	STOCK PRICE
SMGR (PT Semen Indonesia Tbk.)	2017	0.63	278	99,000
	2018	0.56	520	11,500
	2019	1.30	400	12,000
	2020	1.14	451	12,425
	2021	0.88	351	7,250

Source: Prepared by Writer (2023)

The table above shows that from year 2018 to 2019, the DER of PT Semen Indonesia increase from 0.56 to 1.30, so are the stock price. This indicates that DER has a positive relationship with stock prices. The increase in DER mainly due to significant increase in bank loans for the consolidation of PT Solusi Bangun Indonesia (SBI) into the company. The use of debt in financing causes the interest expense borne by the company to be greater, thus causing the income tax expense to decrease. From the year 2020 to 2021, the companies DER decrease from 1.14 to 0.88 which causes the stock price to decrease sharply. This indicates a positive relationship of DER towards stock price. The decrease in debt to equity ratio is mainly due to the decrease in the company's total liabilities of 13.9% as the company has repaid its loans. As a result, the finance cost decreased by almost 30%,

however it causes an increase in the income tax expense as finance costs is tax deductible. Investors might view that the use of debt is the company strategy to optimize the capital structure so that it could bring more benefits to the company by reducing its cost of capital.

The second factor EPS decrease in 2019 has caused stock price to increase which indicates that EPS has a negative relationship towards stock price. The decrease in the EPS is caused by the declining net profit due to the increase in the financing cost of the company in the acquisition process of Holcim. However, the company profitability in 2019 increased compared to 2018, which can be seen from the increasing operating income of the company in 2019 by 26.73% in connection with the acquisition of PT Holcim. Furthermore, in 2019 the company has also carried out a refinancing program to obtain a lower loan interest so that the company can reduce its future financial costs. Investors expect the company net income to grow in the future, hence increasing the demand for the company stock which causes the stock price to increase.

Previous research on the effect of DER on stock prices has been done. According to Syofyan et al. (2020), DER has a significant negative relationship towards stock price. Based on their research, investors will react negatively to a high value of debt because debt is a burden borne by their investment and a company with higher debt has more risk to liquidate. However, other research on DER conducted by Adikerta & Abundanti (2020), stated that DER has a positive

influence towards stock price. By using debt financing the company can reduce tax obligations therefore increasing firm value.

According to Munandar & Djazuli (2020), EPS has a positive influence towards stock prices because EPS shows the amount of net profit that is available to distribute to shareholders. Increase in EPS is also a means more income that will be received by shareholders. So higher EPS will attract investors to invest which causes stock prices to increase. Conversely, according to Rohim et al. (2019), EPS has negative influence on stock price because there is intervention in publishing financial statement in the interest of certain parties, which cause asymmetric information in which company's management has better information than investors. Therefore, giving bad signals to investors and cause investors to lose their trust.

Further study is required to determine the correlation between the independent and dependent variables in this study because the results of previous studies were inconsistent. Based on the background of the study as indicated above, the author is interested to figure out how DER and EPS affect stock price in this research with the title: **“The Effect of Debt to Equity Ratio and Earning per Share on Stock Price of LQ45 Companies Listed on the Indonesia Stock Exchange”**.

1.2 Problem Limitation

Problem limitation is needed to prevent the discussion from becoming too broad so that the scope of study becomes clearer. Following are the limitation of problem in this study:

- 1) Independent variable, that consist of DER and EPS.
- 2) Dependent variable, which is company stock price.
- 3) This research is conducted on LQ 45 companies in Indonesia Stock Exchange for period 2017-2021.
- 4) The object of research is companies that pass the requirements of the research sample.

1.3 Problem Formulation

Based on the background, above, the problem formulation can be outlined as follows:

- 1) How does DER affect the stock price of companies listed on LQ 45 Index on Indonesia Stock Exchange for period 2017-2021?
- 2) How does EPS affect the stock price of companies listed on LQ 45 Index on Indonesia Stock Exchange for period 2017-2021?
- 3) How does DER and EPS affect the stock price of companies listed on LQ 45 Index on Indonesia Stock Exchange for period 2017-2021 simultaneously?

1.4 Objectives of the Research

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

- 1) To determine the effect of DER towards the stock price of companies listed on LQ 45 Index on Indonesia Stock Exchange for period 2017-2021.
- 2) To determine the effect of EPS towards the stock price of companies listed on LQ 45 Index on Indonesia Stock Exchange for period 2017-2021.
- 3) To determine if DER and EPS have simultaneous effect on stock price of companies listed on LQ 45 Index on Indonesia Stock Exchange for period 2017-2021.

1.5 Benefit of Research

1.5.1 Theoretical Benefit

This research is expected to be reference materials and literature for further research on similar topics.

1.5.2 Practical Benefit

Based on the problem formulation and research objectives that have been discussed above, it is expected that this research will provide benefits for:

a. Company

This research is expected to be one of the considerations for company management in taking decision.

b. Investor

This research is expected to provide information for investors in making investment decisions in capital market.

