

# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

In a country's economy, capital market has an important role as an indicator that determines economic growth, whether it strengthens or weakens. Capital market is a place for people who have excess in funds and with those who experience lack of funds. Capital market involves long-term financial instruments to be traded such as stocks, bonds, mutual funds, obligations, exchange traded funds, and derivatives which falls under investment activities (IDX, 2018). Investments are buying assets in the present to get a higher return in the future, it can be an alternative source of financing for corporate activities. The source of this financing can be through the sale of shares and the issuance of stocks by companies that need funds. It means that obtaining funds to develop the company from investors, and investors that enter the capital market gain the return from the excess funds.

The companies that distributes their shares should go public or register initial public offering (IPO). This capital market which will be researched is called Indonesia Stock Exchange (IDX) or *Bursa Efek Indonesia (BEI)*. Both of companies and investors activities will form increase or decrease of stock price related with the demand and the supply.

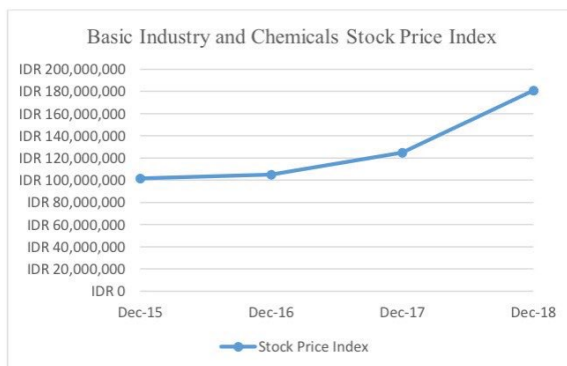
As Indonesia is Free Trade Area (FTA) among countries which makes companies can freely export goods to foreign countries that need goods from Indonesia as cost of production and labor is cheaper than developed countries, or country that has no ability to produce the goods such as basic materials. Basic industry and chemicals sector companies are the companies that produce basic materials needed for other companies to be processed further especially manufacturing sector to produce goods for consumers. As Indonesia government has implemented 'Making Indonesia 4.0', companies of basic industry and chemicals sector will help to achieve economy goals, decrease unemployment as industry need a lot of employees, and improve the development of Indonesia economy (Kompas, 2019).

Basic industry and chemicals sector companies are good for potential investors because it has bright prospect by improving the development towards natural resources as there are more natural resources in Indonesia compared to other Southeast Asia (SEA) countries. Stock price index for this sector is made to provide more detailed information for shareholders about the development of companies in these sector, because stock price index reflects company's stock price whether it's rising or falling. If the stock index rises then it means most companies from basic industry and chemicals sector are operating well, and vice versa. Stock price index of basic industry and chemicals sector for selected period will be shown as below:

**Table 1. 1 Basic Industry and Chemicals Stock Price Index**

<b>Year</b>	<b>Basic industry &amp; chemicals stock price in million</b>
Jan 2016	IDR 101,707,092
Dec 2016	IDR 105,101,177
Dec 2017	IDR 124,803,205
Dec 2018	IDR 180,975,882

Source: data from IDX (IDX, 2020)



**Graphic 1. 1 Basic Industry and Chemicals Stock Price Index**

Source: data from IDX (IDX, 2020)

Based on the graph above, it can be seen that the growth of basic industry and chemicals stock price index continued to increase consecutively from the beginning of 2016 until the end of 2018. In 2016 the stock price index started at IDR 101,707,092 million and in end of 2018 the index stock price is IDR 180,975,882 million. With growth by 77.9%, this indicates that companies' performance of this sector went smoothly.

Stock prices will always change by several conditions, situations, and circumstances related to market condition that determine a stock price experiencing fluctuations. According to Theresia and Arilyn (2015), stock price is the basis of investment considerations for investor because stock price can reflect the value of its company. Investor who buy shares will expect the price of shares to increase, while investor who sell shares will expect the price of shares that have been sold to decrease, in which this will cause the stock price to fluctuate (Dewi & Suaryana, 2013). According to Yulianto (2015) a country's economy especially

macroeconomic conditions can also affect stock prices such as exchange rates, interest rates, inflation rates, economy growth, etc. Besides, microeconomic can affect stock prices such as liquidity ratio, profitability ratio, and other internal factors.

As big companies will not only sell their products in Indonesia, they will also sell in foreign countries. Therefore, the transaction will be in foreign currencies, company that receives transaction in foreign currency can change to domestic currency by using exchange rate. Exchange rate is price or value of one country currency against other country currency. Exchange rate used in this study is the closing price of US Dollar against Indonesia Rupiah (USD/IDR) per year because USD is global currency. Strengthening in USD means that economy outlook in Indonesia is gloomy, this is according to Kurniadi (2011) who stated that increase in exchange rate will decrease the stock price.

Companies that has registered in capital market will always has debt because debt can help the company in tax savings or to develop the company itself. When company borrows money from bank, there will be fee to be charged by bank using interest rate offered. Interest rate are the monetary policy issued by central bank to control the money supply. If the money supply is high, it will encourage others to purchase more which will make the price of goods increase, therefore government will increase the interest rate to balance the price and also to control the money supply. In this study, the interest rate used is closing rate per year at December which uses BI 7-Days Repo Rate. Increased in interest rate of BI 7-days

repo rate will decrease the stock price, this is according to Agustin (2019) who stated that increase in interest rate of BI 7-DRR will negatively affect stock price.

Some company can have debt both from banks or use exchange rate depending on the rates offered. For example, a company that uses derivative financial instrument to mitigate the risk such as interest rate swap or forward contract. Interest rate swap is when there's 2 companies from domestic and foreign company that agree to exchange interest rate with the agreed amount of money. Forward contract is when company wants to buy or borrow money in foreign currency with fixed exchange rate to hedge the risk in increase value of USD.

According to Sartono (2008) dividend is a decision whether the profits obtained by the company will be distributed to shareholders as dividends or it will be retained in the form of retained earnings in the future to development of company. Dividend payout ratio (DPR) is dividend per share divided with earnings per share. Earnings per share indicates the earnings of a company. Increase in dividend payout ratio will attract investor because it indicates that the company generates profit. Therefore, increase in dividend payout ratio will increase stock price, this is according to Agka Wisnu Pratama (2016) who stated that increase in dividend payout ratio will increase stock price, and decrease of dividend payout ratio will also decrease the stock price.

In order to know the relation of exchange rate, interest rate, and dividend payout ratio on stock price, there are three companies from basic industry and chemicals sector which will be shown as below regarding the phenomena:



**Graphic 1. 2 Exchange Rate and Stock Price of Three Companies at Basic Industry and Chemicals Sector for year period of 2016-2018**

Source: Prepared by author (2020)

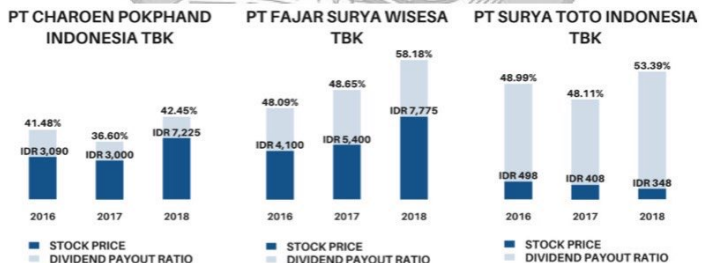
Based on the graph above, the company's stock price of Charoen Pokphand Indonesia Tbk. experienced fluctuation as Rupiah depreciated consecutively for 3 years. However, in 2018, the stock price increased double as USD strengthen for Rp 14,481/USD. Company's stock price of Fajar Surya Wisesa Tbk. increased consecutively for 3 years as the exchange rate also increased in 2016-2018. And for company's stock price of Surya Toto Indonesia Tbk. decreased consecutively for 3 years as the exchange rate increased in 2016-2018. This phenomenon of Charoen Pokphand Indonesia Tbk. and Fajar Surya Wisesa Tbk. was against the idea that stated the increase of exchange rate will cause stock price to increase.



**Graphic 1. 3 Interest Rate and Stock Price of Three Companies at Basic Industry and Chemicals Sector for year period of 2016-2018**

Source: Prepared by author (2020)

Based on the graph shown above, the company's stock price of Charoen Pokphand Indonesia Tbk. increased as interest rate increased, and decreased as interest rate decreased. However, the company's stock price of Fajar Surya Wisesa Tbk. increased consecutively for 3 years although the interest rate decreased in 2017. On company's stock price of Surya Toto Indonesia Tbk. decreased consecutively as interest rate experienced fluctuation. This phenomenon of Charoen Pokphand Indonesia Tbk. and Fajar Surya Wisesa Tbk. were against the idea that stated the increase of interest rate will cause stock price to decrease.



**Graphic 1. 4 Dividend Payout Ratio and Stock Price of Three Companies at Basic Industry and Chemicals Sector for year period of 2016-2018**

Source: Prepared by author (2020)

Based on the graph above, the company's stock price of Charoen Pokphand Indonesia Tbk. increased as dividend payout ratio increased, and decreased as dividend payout decreased. The company's stock price of Fajar Surya Wisesa Tbk. increased as dividend payout ratio also increased consecutively for 3 years. On company's stock price of Surya Toto Indonesia Tbk. decreased as dividend payout decreased in 2016-2017. However, in 2018, the stock price is decreased although the dividend payout ratio increased. This phenomenon of Surya Toto Indonesia Tbk. was against the idea that stated the increase of dividend payout ratio will cause stock price to increase.

Stock price is one of the important variables that need to be considered when trading and making investment decisions because it is the results that determines profits rate that will be obtained by investors. Investors are recommend to do an analysis of the investment instrument to be chosen in order to minimize the risk and to find out the factors that affect the stock price whether it is external or internal factors (Wijaya & Nursanti, 2019). Based on the background's description, the researcher is interested in doing research on some issues mentioned that affect the stock price. Therefore, writer choose the title **“The Effect of Exchange Rates, Interest Rates, and Dividend Payout Ratio on Stock Price at Basic Industry and Chemicals Sector Companies Listed on Indonesia Stock Exchange”** as subject of the study.



## 1.2 Problem Limitation

In order to get the desired research results, author will make limitations so that the research conducted is not too broad or distorted:

1. This research uses exchange rates, interest rates, dividend payout ratios as independent variables and stock prices as dependent variable.
2. This research focuses on companies of Basic Industry and Chemicals sector listed on Indonesia Stock Exchange for period year of 2016-2018.
3. The author uses 18 companies as sample out of 78 companies from both developed and developing companies as population of Basic Industry and Chemicals companies listed on Indonesia Stock Exchange.
4. The researcher uses Statistical Product Service Solutions (SPSS) base 25.0 to find out the results of research objectives.

## 1.3 Problem Formulation

Based on the background outlined above, the researcher formulated the problem to be proposed in this study are:

1. Does Exchange Rates have significant effect on stock price at Basic Industry and Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018?
2. Does Interest Rates have significant effect on stock price at Basic Industry sector companies listed on Indonesia Stock Exchange for period year of 2016-2018?

3. Does Dividend Payout Ratio (DPR) has significant effect on stock price at Basic Industry and Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018?
4. Does Exchange Rates, Interest Rates, and Dividend Payout Ratio (DPR) simultaneously have significant effect on stock price at Basic Industry and Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018?

#### **1.4 Objective of the Research**

There are several objectives of this research that researcher wants to achieve which are as follows:

1. To find out whether Exchange Rates affects stock prices at Basic Industry and Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018.
2. To find out whether Interest Rates affects stock prices at Basic Industry and Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018.
3. To find out whether the Dividend Payout Ratio (DPR) affects stock prices at Basic Industry and Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018.
4. To find out whether Exchange Rates, Interest rates, and Dividend Payout Ratio (DPR) simultaneously affect stock prices at Basic Industry and

Chemicals sector companies listed on Indonesia Stock Exchange for period year of 2016-2018.

### **1.5 Benefit of the Research**

Based on the research limitations and objectives, there are two types of benefit which can be contributed as follows:

1. Theoretical benefit

This research means to train scientific thinking based on the knowledge obtained in college and is expected to improve knowledge or understanding of exchange rates, interest rates, dividend payout ratio, and stock prices.

2. Practical benefit

There are practical benefits for several parties which are as follows:

- a. To academics, the results of this research are expected to add insight and gain more knowledge that has been obtained through this research and it can be used as teaching materials.
- b. To investors, the results of this research are expected to provide information to investors in making decisions, as to maximize profits and minimize losses that will occur.
- c. To researchers, the results of this research are expected to give broader insights and able to apply knowledge that has been obtained previously and can be used as a reference for other researches.

## 1.6 System of Writing

The writing system of this research consists of information contained in each chapter which consists of the following sections:

- CHAPTER 1: INTRODUCTION.** This chapter outlines background of the study, problem limitations, problem formulations, research objectives, research benefits, and system of writing.
- CHAPTER 2: LITERATURE REVIEW AND DEVELOPMENT OF HYPOTHESIS.** This chapter explains grand theories and theories that related to variables, previous researches, hypothesis development, research models, and framework of thinking.
- CHAPTER 3: RESEARCH METHODOLOGY.** This chapter describes the research design, collection of population and sample, methods in data collection, operational definitions and data analysis methods.
- CHAPTER 4: DATA ANALYSIS AND DISCUSSION.** This chapter describes the general view of research object, data analysis, discussion from analyst data, and data interpretation.
- CHAPTER 5: CONCLUSION.** This chapter explains the conclusion on the variables studied and provides recommendation for other parties.