CHAPTER I
INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Economic growth in Indonesia in the past recent years has experienced rapid developments. This is indicated by the progress of developments in various sectors. This economic growth is one of the triggers for investing activities. The capital market has become an important part of Indonesia's economic growth. The capital market refers to a market for trading securities, namely, bonds and stocks (Tandelilin, 2010). In Indonesia, the major capital market is Indonesia stock exchange (IDX) which was a result of merger between *Bursa Efek Jakarta* and *Bursa Efek Surabaya* which is currently under the supervision of *Otoritas Jasa Keungan* (OJK). According to *UU No. 8 tahun 1995* regarding capital market, the definition of capital market is activities that are concerned with public offerings and securities trading, public companies relating to the securities issued, as well as institutions and professions related to securities.

Nowadays, people are interested in investing on stocks since it has more appealing rate of return than other form of investment, namely banking products. For illustration, as for July 2019, Bank of Central Asia annual deposito rate is at 5.75% for deposits below 2 billion rupiah. Which means that the customer only get 0.47% return on their deposits monthly, where with trading stocks in the capital market, if done actively and effectively, investors can gain a faster and higher return on their investment.

Return is the money made or lost on an investment which is generally expressed in percentage of the stock purchase price. The return that will be addressed in this research is the stock return from capital gain. The higher the stock price above the purchase price, the higher return received by the investor and likewise, the lower the stock price below the purchase price, the lower return the investor received this type of gains refers to capital gain. The prices of stocks that are traded are always fluctuates, making it difficult for investors to predict their investment gains.

Below is a graph of *Indeks Harga Saham Gabungan* (IHSG) of companies that are listed in Indonesia stock exchange for five consecutive years starting from year 2014 to year 2018.

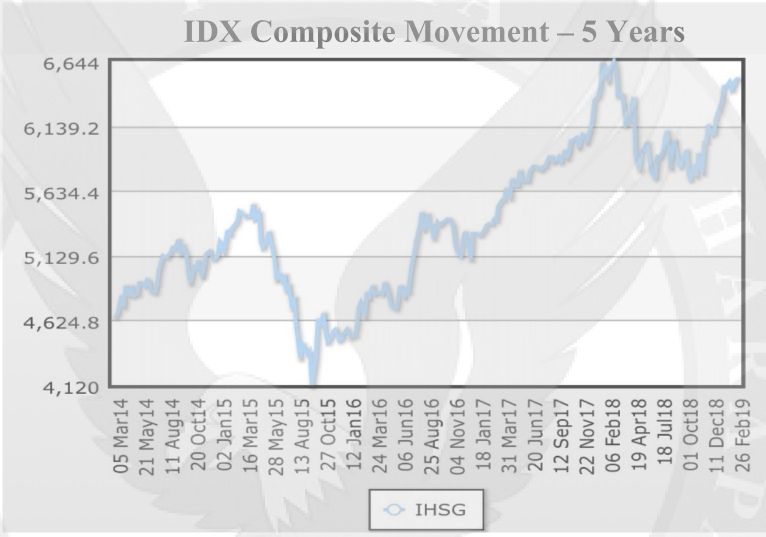

Figure 1.1 The Fluctuation of Stock Price Index Year 2014 to 2018
Source: https://ihsg-idx.com

As we can see from the *Indeks Harga Saham Gabungan* (IHSG) graph above, that the movement of stock price fluctuates rapidly from 2014 to 2018. This stock price fluctuation goes hand in hand with stock returns that occur. Investor main goal in investing is to get the highest return from their investment. According to Zubir (2011), higher levels of uncertainty(risk) in financial investing are often associated with the possibility of higher return and vice versa. However, nothing is guaranteed. Therefore, it is important to have effective investment planning so that investors can maintain their investment and get the highest return on their investments.

There are many factors that influence stock return, both microeconomic and macroeconomic. Microeconomic factors that affect stock returns is factor that are internal within a company, such as its company performance. The performance of a company can be assesed by using financial ratios. Financial ratios are often used by investors to evaluate the company performance. Financial ratios consists of profitability ratios, leverage ratios, market value ratio, liquidity ratios, and activity ratios (Mahmud, 2013). In this research, the researcher is using profitability ratio, leverage ratio and market prospect ratio as the proxy for microeconomic variables.

Kasmir (2013) stated that profitability ratio is a ratio that is employed to analyze the company ability to generate profits. Profitability ratio consist of profit margin, return on assets (ROA), return on investment (ROI), and return on equity (ROE). In this reasearch, profitability ratios that are employed is ROE. ROE is a profitability ratio that measures the ability of a firm to generate profits from its shareholder investment in the company. A high ROE value will indicate that the company has a good performance and prospects. The higher the net income of a company, the higher its ROE.

Financial leverage ratio is a ratio that shows the company's ability to pay all its debts and obligations, long term and short term. Financial leverage ratio consist of debt ratio, debt to equity ratio (DER) and equity ratio. The leverage ratio used in this research is debt to equity ratio (DER). DER illustrates the ratio of debt and equity in the company's funding and shows the capability of the company's own capital to meet all of its obligations (Kasmir, 2013).

Market prospect ratio assess the management's ability to generate market value above the investment cost (Wiagustini, 2014). This ratio consist of earnings per share (EPS), price earnings ratio, dividend payout ratio, and dividend yield. The market prospect ratio that is used in this research is EPS. According to Kasmir (2013), EPS measures the amount of net income earned per share of stock outstanding. High EPS value indicates that the company is in a good shape.

Macroeconomic factors that influence stock returns are inflation, interest rate, foreign exchange (exchange rate), economic growth rates, fuel prices, and political events (Tandelilin, 2010). In this research we are employing inflation, interest rates and foreign exchange as the proxy for macroeconomic variables.

Inflation describes the condition in which the price of goods increased resulting in a decrease in the purchasing power of money since inflation weakens the value of the currency (Yunita et al., 2016). According to Tandelilin (2010), inflation is the tendency of prices of goods to generally and continuously rise. The increase in the price of one or two goods in not considered as an inflation, unless the increase is extended to most of the prices of other goods. Inflation has a negative effect on stock price because inflation increases the cost of a company, if the company income is lower than its costs, it will make the profitability of the company become lower, which will erode investment returns of the investors.

Interest rate refers to the amount charged by a lender to a borrower for the use of assets. High interest rates indicate a negative signal to stock prices and it will affect the present value of the company's cash flow (Tandelilin, 2010). High interest rate can also cause investors to withdraw their investments in stocks and move them to investments in the form of savings or depositos. Bank Indonesia has the authority to set the interest rate that is known as the BI rate. This BI rate works as a benchmark for other banks in Indonesia in setting their loan interest rate or the interest of their deposits.

Exchange rate is the relative value of a currency to other currency (Andayani and Mustanda, 2018). Depreciation of domestic currency against foreign currency can increase the volume of exports. This can increase the profitability of the company, which would cause the company's stock price to increase. However, the depreciation of the domestic exchange rate can have negative impact on issuers who have debts in foreign currencies but only sold their products domestically.

Wide varieties of agricultural tropical products, namely palm oil, rubber, cocoa, rice and etc., are produced in Indonesia. Agriculture has always been one of the prime sources of Indonesia's gross domestic product (GDP) development. However, the agriculture share of the country's GDP has declined markedly during the past five decades.

According to Lukman (2013), Indonesia agriculture sector stock index experienced pressure throughout 2010 where at the beginning of 2010, the agriculture index touched 1993.77 and in the middle of 2010 it fell 28% to 1427.35. However, more recent news stated that agriculture has boost the IHSG increase. Indonesia's agriculture sector is forecasted to grow even more in the future, making it a sector that worth keeping an eye on.

The research on the effect of microeconomic and macroeconnomic variables on stock return has been widely studied by other researchers. Andayani and Mustanda (2018), stated that partially, ROE, inflation, and foreign exhange rate proves to have significant effect on stock return. While DER, EPS, and interest rate has affected stock return insignificantly.

However, according to a research conducted by Artaya et al. (2014), who also has researched about EPS, DER, foreign exchange and interest rate effect on stock return, found that partially, EPS, DER, and interest rate has significant effect on stock return while foreign exchange has no significant effect on stock return.

Moreover, Devianti (2017) found that partially, inflation does not have significant effect on stock return, which in accordance with other researchers namely Amalia (2016) and Yunita et al. (2016). Contradictively, Kriswanto (2014), Andayani and Mustanda (2018), and Utami et al. (2015) stated that inflation has significant effect on stock return.

The results of studies that analyze the effect of foreign exchange and ROE partially on stock return also has different conclusions. The research carried out by Artaya et al. (2014) conclude that foreign exchange has insignificant effect on stock return, while the result of the research conducted by Andayani and Mustanda (2018) and Utami et al. (2015) resulted vice versa. Furthermore, Andayani and Mustanda (2018) and Mughni (2017) concluded that ROE has significant effect on stock return while Amalia (2016) and Yunita et al. (2016) has concluded otherwise.

Based on the results of previous studies where it still shows contradictory results, the researchers are interested in studying this topic further with the independent variables of microeconomic and macroeconomic. Each proxy employed from the independent variables is return on equity, debt to equity ratio, earnings per share, inflation, exchange rate, and BI rate. Moreover, this study used publicly listed Indonesian agricultural companies as the research object, hence this research is titled **"The Effect of Microeconomic and Macroeconomic Variables on Stock Return in Agricultural Companies Listed on Indonesia Stock Exchange".**

1.2 PROBLEM LIMITATION

There are several limitations to the study that is conducted such as

1. The research is limited to agriculture companies that are listed on the Indonesia stock exchange (IDX).
2. The research is limited to the data on year 2014-2018.

1.3 PROBLEM FORMULATION

Based on the description above, the formulation of problem in this research is as follows:

1. Is there a significant effect between ROE and stock return?
2. Is there a significant effect between DER and stock return?
3. Is there a significant effect between EPS and stock return?
4. Is there a significant effect between inflation and stock return?
5. Is there a significant effect between exchange rate and stock return?
6. Is there a significant effect between BI rate and stock return?

1.4 OBJECTIVE OF THE RESEARCH

Based on the problem formulation, the objectives in this research is as follows:

1. To analyze the effectof ROE on stock return.
2. To analyze the effect of DER on stock return.
3. To analyze the effect of EPS on stock return.
4. To analyze the effect of inflation on stock return.
5. To analyze the effect of exchange rate on stock return.
6. To analyze the effect of BI rate on stock return.

1.5 BENEFIT OF THE RESEARCH

There are two types of benefits that could be expected from this research:

1.5.1 THEORETICAL BENEFIT

For further researchers, these researches are expected to provide additional knowledge for academic progress and can be used as a reference for subsequent research.

1.5.2 PRACTICAL BENEFIT

This research is expected to help agriculture companies in Indonesia regarding the use of microeconomic and macroeconomic and its effect on stock return in measuring the company's financial performance. Besides, this research can also be used as a tool for investors to analyze stocks that are traded on stock markets through the variables used in this research so that investors can choose the right investment choice.

1.6 SYSTEMS OF WRITING

This research discusses the effect of microeconomic and macroeconomic on stock returns and is divided into five chapters. Chapter one of this research talks about the introduction of the research which consist background of the research, problem limitation, problem formulation, objective of the research, benefit of the research, theoretical benefit, practical benefit and systems of writing.

Chapter two discusses the literature review and hypothesis development which includes theoretical background, previous research, hypothesis development, research model and framework of thinking. The theories used in this research, namely signaling theory, trade-off theory and other theories will be further discussed in this chapter.

Chapter three deals with the research methodology, these include research design, population sample, data collection method, operational variable definition and variable measurement, and data analysis method. This research is a quantitative research and implementing SPSS 25 program to aid the researcher to obtain the research result.

Chapter four talks about the data analysis and discussion, which describes the research object, data analysis, descriptive statistic, result of data quality testing, result of hypothesis testing and discussion. The final chapter of this research, which is chapter five, discuss conclusions, implications and recommendations made from the results of the research conducted.