

# CHAPTER I

## INTRODUCTION

### **1.1. Background of Study**

Stock is one of the most popular investments that many investors choose due to stock is able to give people a chance to start their investment in the small amount of money and able to provide an attractive level of profit. Basically, the investors that buy the stocks will obtain dividends and capital gain as their advantages. Dividends are the distribution of profits provided by the company and derived from profits generated by the company. Dividends distributed by companies can be in the form of cash dividends and in the form of stock dividends as well. Capital gains are profits from the sale or purchase of shares in the form of excess selling value of the purchase value of shares.

The stock price is a very important factor and must be considered by investors in doing an investment because the stock price reflects the value and the achievement of the company. Company with a good performance will attract investors to invest in the company's stocks. Investors are interested to the company with good fundamentals, lots of trades and prices go up. Stock prices in the capital market consist of three categories, namely the highest price (high price), the lowest price (low price) and the closing price (close price). The high or low price is the highest or lowest price that occurs on a day in the exchange. The closing price is the price that occurred last at the end of the exchange hour. Stock price index is an indicator that shows the movement of stock prices.

As a developing country, Indonesia is one of the countries targeted by domestic and foreign entrepreneurs to increase their wealth through buying stocks in the form of investment. Stocks can be defined as a sign of capital participation of a person or party (business entity) in a company or limited liability company. By including this capital, the party has a claim on company income, a claim on company assets, and is entitled to attend the General Meeting of Shareholders (GMS).

Since 2001, stock price index experienced a significant increase until 2008 reached its peak. But in 2008, there was a world economic crisis that affected stock prices in all industrial sectors. The decline in share prices that lasted until the end of 2008 resulted in investors selling their shares, which resulted in the company's economy become sluggish and stock prices dropped dramatically. The company at that time felt the importance of shares for the continuity of the company's business to maintain its life cycle and also determine the extent to which the company can carry out its activities in a manner overall because capital injections from investors have an impact on expected profits.

Rationally, there is no a specific formula to calculate the stock price exactly. Stock prices can be up and down and unstable. For instance, the movement of the stock prices really unstable during this pandemic of covid-19 .Since this pandemic, IHSG keeps decline with a fairly severe decline. In trading on March 9, 2020, the Jakarta Composite Index closed down by 6.5% to 5,1%. A very rare event CSPI can go down so deep. Unless it is in a serious state such as

an economic crisis. Therefore, stock price will be very interesting as a dependant variable in this research since it is hard to be predicted.

Every investor or potential investor has a specific goal to achieve through investment decisions taken. Generally, the purpose of the investment is to obtain profits, security, and the growth of funds invested. Therefore, in doing a stock investment, investors must analyze the factors that can affect the condition of the company (issuer) in order to get a clearer picture of the company's ability to continue to grow and develop in the future. There are two types of analysis in assessing stock prices such as fundamental analysis of the company through the analysis of financial ratios and technical analysis by looking at stock price movements indicators that show the movement of stock prices. Analysis of financial statements by using financial ratios can be used as a material consideration in determining stock prices.

Return on Equity or ROE is one of the probability ratios that illustrates the ability of the company to generate profits for the shareholders of the capital that they invest in the company (Tandelilin, 2001: 240). The higher the ROE, the better the company is in the view of the investors and it can cause the stock price of the company to increase.

Earning per Share or EPS is one of the accounting information that shows the amount of net profit per share that a company can produce. Earning per Share (EPS) indicates the net profit that the company has obtained for each share during a certain period that will be distributed to all shareholders. Theoretically the higher the EPS, the stock price tends to go up.

The next financial ratio that is related to the stock price is price earning ratio or PER. Price earning ratio indicates the amount of rupiah that must be paid by investors to obtain one rupiah of company profits. Current price earning ratio is widely used by investors as a general guide to measuring the value of shares. Stocks with high growth rates generally have high PER (Hanafi, 2010: 43).

Manufacturing industry is one of the primary sectors on the Indonesia Stock Exchange so that this industry better reflects the state of the capital market. Many investors prefer to invest their funds in manufacturing industry companies because the stock prices of manufacturing industry companies increase every year ([www.idx.co.id](http://www.idx.co.id)). In this study, the author chooses manufacturing companies in consumer goods industry as the object of research because companies in these fields play a crucial role in human life. In line with the increasing rate of population growth in Indonesia, the demand for consumer goods has also increased and this has made the consumer goods sector continue to grow which will bring a positive impact on the stock prices of companies in this sector.

Among 41 manufacturing companies in consumer goods industry that were listed on Indonesia Stock Exchange in the period of 2017 to 2019, the writer chooses PT Indofood Sukses Makmur Tbk and PT Wilmar Cahaya Indonesia Tbk. Due to both of companies already released their official annual 2019 report and fulfilled the criteria that writer wants are the reasons for choosing both of those companies.

**Table 1. 1 ROE, EPS, PER and Stock Price**

<b>Company</b>	<b>Year</b>	<b>ROE</b>	<b>EPS</b>	<b>PER</b>	<b>Stock Price</b>
PT Indofood Sukses Makmur Tbk	2018	0.13	723.3	10.3	7,450
PT Indofood Sukses Makmur Tbk	2019	0.12	750.4	10.6	7,925
PT Wilmar Cahaya Indonesia Tbk	2018	0.10	168.7	8.2	1,375
PT Wilmar Cahaya Indonesia Tbk	2019	0.19	359.9	4.6	1,610
PT Tunas Baru Lampung Tbk	2018	0.16	143.6	6	865
PT Tunas Baru Lampung Tbk	2019	0.13	135	7	995

Source: Prepared by the Writer (2020)

According to the phenomenon table above, it shows that the stock price of PT Indofood Sukses Makmur Tbk still increased while the ROE is decreased. Then, the stock price of PT Wilmar Cahaya Indonesia Tbk still increased while the PER is decreased. And the stock price of PT Tunas Baru Lampung Tbk still increased while the ROE and EPS are decreased. Due to this inconsistency, the writer is interested in examining whether ROE, EPS and PER affect stock prices or not. Therefore, the writer is decided to do a research with the title of **“The Effect of Return on Equity, Earning per Share, and Price Earning Ratio to the Stock Prices of Manufacturing Companies Listed in Indonesia Stock Exchange.”**

## **1.2 Problem Limitation**

In order to the research that conducted is not widespread and can focus on the main problem, then the author limits the research such as :

1. Financial performance in this study is based on three financial ratios consists of Price Earning Ratio (PER), Earning Per Share (EPS) and Return On Equity (ROE).

2. The company in this study is a manufacturing company in consumer goods sector that has gone public and is listed on the Indonesia Stock Exchange (IDX) and has complete financial statements.
3. This study is using data in 2017 to 2019 with use up to date data considerations.

### **1.3 Problem Formulation**

Based on the background described above, the problems are identified are as follows:

1. Does ROE partially affect stock prices in manufacturing companies?
2. Does EPS partially affect stock prices in manufacturing companies?
3. Does PER partially affect stock prices in manufacturing companies?
4. Does ROE, EPS, PER simultaneously affect stock prices in manufacturing companies?

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

The purpose of this research is to answer the issues that are considered important to be examined are as follows:

1. To determine the effect of Price Earning Ratio (PER) on stock price partially in manufacturing Companies listed at Indonesia stock exchange.
2. To determine the effect of Earning Per Share (EPS) on stock price partially in manufacturing Companies listed on the Indonesia stock exchange.
3. To determine the effect of Return On Equity (ROE) on stock price partially in manufacturing Companies listed on the Indonesia stock exchange.

4. To determine the effect of ROE, EPS, and PER on stock price simultaneously in manufacturing Companies listed on the Indonesia stock exchange.

## **1.5 Benefit of Research**

The research on “The Effect of Return on Equity , Earning per Share and Price Earning Ratio to the Stock Prices of manufacturing companies listed in Indonesia Stock Exchange” is expected to be useful for either related or unrelated parties. The benefit of this research consists of two types of benefit , such as :

### **1.5.1 Theoretical Benefit**

This Benefit explains that the results of research are useful in contributing ideas or enriching concepts, theories of science from research in accordance with the field of science in a study. Here are the theoretical benefits of this research, such as ;

1. For Investors

This research is expected to increase knowledge of investors for financial information in making decisions to invest in the capital market, in order to minimize the risks that may occur as a result of deep purchase of shares in the capital market.

2. For Researcher

This research is expected to give a better understanding for the researcher and could be as a reference material for further research, especially for students who will conduct research on the effect of financial ratio analysis factors on stock price.

### 1.5.2 Practical Benefit

Practical benefits are the benefits that could be felt when applied in the real world and could be used by people. Here is the practical benefit of this research, such as :

1. For Companies

For research companies, it is expected to be used as material information about the methods adopted if the company experiences financial difficulties so as not to go bankrupt.

2. For Writers

Can add insight, knowledge and experience in research field and is a manifestation of the application of knowledge gained during lectures.

