

# CHAPTER I

## INTRODUCTION

### 1.1 Background

Indonesia is the biggest economy in Southeast Asia. Indonesia ranked 7<sup>th</sup> worldwide by GDP and 15<sup>th</sup> by nominal GDP. Indonesia is also just behind China as the world's fastest growing G20 economy (AFM, 2020). The amounts of stocks listed on Indonesia's stock market has grown from 24 in 1987 to over 700 in 2020. Since November 2015, the Indonesian government, through Indonesian Stock Exchange, have started a campaign called *Yuk Nabung Saham*, which loosely translated means "let's save stock". This program was intended to increase Indonesians' awareness on Indonesia's stock market and interests on investing in stocks. It was intended to shift Indonesian society from a saving society into an investing society. Evidently, KSEI recorded that the number of capital market investors in Indonesia have increased from 1.6 million on 2018 to 6.1 million in August 2021. This shows that the *Yuk Nabung Saham* program has successfully increase Indonesians' awareness regarding the stock market. As of January 2021, Indonesia's total market cap is Rp 6,763.37 trillion, a 36% increase compared to Rp 4,972.7 trillion in December 2015 (IDX, 2016, 2021). Conversely, looking at Indonesia's annual GDP growth rate, there has been a slowdown in growth since 2010. According to (World Bank, n.d.), Indonesia's GDP growth rate has dropped from 6.224% in 2010 to 5.018% in 2019.

According to (WHO, 2020), on 31 December 2019, Wuhan Municipal Health Commission released an official announcement stating that they found several cases of ‘viral pneumonia’. On 9 January 2020, a novel coronavirus was first determined by the Chinese authorities as the cause. Then, on 11 January 2020, the first death from the novel coronavirus was reported. The Chinese government quickly made containment procedures with extreme quarantine to limit the spread of the virus. The novel coronavirus was then named COVID-19 on 11 February 2020 by WHO. On 11 March 2020, WHO made an official statement that COVID-19 was declared a pandemic after witnessing high levels of spread and severity. Soon after, several countries also reported cases of COVID-19 and progressively the whole world started to practice social distancing.

According to (Zach, 2003), stock return may be affected by major events. There has also been evidence that pandemic diseases may affect stock return, such as the 2002–2004 Severe Acute Respiratory Syndrome (SARS) outbreak, the 2015–2016 Zika virus epidemic, and the 2013–2016 Ebola virus disease epidemic. The SARS outbreak infected a total of 8,089 people and caused 774 deaths. According to (Chen et al., 2007), the SARS outbreak successfully managed to affect stock return. Hence, it is possible that the COVID-19 pandemic also affects stock return.

Unfortunately, due to the COVID-19 pandemic, Indonesia’s GDP growth rate dropped to -2.04% in 2020. The infectious COVID-19 virus that appeared in the end of 2019 had caused a global scale economic and social

calamity. As of 7 September 2021, the number of total confirmed COVID-19 cases in Indonesia have reached 4,133,433 and 221,134,742 worldwide. In addition, number of deaths caused by COVID-19 is 136,473 for Indonesia and 4,574,089 worldwide. This global economic slowdown also affected Indonesia's stock performance largely. Just like the Indonesian economic crisis in 1998 and the global financial crisis in 2008, Jakarta Composite Index experienced a downfall, even though not as devastating as the preceding crisis. On 2 March 2020, Indonesian President Joko Widodo announced Indonesia's first two cases of COVID-19. During that same month, the market experienced a 16% decline, back to the price level of January 2016. From 10 April to 23 April 2020, the first social distancing measure was imposed by Jakarta Governor, Anies Baswedan, in effort to slow down the COVID-19 spread (Wijaya, 2020). This effort was later followed by other provinces in order to help reduce the number of new cases. The market then slowly recovered during the months following the social distancing efforts.

Stock return is the capital gain or loss received through stock by an investor or trader (Julianto & Syafarudin, 2020). Capital gain happens when the current value of the stock exceeds the initial value of the stock at the time of purchase, which is basically the profit an investor or trader received after holding on a stock. On the contrary, capital loss happens when the current value of the stock is lower than the initial value of the stock at the time of purchase. Experiencing capital gain would result in a positive stock return, whereas experiencing capital loss would result in a negative stock return. There are two

types of stock return: realized return and expected return. Realized return is the actual return that has been received by the investors; whereas expected return is the return that the investors expect to gain in the future. Expected stock return can be measured based on the historical price of the stock, which is related to the realized return of the stock. This method is called technical analysis. Furthermore, stock return can also be measured based on the performance of the company, which can be done through financial ratios. This method is known as fundamental analysis.

Fundamental analysis is usually done by analyzing a firm's financial report. Every year, every public company in Indonesia is required to publish their financial report. This financial report is essential for several parties such as stakeholders, investors, creditors, and the government. Each of those parties have their own way of using the financial report. In order for an investor to estimate the expected return of a stock, they would need to interpret the information and data provided inside the financial report. Investors would use a company's financial report to calculate the expected return of the company's stock by using tools such as financial ratios. Financial ratios are further divided into five categories: liquidity ratios, leverage ratios, asset management ratios, profitability ratios, and market value ratios. Each category serves a different purpose on dissecting a company's financial report. However, in this research, we use leverage ratio, profitability ratio and market value ratio.

Return on asset (ROA) is a financial ratio used to determine how well a company can use its assets to generate profits. ROA is included in the

profitability ratios category. ROA is calculated by dividing net income with total assets. Hence, we can conclude that the higher the ROA, the more profitable the company is. ROA as an independent variable has a positive impact towards stock return as a company with high ROA can generate a high amount of profit subjective to the value of its assets, hence increasing stock return. A high ROA rate would increase investors' trust towards a company as companies with high profitability rate are able to use their profits to further expand their company, which means more people would invest their money on that company's stock. A company with high profitability rate is also able to share its profits to investors in a form of dividend, hence increasing stock return. Also, as a company grows larger, their stock price tends to grow, which results in a higher stock return.

Market capitalization defines the total value in money of the company's outstanding shares of stock. It is calculated by multiplying the number of outstanding shares with the current price of the stock per one share. Market capitalization helps investors to understand and compare the size of one company with the other. Market capitalization reflects how investors value the stocks in the market. Investors who trust the company and its future prospect would invest their money in the company, thus increasing the market capitalization of the company. Companies with higher market capitalization is also considered larger in size, hence why investors would trust it more. Market capitalization as an independent variable has a positive impact towards stock return as a high market capitalization means that investors are interested in

investing their money into that company, hence increasing expected stock return. As more investors are interested in the stock, the stock price will continue to rise, and the stock return will also increase.

Debt-to-equity ratio (DER) is a financial ratio used to determine the amount of leverage or debt used by a company to run its operations. DER is calculated by dividing the total amount of liability with equity. Hence, we can conclude that the higher the DER, the higher the company's liabilities are, which means a great part of the company's operations are funded from debts. This poses a high risk for investors because there is a chance that the company would not be able to pay back its debts if they failed to generate enough income. Another thing to note is that liabilities come with interests. Too much liability can be very costly for a company, and it would reduce the company's income. DER as an independent variable has a negative impact towards stock return because a company with high DER is usually avoided by investors because a company's income is deducted by its debts and interests, hence higher DER rate means the company has a high amount of liability and it would lessen the profits the company can gain. The less profits a company can earn, the less likely it is able to expand their business. When the business is not growing, the stock price will not grow, and it would result in less stock return.

Company size is a measure of the scale of a company. Company size is determined from the total amount of asset that one company has. The more asset a company owns, the more likely it is to generate larger profits. This is because companies with larger amount of assets are expected to have enough



funds to support their operations and generate decent amount of profit. Hence, investors tend to prefer investing their money in companies with higher amount of asset as it is less risky. Whereas smaller companies do have more space to grow but is also more prone to losses and bankruptcy. Company size as an independent variable has a positive impact towards stock return as companies that are larger in size are less risky to invest in compared to smaller-sized companies. More investors will prefer to invest their money on companies that are larger in size that is more promising. This will cause the stock price to rise, hence causing a higher stock return.

According to Indonesia Stock Exchange in 2020, there are a total of 9 stock sectors in Indonesia: agriculture; mining; basic industry and chemicals; miscellaneous industry; consumer goods; property, real estate and building construction; infrastructure, utility and transportation; finance; and trade, service and investment. Each of the sectors has different amounts of stocks and different rate of stock return. The same stimuli can cause different effects to each stock sectors. During COVID-19 pandemic, there is an increase in demand for healthcare, thus bringing positive stimuli towards healthcare stocks. During the same period, people are asked to stay at home and practice social distancing. People started to pile on food and other essential needs as they are required to stay at home. This results in an increase in demand for consumer goods sector, hence resulting in a positive stimulus for the sector. Social distancing also caused people to travel less as they are encouraged to stay at home more. This translates as a negative stimulus towards transportation

stocks, especially after the government-imposed regulations limiting the number of people allowed to travel. Stock sector as a dummy variable will further research whether different stock sector responds differently towards the COVID-19 pandemic.

This study is a replication of the research done by Abdullah M. Al-Awadhi, Khaled Alsaifi, Ahmad Al-Awadhi, and Salah Alhammadi. The difference in research lies in the independent variables used. The previous study used daily growth in COVID-19 total confirmed cases, daily growth in COVID-19 total death, market capitalization and market-to-book ratio. Meanwhile, this research added return on asset, debt-to-equity ratio, and company size to further measure the profitability, the leverage and the size of the companies. Thus, the variables in this research incorporated not only COVID-19 and market valuation variables, but also profitability ratio and leverage ratio to conduct a more detailed, in-depth, and accurate results. This research also eliminated market-to-book ratio to prevent any problems of multicollinearity. Another difference lies on the sample used for the research. The previous research used companies listed in Hang Seng Index and Shanghai Stock Exchange Composite Index during the period of 10 January to 16 March 2020 with a total of 1579 stocks. This research used all public companies listed in Indonesia Stock Exchange (IDX) whose IPO date is before 1 January 2018 and are not in the financial sector, with a total of 388 stocks.

After comprehensive review of the research background stated above and previous studies, a research gap is found. There has only been minimal



number of studies that researched the effects of COVID-19 cases as independent variables, with added independent variables of ROA and market capitalization, with supporting variables of DER and company size, while also using stock sector as a dummy variable in analyzing stock return. There is also a phenomena gap as COVID-19 pandemic is a new and unexpected major event that recently happened around the globe. There has never been a pandemic as severe as COVID-19. The 2003 SARS outbreak has a very small impact compared to COVID-19, with less than 1,000 death cases. The 1957–1958 Asian flu was closer to COVID-19 with 1.1 million deaths. There is also 1918–1920 Spanish flu that was followed by a recession, although the recession was mainly cause by the World War I. However, even after the world has gone through quite a number of pandemics, none of them is comparable to the COVID-19 pandemic. As COVID-19 pandemic is also relatively new, there have been minimal studies researching about the effects COVID-19 has towards stock return. As a result, it is interesting to research **“THE IMPACT OF COVID-19 PANDEMIC TOWARDS STOCK RETURN IN INDONESIA (Empirical Study on Companies Listed in IDX during the period of 2019–2020)”**

The focus of this study will be regarding stock return. Stock return in this research is measured by the daily percentage change of stock price. As the price of a stock grows and increases, investors would experience capital gain. The investors can then sell their stock in a higher price than the buying price, and the increase of price and value is the stock return. On the contrary, as the

price of a stock falls, investors would experience capital loss, thus the value of their stock decreases and they would have a negative stock return. Hence, this research used financial ratios such as ROA, DER and Market Capitalization as variables to analyze stock returns.

## **1.2 Research Problem**

Based on the background presented above, the research problems are as follows:

- 1) Does return on asset of firm affect stock return in Indonesia?
- 2) Does market capitalization affect stock return in Indonesia?
- 3) Does daily increase of COVID-19 total confirmed cases affect stock return in Indonesia?
- 4) Does stock sector affect stock return in Indonesia?

## **1.3 Research Objective**

The following are the objectives of the study:

- 1) Prove empirically that return on asset of firm affects stock return in Indonesia.
- 2) Prove empirically that market capitalization affects stock return in Indonesia.
- 3) Prove empirically that daily increase of COVID-19 total confirmed cases affects stock return in Indonesia.
- 4) Prove empirically that stock sector affects stock return in Indonesia.

#### **1.4 Significance of the Study**

1) Writer

It is hoped that this research would provide experience, insights, deeper understanding regarding the issue discussed and act as an application of the knowledge gained during the process of learning in university.

2) Future researchers

It is hoped that the results of this study would be able to provide additional knowledge to studies regarding stock return, especially relating to the COVID-19 pandemic.

3) Stakeholders

It is hoped that this study would aid decision making processes and frameworks regarding practices relating to stock purchase, specifically during the COVID-19 pandemic.

4) Readers

It is hoped that this study would help readers to further understand the relation between the COVID-19 pandemic and stock return.

#### **1.5 Scope of the Study**

The scope of the research carried out has limitations as follows:

- 1) The object of research taken is a company that is registered at Indonesia Stock Exchange (IDX).

- 2) The population used in this study is companies that are listed on the Indonesia Stock Exchange (IDX) 2019–2020.
- 3) The dependent variable used in this study is stock return, which is the percentage of price change from the day before to the current day.
- 4) The independent variables used in this study are firm's return on asset, market capitalization, COVID-19 confirmed cases, debt-to-equity ratio (as a control variable), company size (as a control variable), and stock sector (in the form of a dummy variable).

## **1.6 Systematic Discussion**

The research paper is systematically divided into five chapters as follows:

### **CHAPTER I INTRODUCTION**

This chapter will discuss subchapters including background, research problem, research objective, significance of the study, limitation as well as systematic discussion.

### **CHAPTER II LITERATURE REVIEW**

The basic concept definition, related literature review, previous studies, conceptual framework, and hypothesis development will all be covered in detail in this chapter.

### **CHAPTER III METHODOLOGY**

This chapter will describe the research methodology in depth. The population and sample, the empirical model, operational variable specification, and data analysis method are all included.

#### CHAPTER IV RESULT AND DISCUSSION

The impact of return on asset, market capitalization, COVID-19 confirmed cases, and stock sectors will be discussed in this chapter, along with the research's results and empirical findings.

#### CHAPTER V CONCLUSION

This chapter contains the conclusion and recommendations from the previous chapter's results and discussions, as well as suggestions for future researchers.

