

## CHAPTER I

### INTRODUCTION

#### 1.1 Research Background

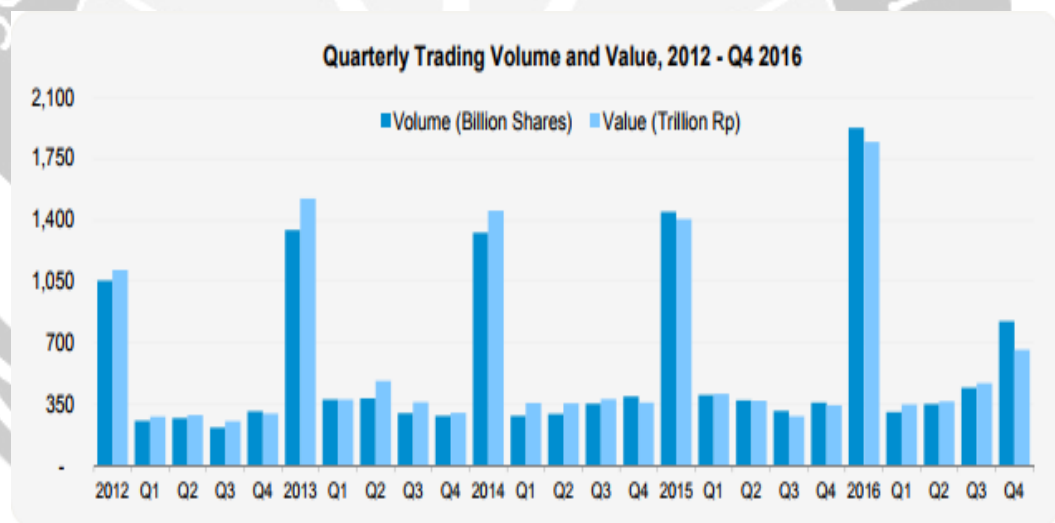
Needs is something that cannot be separated from human life. Every human has different kind of needs. The needs of human will increase as the time goes by. Therefore, human always seeks for new opportunities and try to plan the financial as well as possible. People have many kind of way to generate more money, one of them is an investment. Investment is an option for people to generate more profit in the future, but behind every profit, there will always be risks. Therefore, investors should be knowledgeable about investments.

Considering about risk and return is something that really important when making an investment. Usually, the higher the risk, the higher the return, vice versa. According to Halim (2005), there are two options of investments for investors, firstly invests in financial assets including stocks, bonds, warrants and option, this kind of assets do not have physical form. Secondly invests in real assets including, property, land, and others, this kind of assets have physical form and the value has tended to increase every year.

As mention previously, purchase stocks are one investment alternative. In Indonesia, people can purchase stock through Indonesia Stock Exchange (IDX). The rapid growth of capital market in Indonesia shows that Indonesian people become more interested to invest. According to Financial Service Authority, the capital market capitalization of Indonesia tends to increase every year. In July 2017,

it reached RP. 6.400,11 Trillion. This number shows that investor becomes more realized to invest their money in the Indonesian Capital Market. Law No. 8 of 1995 on Capital Market stated that capital market plays a strategic role in economic development because it provides the public with new investment opportunities for small and medium investors. If the market capitalization increases each year, it means the economic development also getting better.

Furthermore, the trust of investors also can be seen from the total trading volume and also the value of trading. The total trading volume and the value tend to increase every year, even though it decrease, but not significant.



Source: [www.idx.co.id](http://www.idx.co.id) (IDX Statistic 2016)

**Figure 1.1**  
**Trading growth**

From Figure 1.1, can be seen that the trading volume and value fluctuated from 2012-2016. Even though it decrease, but the decline is not significant. Increase in trading volume and the trading value shows that the trust of investors to invest their money in the Indonesia Capital Market also is increasing year by year.

In Indonesia capital market, there are many kinds of people with different background and different mindset. The differences lead to different decision making between the investor. The Efficient Market Hypothesis (EMH) assumes that investors will be rational in making the investment decision, this decision will consider about the information available in the market, the rationality makes investors have a desire to maximize the utility by choosing investment with high return and low risk. Moreover, rational investors will buy the stock when the price is low and will sell it when the price getting higher, but in fact not all investors are rational, especially for the investors in emerging market. The irrational behavior of investor can be explained by behavioral finance theory. The concept of behavioral finance is basically an integration of sociology, economics and psychology. Psychological studies help in understanding group and individual behavior when making appropriate strategy which can influence the decision. The economics help to understand the risk and return for the investors.

In the real world, the market condition cannot fully explain by the Efficient Market Hypothesis (EMH) theory, there will be a time where investor act irrationally, for example, when there is a shock in the stock market that cannot be predicted by using fundamental analysis or technical analysis, all investors will respond to the decline of the stock price by selling the stock, this action will make the stock price getting lower than before. The value of Index Harga Saham Gabungan (IHSG) decreases significantly in a financial crisis that occurred in 2008, but the value of IHSG started to increase significantly in 2009. The sharp fluctuation of IHSG indicates the existence of irrational behavior among Indonesian investor.

Behavioral finance can explain the psychological interaction between behavior and financial decision (Shefrin & Statmant, 2000). In this theory, there are two factors that can explain investor's mistake when making investment decisions, which are information processing biases and behavioral biases. Information processing biases occur because investors cannot process the available information as well and make wrong prediction. Some biases that occur due to an error in the information process are forecasting errors, overconfidence, conservatism and sample size neglect and representativeness. Behavioral biases occur when investors are inconsistent in making investment decision even though all the information available in the market. Some common biases are framing, mental accounting, regret avoidance and prospect theory (Bodie et al., 2009)

The basic assumption of prospect theory is losses and gains have different values and thus investors make decisions based on perceived gains instead of perceived losses. Prospect theory stated that investors become risk-averse when experience gains and become risk-seeking when experience losses. Risk aversion make trader realizing the gains as quick as possible to avoid the possibility the gains turn into losses. Meanwhile, risk seeking make a trader has willingness to hold the stock in the down value with the expectation the stock price will increase and get a bigger return. This condition leads to disposition effect.

Disposition effect is one of the errors in decision making where investors make a decision not in a right time and right price. Disposition effect defines as a tendency for investors to sell the winner stocks too early and holding the loser stock too long (Shefrin & Statmant, 1985). The other research from Odean (1998) found

that in general investors more quickly in realizing the profits rather than realizing the losses. The more the professional the investors, the lower the level of disposition effect (Dhar & Zhu, 2006). Another research from Barber, et al., (2007) found that 84%, investors in Taiwan more quickly in selling the winner stock rather than the loser stocks. When the disposition effect exists in the market, the volatility, return and trading volume are decrease (Goetzmann & Massa, 2008)

The research conducted by Indrayono (2011) proves the existence of disposition effect, before the financial crisis disposition effect weaken positive relationships between book value per share with stock price. Meanwhile, after the financial crisis, disposition effect weakens the relationship between earning per share with stock price. This research in line with the first research about the disposition effect done by Shefrin and Statman (1985) which found the existence of the disposition effect in the Shenzhen stock market of China. In contrast, Salma Zaiane (2013) found that the disposition effect does not exist in the Shenzhen stock market because there is positive relationship between trading volume and volatility. Different results about the existence of disposition effect make the author interested to re-tested whether the disposition effect exists or not in Indonesian capital market.

This research will look at the phenomenon of the disposition effect on blue-chip stocks. Blue-chip stock is the most frequently traded stocks. A blue-chip stock has a large market capitalization, good reputation and many years of business. Almost all research about market anomalies and disposition effect done on value stock, not blue-chip stock, including in Indonesia capital market. Therefore, this research will see whether there is a disposition effect on blue-chip stock in

Indonesia Stock Exchange or not. Even though blue-chip stock tends to be more stable than value stock, but the Jakarta Composite Index (JCI) movement is quite volatile and blue-chip stocks are the most traded stock. Because of this, testing the disposition effect on blue-chip stock is interesting.

There are several factors that become a sign of disposition effect that is trading volume, volatility and return. These factors become endogenous variables which will be tested the relationship. This relationship will indicate whether the disposition effect exists in Indonesia or not. Volatility can be defined as the fluctuation of the returns of a security or portfolio in a given period of time. High volatility indicates inefficient market conditions and become an indicator of bias occurrence. Volatility is closely related to stock return, if the disposition effect occurs, when the returns decrease, the trading volume will remain the same and even increase. This condition shows that the market is inefficient because there is a bias in the market.

One phenomenon that occurs in Indonesia Stock Exchange is the stock price does not reflect its fundamental value. One factor that is affecting the stock price is the demand or investor expectation against the stock. If investors have high expectation against the stock, the demand will increase and the stock price also increases. In addition, investors also tend to be rushed in selling the winner stock and hold the loser stock too long. Based on Figure 1.1, can be seen that Indonesia capital market continues to grow. So further research about the problem exist in the capital market is necessary to conduct. This research focuses in blue-chip stock because previous study only concern in value stock.

## 1.2 Problem Statement

As it is known, on an efficient market, the price of one instrument in the market reflects the real condition of the company that issue the instrument. However, the limited amount of information available in the market can cause bias in the capital market and make the market not efficient anymore. Because of the limited amount of information available, some investors sell the winner stock too early and some of the investors hold the loser stock too long.

In this research, the relationship between volatility, return and trading volume will be tested to indicate whether the disposition effect exist in Indonesia market or not. Based on the research background above, so the problems of the study are as follows:

- a. Is there a disposition effect on blue-chip stocks in Indonesia Stock Exchange?
- b. What is the effect of the disposition effect on the relationship between volatility and return?
- c. What is the effect of the disposition effect on the relationship between trading volume and volatility?
- d. What is the effect of the disposition effect on the relationship between trading volume and return?

## 1.3 Scope of Research

This research only focuses on analyzing the existence of the disposition effect on blue-chip stocks in Indonesia Stock Exchange by looking at the causal relationship between trading volume, return and volatility. This research only

focuses on blue-chip stock because firstly, some previous researches only focus on value stock, secondly, as it is known, blue-chip stocks are some stocks that have good reputation, means that the price also stable. In this research, blue-chip stocks are stock that always listed on LQ-45 from period 2013-2017. This condition makes the investors psychologically not so ready to accept losses, investor always thinks that the price always stable and the possibility to get loss is small, if the investor get a loss on blue-chip stocks, the feeling would be different with the feeling when gain profits, even though the amount is the same. Mentally, investors will be more hurt when experience losses rather than gains. Compare with investors who hold value stocks, this type of investors psychologically more ready to accept the losses. Investors who held value stocks already known that the price of the stocks have a tendency to fluctuate sharply, means that the risk is higher compared with blue-chip stock, so that psychologically investors more ready to accept losses. This research also investigates the influence of the disposition effect on the causal relationship between trading volume, return and volatility. The other factors which not mentioned will not be in the analysis.

#### **1.4 Research Objective**

Based on research background and research problem, then the purpose of the study can be made as follows:

- a. To determine the existence of the disposition effect in Indonesia Stock Exchange
- b. To investigate the influence of the disposition effect on the relationship between return and volatility



- c. To investigate the influence of the disposition effect on the relationship between trading volume and volatility
- d. To investigate the influence of the disposition effect on the relationship between trading volume and return

### **1.5 Research Benefit**

Benefits of the study are:

- a. Researcher

The researcher will know more about the existence of the disposition effect in Indonesia Stock Exchange beside that researcher also know about the influence of the disposition effect to the causal relationship between trading volume, return and volatility.

- b. For the financial advisors

This research is expected to make financial advisors understand more about the existence of disposition effect that make the stock price does not reflect the fundamental value, so that the financial advisors can give better information to the clients.

- c. For the investors

This research is expected to help the investors understand more about the irrational behavior and help them to make a right decision before they invest the money.

d. For Academic

This research is expected to be a reference for the readers to have better understanding of the disposition effect as one of irrational behavior in Indonesia Stock Exchange.

## 1.6 Research Report Outline

### Chapter 1 Introduction

Discussing the introduction about the research. The introduction consist of research background, problem statement, limitation of research, objective of research, benefit of research, and research report outline.

### Chapter 2 Literature Review

Consist of theoretical background and hypothesis development.

### Chapter 3 Research Methodology

Describing the population and sample used in this research, data and data gathering, measurement of variables, and method of analysis.

### Chapter 4 Discussion

Presenting the empirical findings, discussing and analyzing the data.

### Chapter 5 Conclusion

Providing the conclusion from this research, included limitation of the research and the managerial implication.