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Short-Term Response of Indonesian Stock Market Against Political Events

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ABSTRACT

This study is entitled the short-term response of the Indonesian stock market to political events. This study aims to analyze the market reaction to the holding of the presidential election of the Republic of Indonesia which took place in 2019. The researcher uses the literature study method, which is used to observe the information content of a political event that occurs. This study is also intended to examine the difference in the effect of presidential election events on companies under government control and private companies. The research object used is 437 companies listed on the Indonesia Stock Exchange. The results of the research show that abnormal returns are negative the day before the election, then a reversal occurs the day after the election, where the abnormal return value increases and becomes positive, this shows that investors are confident that the presidential election is going well. The results of this study also show that companies under government control are more likely to feel the effects of the presidential election event than private companies.

***Keywords**: Abnormal Return, Presidential Election, Market Reaction, Event Study*

RESEARCH BACKGROUND

The capital market is something significant for economic growth. The capital market plays an important role in the level of economic progress in a country. The capital market is important to transfer or flow funds from parties who have excess funds to those who need funds. But in carrying out its role, the capital market was also inseparable from a number of influencing factors. If an event occurs that affects a country, the capital market will automatically react.

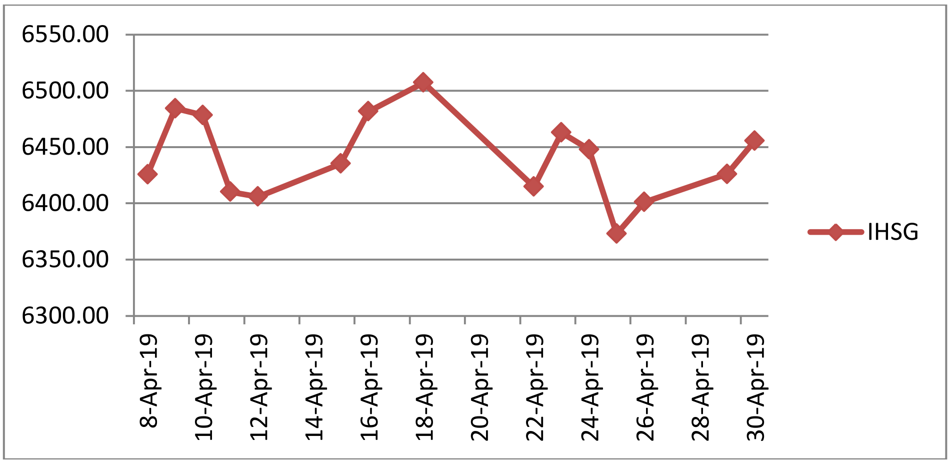
Therefore, a number of political events that occur in a country are also an important part of the non-economic environment but have an impact on capital market conditions. This is because inevitably the political atmosphere will affect the stability of the country's economy. One of the political conditions that has a major influence and can affect the economy is the presidential election which can affect the capital market both directly and indirectly.

The presidential election is one of the events outside the scope of the economy but has an impact on economic stability. The atmosphere of the political climate that tends to heat up before the election is certainly enough to affect economic stability. Therefore, the political climate, especially before the elections, must be maintained so that the economy also becomes stable. A stable economy will invite investors to invest their capital, because with conducive political and economic stability, investors will feel a guarantee of security to invest in the capital market. Conversely, political and economic conditions that are not conducive will make investors hesitate.

Abnormal return merupakan salah satu instrumen yang dapat dilakukan untuk mengetahui kondisi pasar. Bentuk reaksi pasar terhadap suatu peristiwa yang terjadi akan terlihat pada terjadinya perubahan harga saham. Abnormal return bertugas mengukur perubahan harga saham tersebut. Adapun yang dimaksud dengan Abnormal return adalah selisih antara return sebenarnya dengan return harapan. Reaksi perdagangan akan terjadi jika pihak investor memiliki ekspektasi yang berbeda terhadap perubahan harga saham. Spekulasi positif terhadap harga saham yang dimiliki oleh investor akan menimbulkan ransangan bagi investor untuk melakukan transaksi perdagangan.

General elections are a democratic party whose celebrations are held every five-year period. The general election is divided into two rounds, namely legislative elections and presidential and vice presidential elections. The 2019 presidential and vice presidential elections will be held on April 17, 2019. The election is interesting to study because the pair of candidates who will run for the presidency and vice president are the same two pairs of candidates who ran in 2014, namely Joko Widodoo and Prabowo Subianto. It is like a repeat of the previous competition.

In figure 1, a number of information about the movement of JCI (Stock Price Composite Index) is presented. around the 2019 presidential election. The presidential election took place on Wednesday, April 17, 2019 and the market was on holiday. The stock exchange is also closed on Friday, April 19, 2019 due to the death of Isa Al Masih. Given that Saturday and Sunday are holidays, the market began operating again on April 22, 2019. Figure 1 shows the movement of JCI which increased after the presidential election, namely from 6481.54 increased to 6507.22 or presentationally it can be said to have increased by 0.40%.



Sources: www.finance.yahoo.com

Figure 1. JCI Movement 2019 Near Presidential Election

Event studies of political events have been tested empirically in various countries in the world, for example Chen et al (2005) examined the reaction of the Taiwanese capital market, Luhur (2010) examined the Indonesian capital market, Oehler et al (2012) and Bouoiyour and Selmi (2017) investigated the United States capital market. These studies have generally found evidence that markets react to political events, particularly presidential elections. Based on the background previously described, the author is interested in testing the market's reaction to the 2019 presidential election on all stocks listed on the Indonesia Stock Exchange.

LITERATURE REVIEW

Market reaction to political events

Information is an important part of the capital market. Fama (1970) put forward the efficient market hypothesis which was one of the important milestones in the development of financial theory. The market can be declared to be in an efficient condition if no one can get abnormal returns or abnormal returns after adjusting to risk by applying existing trading strategies, both individual investors and institutional investors. In other words, price patterns formed in the market are a reflection or reflection of existing information. Previous research has stated that the existing capital market in Indonesia can be classified into a semi-strong form capital market. Such a capital market model will allow for investors to get abnormal returns.
According to Peterson (1989), what is meant by event study or event study is a form of method applied to test the level of stock prices in the capital market with the aim of investigating whether there is an abnormal return obtained by investors due to the occurrence of an event. According to Hartono (2010), event study is a study conducted in order to study the reaction of a market to an event or event that is widely published as general information.

Event studies can be applied to finance and accounting to study various events, whether at the company, industry, or market level. Previous research has conducted empirical research on the information content of political events. Chen et al (2005) examined various political events on stock performance in Taiwan. In general, the results show that the stock market reacts to political events as indicated by the presence of abnormally significant returns around the events. Luhur (2010) has conducted an analysis of the extent of market reaction to an unusual event, such as the presidential election that took place on July 8, 2009 on LQ45 shares listed on the Indonesia Stock Exchange.

From the results of the analysis, it is known that the abnormal return value is negatin with significant values at t-5, t-4 and t0, while based on standard provisions, abnormal returns will be positive and significant values are at t-10 and t + 7. Therefore, based on the results of the analysis, it is concluded that there is no significant average abnormal return value before the presidential election occurs and after the presidential election. Oehler et al (2012) examined market reaction to the United States presidential election in 1976-2008. They found significant abnormal returns in many industries, both positive and negative. Bouoiyour and Selmi (2017) examined the price of political uncertainty from the 2016 United States presidential election. Analysis is carried out at the sectoral level. The results found that there were abnormal positive returns during the presidential election in several sectors.

The main purpose of this paper is to see the market's reaction to the 2019 presidential election in Indonesia. Previous research (Chen et al, 2005; Sublime, 2010; Oehler et al, 2012; Bouoiyour and Selmi, 2017) show that presidential elections have significant information content. The study expects that the market will react to the presidential election. Therefore, the first hypothesis proposed as follows:

H1: There are significant abnormal returns around the presidential election.

The Role of Government-Controlled Companies

The study further wanted to examine the difference in influence between government-controlled firms and private firms. There are two theories that can explain the role of government-controlled companies. Development theory states that the presence of government-controlled companies is needed to assist the government in development programs (Trinugroho et al, 2014).

Shleifer and Vishny (1994) put forward a grabbing hand theory that explains that state-owned enterprises may not work efficiently because they are subservient to politicians and bureaucrats. Politicians and bureaucrats have an incentive to extract those corporate resources because they have the power to do so. Following the 1997/1998 financial and economic crisis, as part of a restructuring program, the Indonesian government privatized several state-owned enterprises through initial public offerings. However, the government retains majority ownership (Prabowo et al, 2014).

The research argues that government-controlled companies will be more affected by political events, especially presidential elections. Arguably, since those companies are controlled by the government, who will be the president is more important to minority shareholders. The new regime can determine corporate policies and strategies translated by the board of directors under the supervision of the board of commissioners. Board members are elected or appointed at the general meeting of shareholders, but since the government is the majority, most of its members are representatives of the government. Thus, the second hypothesis is formulated as follows:

H2: Government-controlled companies have abnormally higher returns around presidential elections.

RESEARCH METHODOLOGY

Data

This study aims to test the market reaction related to the presidential election of the Republic of Indonesia. The study used a population of all companies listed on the Indonesia Stock Exchange. The presidential election was held on April 17, 2019. The study excluded companies that took corporate action during the window period to avoid the confounding effect. The study excluded companies that did not have complete data. The total research sample was 437 companies. Individual stock price and JCI data are obtained from www.finance.yahoo.com. Financial information is obtained from the company's financial statements published in www.idx.co.id.

Event Studies

The period of events used is five days before and after the events of the presidential election. Short periods of events may not capture the overall market reaction, but longer periods of events will make market reactions unclear due to the confounding effect. The estimation period is 120 days before the event period. April 17, 2019 is still considered as the date of the event (t0) even though it is a national holiday and there is no trading activity in the capital market. One sample t test was used to test the significance of abnormal returns around the presidential election.

Score *Abnormal return* defined by having this formula:
:

$$\boldsymbol{AR_{it} = R_{it} - E(R_{it})}$$

Which AR_{it} is the *abnormal return* for return i at period t, R_{it} which the real *return* for I *return* at period t, and $E(R_{it})$ iis *expected return* for i return at t period..

While expected return calculated by index single model, formulated as follows:

Sementara itu, nilai *expected return* dihitung dengan model single index, yang rumusnya adalah sebagai berikut:

$$\boldsymbol{E(R_{it}) = \alpha_i - \beta_i E(R_{mt})}$$

which α_i is the part of *return* stock not influenced by market performance, β_i is the *return* stock sensitivity to the market development (mentioned beta return i), and R_{mt} is the market *return* at t period..

This study also calculates cumulative abnormal return with the formula:

$$\boldsymbol{CAR(\text{Ʈ}_1, \text{Ʈ}_2) = \Sigma_{\text{Ʈ}_2}^{\text{Ʈ}_1} AR}$$

Which $CAR(\text{Ʈ}_1, \text{Ʈ}_2)$ is the *cumulative abnormal return* from period Ʈ_1 ke Ʈ_2 in the case situation and AR is the *abnormal return*.

Regression

The study also examined differences in the influence of government-controlled firms and private firms. To perform this test, an empirical model needs to be built. The dependent variable used is cumulative abnormal return (CAR). The main independent variable is the dummy variable which is worth 1 for government-controlled companies (the government is the majority shareholder) and 0 for private companies. There are 20 government-controlled companies and 417 private companies.

The study included several control variables. First is the size of the company calculated by the natural logarithm of total assets in 2018 (LNTA). The second control variable is the company's leverage which is calculated by dividing total debt by total assets (DAR) in 2018. This study also controls the industry following the Jakarta Stock Industrial Classification (JASIA). This study uses a number of dummy variables to represent industry differences, namely Agriculture; Mining; Basic Industry and Chemicals; Consumer Goods; Miscellaneous Industry; Property, Real Estate, and Building Construction; Infrastructure, Utilities, and Transportation; Finance; and Trade, Service, and Investment. Because it is a study with cross-section data, ordinary least suare (OLS) is used to test the following empirical models:

$$CAR_i = \beta_0 + \beta_1 DGCF_i + \beta_2 LNTA_i + \beta_3 DAR_i + \beta_4 DAGRI_i + \beta_5 DMINING_i + \beta_6 DBASCHEM_i + \beta_7 DCONSGOOD_i + \beta_8 DMISCEL_i + \beta_9 DPROPESBU_i + \beta_{10} DINFUTRANS_i + \beta_{11} DFINANCE_i + \beta_{12} DTRADSERVIN_i + \varepsilon_i$$

Which:
$CAR_i =$ *cumulative abnormal return*
$DGCF_i =$ variable dummy for public corporate managed by the government
$LNTA_i =$ natural logarithm from total asset
$DAR_i =$ *debt to assets ratio*
$DAGRI_i =$ variable dummy for farming industry
$DMINING_i =$ variable dummy for mining industry
$DBASCHEM_i =$ variable dummy for base and chemical industry
$DCONSGOOD_i =$ variabel dummy for consumer industry
$DMISCEL_i =$ variabel dummy for varied industry
$DPROPESBU_i =$ variabel dummy property, real estate, building developer
$DINFUTRANS_i =$ variable dummy for infrastructure, utility and transporation
$DFINANCE_i =$ variable dummy for financial industry
$DTRADSERVIN_i =$ variable dummy untuk industri trading, services and investment sector
$\varepsilon_i =$ error

RESULTS AND DISCUSSIONS

Case Study

Table 1 presents the results of one sample t-test. From the table it is known that there is a significant abnormal return including t-3, t-1, t + 1, and t + 2, and it lasts for four days. In the days before the event date (pre-events), the market tends to fluctuate. It can be seen that abnormal returns on t-5 and t-4 are positive but not significant. Abnormal return is positive and significant at t-3, which is then followed by a negative and significant reaction at t-1.

One day after the presidential election (t+1) there was a rebound in the stock market and the curve changed, showing abnormal positive and significant returns. However, this is not persistent because the next day (t+2), the abnormal return becomes negative and significant. Then at t + 3 to t + 5 no significant abnormal returns were found.

Abnormal negative and significant returns on the day leading up to the election (t-1) indicate that investors are taking wait-and-see steps due to political uncertainty. Most investors prefer to sell their shares until the election is held. Abnormal returns become positive and significantly affected one day after the election (t + 1) due to confidence in political stability and security.

There is an abnormally negative and significant return at t+2. But this is not too surprising because it is expected to take profits after a significant and positive return the previous day. This is evidenced by the increase in the abnormal average return curve to reach a peak of t + 5 after the presidential election. In general, it can be concluded that the presidential election of 2019 brought an overall positive market reaction.

Political events in the form of the 2019 Indonesian presidential election have significant information content, which is in line with previous research (e.g. Chen et al, 2005; Sublime, 2010; Oehler et al, 2012; Bouoiyour and Selmi, 2017). The capital market category in Indonesia is classified as a capital market that is half strong when viewed from its market efficiency. This is due to the presence of prolonged abnormal returns at more than three points in time around the event. As explained by Fama (1970), prolonged abnormal returns mean a late market response in absorbing and interpreting information.

Table 2 One-Sample T-Test Result

Period	Date	AAR	PROB.
t-5	10-Apr-19	0,00024	0,482
t-4	11-Apr-19	0,00326	0,327
t-3	12-Apr-19	0,00185*	0,056
t-2	15-Apr-19	0,00234	0,215
t-1	16-Apr-19	-0,00512**	0,016
t+1	18-Apr-19	0,00301***	0,000
t+2	22-Apr-19	-0,00196*	0,083
t+3	23-Apr-19	-0,00167	0,287
t+4	24-Apr-19	0,00139	0,461
t+5	25-Apr-19	0,00398	0,356

***, **, and * showed significant in the level of 1%, 5%, and 10%.
Sources: Data managed by Author (2021)

Regression Results

Regression results of determinants of cumulative abnormal return (CAR) are presented in Table 3. The coefficients of the dummy variable for government-controlled public companies were found to be positive and significant, indicating that those companies had abnormally higher returns during the window period. The findings confirm a second hypothesis that public companies that are under government control and subject to state policy will feel more affected by the events of the ongoing presidential election. As stated by Fisman (2001), proximity to political power has an impact on the market value of companies, particularly in emerging markets.

Table 2. Regression Test Result

Variable Dependent: CAR	
DGCF	2,64537***
	(0,0038)
LNTA	1,54872
	(0,2934)
DAR	0,28853
	(0,8350)
DAGRI	-0,3728
	(0,6756)
DMINING	0,18547
	(0,7537)
DBASCHEM	1,45473
	(0,1586)
DCONSGOOD	0,5496
	(0,1486)
DMISCEL	0,15639
	(0,3652)
DPROPESBU	1,76432
	(0,5284)
DINFUTRANS	2,48632
	(0,1235)
DFINANCE	0,83425*
	(0,0545)
DTRADSERVIN	0,78534
	(0,5842)
Observasi	437
R^2	0,1158
Adj R^2	0,0974
F-stat	3,1853
Prob (F-stat)	0,0000

Score in brackets is *p-value*. *** and* showed significant in the level of 1% and 10%.
Sources: Data managed by Author (2021)

SUGGESTIONS

This research was held in order to test market reaction to the holding of the presidential election of the Republic of Indonesia which took place in 2019. There are several important findings from this research. The results of this study include, first, the existence of significant abnormal return values which are at the values of t-3, t-1, t + 1 and t + 2.

Second, the abnormal return value is still at a negative number one day before the presidential election, and after the presidential election the abnormal return number increases to a positive value, especially one day after the election implies that investors consider that the election has been carried out properly. Third, public companies controlled by the government have abnormally higher returns than private companies, indicating that they are more affected by political events, especially presidential elections. Fourth, the Indonesian capital market is classified as semi-strong which allows investors to obtain abnormal returns.

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