

CHAPTER I

INTRODUCTION

A. Background of the Study

Economic growth is certainly an indicator of a country's success. Integrated systematics and the success of government policies in encouraging economic activity. Especially in Indonesia, economic growth is getting better with the digitalization era. The important thing about economic growth is macroeconomic variables that are always maintained such as inflation, interest rates, currency rates, national income, and so on. Based on the latest data from the Central Statistics Agency (BPS), Indonesia's economic growth for the third quarter of 2023 grew 4.94% on a regular basis. *year on year* and grew by 1.60% on a regular basis *quarter to quarter*. This growth is supported by the performance of SOEs and private parties and government policy efforts. Of course, with consistent economic growth, investment flows into the country are getting bigger, both in the real sector and the financial sector through the capital market.

Investment plays an important role in economic growth. National income or GDP is closely related to investment. Investment in the form of increased investment will have a positive impact on the production process in an increasingly active business, then it will also have an impact on increasing household consumption. Investment is a desire on how to use some of the existing funds or resources owned to obtain large profits in the future (Suyanti & Hadi, 2019). The types of real investment are in the form

of gold, land property, business capital, precious metals. This type of investment in the era of digitalization is no longer developing because people have now begun to switch to financial investments, such as stocks, mutual funds, bonds and so on. This happens because to invest in the real sector, the community must have a large enough capital, so that students, students, or people who do not have financial capacity are more unable to invest. For this reason, people have dominated financial investment or often also called the capital market.

The capital market is a means of funding for companies and other institutions and as a means for buying and selling long-term financial instruments and other related activities. The current growth of the capital market certainly has an impact on economic growth. Countries that have capital market growth will definitely experience economic growth. At this time the Indonesian capital market always grows every year. This can indeed be seen from the increasing enthusiasm of domestic investors to invest in the capital market.

Capital markets can play an important role in a country's economic development. This is because the capital market can function as:

1. A means to raise public funds to be channeled into productive activities
2. Easy, cheap, and fast sources of financing for the business world and national development
3. Encourage the creation of business opportunities and at the same time create national development
4. Increase the efficiency of production resource allocation

5. Strengthening the operation of financial market mechanisms in managing the monetary system, because the capital market can be a suggestion of "*open market operations*"
6. Suppress high interest rates towards a reasonable *rate*.
7. As an alternative investment for the investor market.

The capital market is a means of financing for companies and other institutions (such as the government) to obtain funds from the public. The funds will be used as capital for the company to expand its business, while for the community it is an opportunity to make profits in a short or long time. The capital market has a big role for a country's economy because the capital market performs 2 functions at once, namely the economic function and the financial function. The capital market is said to have an economic function, namely a market that provides facilities or vehicles that bring together 2 interests, namely parties (investors) who have excess funds and parties who need funds (issuers), while for the financial function, namely the capital market, provides the possibility and opportunity to obtain returns for fund owners, in accordance with the characteristics of the chosen investment. So it is expected that with the capital market, economic activity will increase, especially for companies to be able to run their operational business, get more profit and build investor confidence.

Figure 1. 1

Growth of Capital Market Investors by Age



Source : www.ksei.co.id

Based on data from PT. The Indonesian Central Securities Depository (KSEI) for the number of Indonesian investors is dominated by Generation Z, those under 30 years old at 55.98% as of Maret 2024. This is a positive indication that many people have begun to realize the importance of financial management, especially investment. However, this also needs to be considered because novice investors often do not recognize the risks that occur in the market, leading to significant losses for many investors, especially those who have just entered the capital market. Therefore, the role of OJK is expected to create regulations that protect investors.

Currently, the most popularly traded investment in the capital market is stocks. The Indonesia Stock Exchange has 43 stock index, one of which is the SRI-KEHATI Index. The SRI-KEHATI Index refers to the Principles for Responsible Investment, measuring the performance of 25 listed companies with good fundamentals and financial performance, promoting sustainable business practices, environmental awareness, and good corporate governance, known as Sustainable and Responsible Investment (SRI). Currently, the SRI-KEHATI index is the only index that

applies investment principles with a focus on Environmental, Social, and Good Governance (ESG).

Table 1. 1

Index Growth 2018 – 2022

Index	2018	2019	2020	2021	2022	Average
LQ45	-8.95%	3.20%	-7.82%	-0.37%	0.62%	-2.66%
IDX30	-8.82%	2.42%	-9.31%	-1.03%	-1.80%	-3.71%
SRI KEHATI	-4.26%	5.78%	-7.76%	-1.09%	14.00%	1.33%
COMPASS 100	-6.35%	1.52%	-5.52%	-3.42%	-0.82%	-2.92%
MNC36	-3.77%	0.74%	-9.21%	-2.80%	12.97%	-0.41%

Source : Processed by the author, 2023

Based on Table I.1 above, the trading growth of LQ45, IDX30, KOMPAS100, SRI-KEHATI and MNC36 indices is very fluctuating every year. However, growth over the last 5 years is still controlled by the SRI-KEHATI index which has an average positive growth of 1.33%. This positive growth of SRI-KEHATI reflects that the SRI-KEHATI index is the index that has the most potential to provide profits with a list of 25 stocks valued in terms of liquidity and core business that have gone through an evaluation and monitoring process by the Indonesia Stock Exchange. The objectives of the SRI-KEHATI Index are to provide additional investment options for investors by selecting issuers that have a good record in an effort to encourage sustainable businesses.

In general, there are two stock analysis techniques that can be used, namely technical analysis and fundamental analysis. In technical analysis

there are charts, trendlines, indicators, candlesticks, and stock pattern patterns. Just focus on charts and analyze based on past price history. So this analysis is more likely to be used for a short period of time. The fundamental analysis is divided into 2, namely relative analysis, which compares with other companies and absolute stock valuations based on financial performance, the capacity of the company. The analysis used in this study is the fundamental analysis of absolute methods, namely *the Dividend Discount Model (DDM)* and *Discounted Cash Flow (DCF)* with the calculation of the level of accuracy used is the root mean squared error.

The main mistake of an investor or potential investor is when looking at stocks is the misprice. This misprice risk occurs because investors incorrectly estimate and identify stock prices. Therefore, as a solution, investors must analyze the fairness of stock prices or intrinsic value to reduce these risks. In other words, intrinsic value has the function of showing how much the fair value of the stock is, as well as determining the estimated profit earned by investors.

However, this must also be supported by the accuracy of fundamental analysis and the risks that will be faced with stock investment. In calculating intrinsic value or fair value, of course, investors must know the model that is in accordance with current developments. To calculate the intrinsic value and rate of return there are many calculations. Since five centuries ago where William Sharpe (1964) and John Lintner (1965) formulated a model called the Weighted Average Cost of Capital (WACC) and Capital Asset Pricing Model (CAPM).

Weighted Average Cost of Capital is a calculation of the company's total cost of capital from all funding, both in terms of equity and debt. This calculation is used to determine the level of present value of the company's business and investment performance. Capital Asset Pricing Model is a model in finance used to estimate the expected rate of return of a particular financial asset, such as stocks or bonds, based on systematic risk or market risk. The concept of CAPM is only based on 1 variable, namely the beta variable, which is an indicator of return assessment. Both models will be used in *the Dividend Discount Model (DDM)* and *Discounted Cash Flow (DCF)*.

With the explanation above, the author is interested in conducting stock analysis research entitled "*Fundamental Analysis of Stock Prices Using Dividend Discount Model (DDM) And Discounted Cash Flow (DCF), in Making the Right Investment Decisions.*" (Case Study on SRI-KEHATI Index Stocks Listed on IDX for the 2018 – 2022 Period).

B. Research Problem Formulation

Based on the background above, the formulation of the problem to be studied in this study is as follows:

1. How does the valuation of SRI-KEHATI's share price with the calculation of *Discounted Cash Flow* compare to the market price?
2. How does the valuation of SRI-KEHATI's share price with the calculation of *Dividend Discount Model* compare to the market price?
3. How does the accuracy of *the Dividend Discount Model* and *Discounted Cash Flow* compare with the Root Mean Square Error?

C. Research Objectives

Based on the questions described above, the purpose of the study can be concluded as follows:

1. Analyzing the comparison of market price with the fair value of the Sri Kehati index using the valuation method Discounted Cash Flow for the period 2018 – 2022.
2. Analyzing the comparison of market price with the fair value of the Sri Kehati index using the valuation method Dividend Discount Model for the period 2018 – 2022.
3. Analyzing the valuation comparison of the Dividend Discount Model and Discounted Cash Flow with the calculation of Root Mean Square Error for the period 2018 – 2022.

D. Research Benefits

In this study, researchers hope to provide benefits for all parties who have an interest in capital market investment by considering the fundamental aspects of the company. Based on the statement above, the benefits of this research for the purposes of academics, investors, investment managers and researchers are:

1. For University

Contribute to the university by adding research references for capital market management studies as well as references to learning materials related to fundamental valuation, such as the Dividend Discount Model (DDM) and Discounted Cash Flow (DCF) valuation.

2. For Potential Investors and Investment Managers

- a. The results of this study can be used as a consideration for calculating the fair value of shares.
- b. For making the right investment decision, the results of this study can be used as a reference for investors and investment managers to compare fair value with market prices and determine undervalued, fair value or overvalued conditions.

3. For Researchers

This research can provide insights and serve as a guideline for comparison with existing research results, as well as complement data for future research.

E. Research Systematics

Systematizing research aims to provide a more detailed research picture and facilitate discussion. The systematics of research writing are as follows:

CHAPTER I INTRODUCTION

This chapter outlines the research background, problem formulation, research objectives, research benefits, and research systematics.

CHAPTER II REVIEW OF RELATED LITERATURE

This chapter describes the theoretical foundations related to the title of the thesis, namely Economic Theory, Investment Theory, Capital Market, Stocks, Stock Index, Stock Analysis Methods, Comparison

of Root Mean Square calculations. This chapter also contains a framework of thought and hypotheses.

CHAPTER III RESEARCH METHODOLOGY

This chapter describes the methods used in research, which include the time and place of research, research methodology, types of data, population and sample, data collection techniques, operational definitions of variables and data analysis techniques using Dividend Discount Model, Discounted Cash Flow with accuracy method Root Mean Square.

CHAPTER IV RESULTS OF RESEARCH AND DISCUSSION

This chapter presents the profile company to be studied and presents data analysis in the form of valuation calculations.

CHAPTER V CONCLUSION AND SUGGESTION

This chapter presents conclusions from research results obtained from the discussion of previous chapters, as well as suggestions for these conclusions.