

CHAPTER I

INTRODUCTION

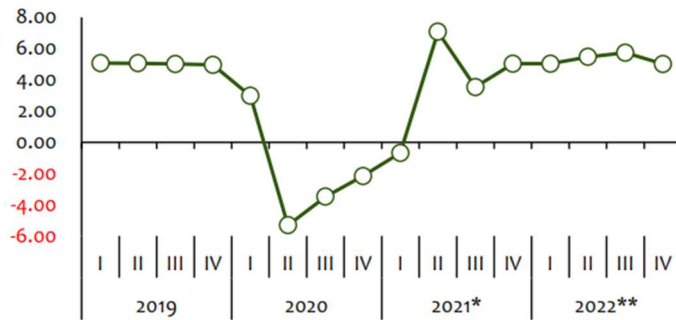
1.1. Research Background

The Indonesian stock market has experienced a noteworthy epoch following the onset of the COVID-19 pandemic. This global health crisis has wielded substantial repercussions on the worldwide economy and financial markets. The economic volatility stemming from the pandemic has rendered investors and market participants particularly susceptible to psychological factors and communal behavioral patterns. When the market experiences uncertain conditions, investors will face uncertainty about the source of information and uncertainty about market conditions that cause panic for Investors who harbor concerns regarding the performance of their investment portfolio. This phenomenon indicates the occurrence of herding behavior.

The Efficient Market Hypothesis Theory (EMH) which is a traditional financial theory explains the rational behavior of investors in making investment decisions. This can be interpreted that investors' decisions are based on relevant information to maximize their profits and their investment decisions are not confused by information and are not influenced by emotions (Byrne & Brooks Baillie Gifford, 2008). However, the reality is that investors can sometimes act irrationally and cause bias. So economists reject the traditional theory regarding the many anomalies found in the market that cannot be explained by the EMH theory. Therefore, Behavioral Finance theory emerged which explains that irrational behavior is influenced by psychological factors.

According to Adem & Sarioğlu (2020), Herding behavior bears substantial ramifications for financial markets as it prompts investors to divert their attention from individual market analyses, opting instead to scrutinize and replicate the actions of their counterparts. Viewed through a behavioral lens, herding gives rise to emotional aberrations. Herding can be categorized into two distinct forms: intentional herding, where investors consciously mimic the actions of their counterparts, and unintentional herding, wherein investors share a common set of information propelled by fundamental factors (Galariotis et al., 2016). In general, there are two types of herding behavior: irrational and rational. Herding behavior is regarded as rational when an investor is aware of what is going on in the stock market and can make judgments that will increase earnings under these circumstances. Meanwhile, if an investor decides due to pressure, panic, and emotions due to seeing other investors selling their shares in these conditions, herding behavior is irrational. These conditions result in money being taken when the market is not too bad and in this condition the capital market becomes unstable.

According to Christie & Huang (1995), the opportunity for herding behavior to emerge is greater when market conditions are in a period of market stress which can be seen from the decline in the real sector or GDP and the weakening of the stock market or JCI.



Source : Badan Pusat Statistik (BPS)

Figure 1.1 GDP Condition In 2019-2022

It can be seen from Figure 1.1 that before the COVID-19 pandemic occurred, Indonesia's economy grew by around five percent (y-on-y). The onset of the Covid-19 pandemic in early 2020 precipitated a downturn in Indonesia's economic growth. In the second quarter of 2020, the Indonesian economy contracted by 5.32 percent year-on-year. The Indonesian economy began to grow positively (y-on-y) in the second quarter of 2021 and will continue to grow consistently above five percent until the end of 2022. The impact of this pandemic is also felt in the capital market, precisely in the Indonesian stock market which can be seen from the development of the JCI.



Source: Yahoo Finance

Figure 1.2 JCI Condition 2019-2022

It can be seen from the graph above that there was a drastic decline from 2019 to 2020, where in 2019 it closed at 6,323.47 IDR then dropped dramatically in 2020, precisely on March 15, 2020, at 4,194.94 IDR and again experienced an increase in 2021 and 2022 of 6,581.48 IDR and 6,850.62 IDR. This situation will signify the manifestation of herding behavior within the Indonesian stock market.

Based on the International Monetary Fund (IMF) Indonesia is a country whose market conditions continue to develop or can be called an emerging market. The research results of Chang et al. (2000) found herding behavior in two emerging market countries, namely South Korea and Taiwan, while in developed market countries, namely the United States and Hong kong, there was no herding behavior. This can be interpreted that there is a high probability of herding behavior in emerging market countries, while there is a small possibility of herding in developed market countries during market stress. Herding unfolds when a collective of investors collectively make investment decisions based on specific information, disregarding other relevant factors like news or financial reports. Herding behavior which refers to the tendency of investors to follow trends or collective market decisions rather than making decisions based on fundamental analysis or individual information, can affect market stability and result in unnatural volatility.

While numerous researchers have delved into the examination of herding behavior, a limited number have undertaken such investigations within the framework of the COVID-19 pandemic. This is because the occurrence is a first that has never been encountered before. Several researchers have used Chang, Cheng, and Khorana's

CSAD (Cross Section Absolute Deviation) approach to analyze how COVID-19 affects herding behavior. Research by Nouri-Goushki & Hojaji (2023) discovered evidence indicating that the emergence of herding behavior in Iran was instigated by the COVID-19 pandemic, further exacerbated by market volatility. This phenomenon was also observed in the course of the research. In addition, research by Espinosa-Méndez & Arias (2021) unearthed compelling evidence pointing towards an intensified occurrence of herding behavior in the capital markets of Europe as a consequence of the COVID-19 pandemic.

Based on the Phenomenon and Research Gap identified by earlier researchers support the researcher's belief that herding should be detected, especially in the Indonesian stock market. The author is interested in detecting herding behavior on the Indonesia Stock Exchange, especially the LQ-45 index. his stems from one of the rationales behind herding behavior elucidated by Chang et al. (2000) where in investors exhibit a preference for stocks that possess greater familiarity and liquidity. In the Indonesia Stock Exchange, stocks that fall into this category are stocks that are constituents of the LQ-45 index because they have good fundamentals and are actively traded.



Source: Refinitive Eikon

Figure 1.3 Condition of LQ-45 Index during 2019-2022 in Indonesia

The LQ45 serves as a stock market index within the Indonesia Stock Exchange (JSE). Comprising 45 companies, the LQ45 index includes entities that have been ranked among the top 60 companies boasting the highest market capitalization over the preceding 12 months. In the graph above, it can be seen that the development of the LQ-45 index during 2019 is under normal market conditions. However, in 2020 it experienced high volatility whereas in 2020 it was a period of market stress conditions. In 2021 and 2022 the market returned to normal.

The difference between this research and previous research is that this research focuses on the LQ-45 index in 2019-2022, this research will use quantile regression analysis, whereas most previous studies used linear regression analysis. This research employs four distinct time frames, specifically 2019, 2020, 2021, and 2022, to discern the impact of typical market conditions preceding and following the advent of COVID-19. Additionally, the study seeks to explore the influence of market stress conditions

that transpired during the occurrence of COVID-19 on herding behavior within the Indonesian stock market, particularly among LQ-45 stocks. Given the contextual backdrop of the issue, the researcher is inclined to investigate the working title **"Analysis of Herding Behavior Before, During, and After COVID-19 Pandemic On The Indonesia Stock Exchange In 2019-2022 Case On Liquid 45 Index (LQ-45) "**

1.2. Research Question

Drawing from the aforementioned contextual framework, a set of research inquiries is delineated as follows:

1. Does herding behavior exist among stocks comprising the LQ-45 index before the COVID-19 pandemic in 2019?
2. Does herding behavior exist among stocks comprising the LQ-45 index during the COVID-19 pandemic in 2020 and 2021?
3. Does herding behavior exist among stocks comprising the LQ-45 index after the COVID-19 pandemic in 2022?

1.3. Objective of the Research

Derived from the aforementioned research inquiries, the research endeavors to achieve the following objectives :

1. Examine the existence of herding behavior in stocks listed on the LQ-45 index before the COVID-19 pandemic in 2019.
2. Examine the existence of herding behavior in stocks listed in the LQ-45 index during the COVID-19 pandemic in 2020 and 2021.

3. Examine the existence of herding behavior in stocks included in the LQ-45 index after the COVID-19 pandemic in 2022.

1.4. Contribution of the Research

This study is anticipated to yield advantages and comprehensive insights for all stakeholders with a vested interest in the discourse on herding behavior within the ambit of this research, including:

1. Theoretical Contribution

The anticipated outcomes of this research aim to extend and make substantive contributions to the domain of financial management, particularly in the realm of investor herding behavior within the Indonesian capital market.

2. Practical Contribution

- a. For Researcher

The anticipated outcomes of this study aim to enhance the author's comprehension and insights into the concept of herding behavior, which constitutes the focal point of this research.

- b. For Other Researchers

The findings of this study are envisaged to serve as a guide, point of reference, and informational source for subsequent research endeavors, particularly in the examination of investor herding behavior within the stock market.

c. For Investors

The anticipated outcomes of this study are poised to function as a reference and informational reservoir for investors, fostering a propensity for rational decision-making. Moreover, it aims to impart a comprehensive understanding of the repercussions associated with herding behavior.

d. For Regulators

The anticipated outcome of this research is envisaged to serve as a factor for regulators in formulating decisions and strategies, taking into account the ensuing impacts. This, in turn, is anticipated to bolster investor confidence and instill a sense of assurance among economic actors, particularly within the capital market.

1.5.Scope of the Research

This study exclusively centers its discourse on delving into the herding behavior exhibited by investors in stocks enlisted in the LQ-45 index during the period from 2019 to 2022. The dependent variable in this research is Cross Section Absolute Deviation (CSAD), while the independent variable encompasses market return, extracted from the daily closing price data of stocks. The delineation of research limitations in this study is deliberate, aiming to enable the researcher to concentrate on ensuring data validity, specificity, and depth. This approach facilitates a more streamlined development of the data and enhances the overall research process.

1.6.Outline of the Research

This study comprises five chapters, each of which is segmented into subsections, structured by the following organizational framework:

CHAPTER I INTRODUCTION

This segment encompasses six subsections, specifically the research background, research questions, research objectives, research contributions, research scope, and the research outline.

CHAPTER II LITERATURE REVIEW

This section comprises the theory used and the explanation of each variable of this research. Furthermore, the hypothesis development, previous studies, and the research conceptual framework are contained in this chapter as well.

CHAPTER III RESEARCH METHOD

This section encompasses the explication of the methodology employed in this study, covering aspects such as the population and sample, data types and sources, measurement, and operational definition of research variables, and the techniques employed for data analysis.

CHAPTER IV RESULT AND DISCUSSION

This segment incorporates the outcomes of the data analysis, a comprehensive discussion thereof, an exploration of the research hypotheses and their acceptance or rejection, and a comparative analysis with the employed theory and prior studies.

CHAPTER V CONCLUSION

Within this chapter, a synopsis of the research, a delineation of research limitations, and recommendations for prospective research are encapsulate.

