Indonesia Capital Market Recovery: An Analysis

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Abstract. The capital market is an important integral part of the economy. The Indonesian capital market is growing at a higher pace compared to the Indonesian economy. An interesting phenomenon that occurred during the Covid 19 Pandemic was that the recovery of the capital market in Indonesia happened before the recovery in the real economy. What is even more interesting is that the capital market in Indonesia has not only recovered but reached a higher peak than before the Covid 19 Pandemic. This study uses using qualitative method. This research seeks to find a theoretical background from previous research to explain the phenomenon of rapid recovery and rising market values. The factors used are changes in market regulations and operations, demographics, technology, banking conditions, geopolitical conditions in the Southeast Asia region, and the Covid 19 pandemic. In the end, all these factors together push the asset value increase rapidly to a higher peak.

Keywords: Indonesia Stock Exchange · Recovery · Covid 19 Pandemic

1 Introduction

Funding is an integral part of economic activity. Both the public and private sectors require funding to carry out their activities. The more available funding and the cheaper the funding costs, the smaller the funding costs. With cheaper funding, the state can provide services at lower costs for the public sector. Meanwhile, for the private sector, this means greater profits.

One funding source for the state and the private sector is the capital market. The capital market allows the collection of funds to be carried out more efficiently and in large quantities. Efficiency in the capital market arises because capital seekers can directly meet financiers without going through intermediaries so that no fees need to be paid to intermediaries. The capital market allows retail fund owners to join to create a significant accumulation of funds in terms of numbers. There are several growing views on the role of the capital market. These views include:

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1.1 View of the Capital Market as an Efficient Asset Allocator

The capital market is a place to bring together companies that need capital with those who have capital and are willing to invest. In contrast to banks, banks act as intermediaries who provide a fixed and definite rate of return to consumers. As a consequence, the bank also limits the risk it can accept. The higher the risk, ideally, the higher the return. Innovation is one form of risky investment because the new technology created is not necessarily successful. After the technology is found, it does not necessarily mean that it has economic value [8].

Furthermore, after a technology has economic value, the technology is not necessarily accepted by the market. Finally, when the market accepts the technology, it does not necessarily provide economies of scale for the company. From this stage, it can be seen that innovation is a risky thing for investors but will provide significant returns when the innovation provides economies of scale. This is where the role of the capital market comes in, where investors who dare to take risks will be able to invest in innovative companies [9]. In contrast, more risk-averse investors can invest in defensive companies.

1.2 The Capital Market View as a Means of Redistribute of Wealth

In an agriculture-based economy, wealth is related to land ownership. Wealth comes from selling goods from agricultural products. The community class is divided into landowners and workers who work on the land. Landowners also consist of small landowners and large landowners. Agriculture is an industry with economies of scale, i.e., when someone owns a large land area, the new landowner benefits greatly from managing the land.

Meanwhile, small landowners will find it challenging to get significant returns due to the absence of economies of scale. This condition is even more challenging for workers who work on the land. Therefore, the accumulation of land ownership will be a challenge. This condition is different from the existence of the capital market, which provides an opportunity for retail investors with limited capital to own shares in a large-scale business. Employees are even expected to participate in owning the company by buying company shares so that the relationship that exists is not only the relationship between workers and owners of capital. Thus, as in the previous period, the company focused on generating returns for investors, but now these investors also consist of workers. Hence, these workers also enjoy the benefits when the company grows.

1.3 Capital Market View as a Driver of Innovation

Schumpeter categorizes novelty into two, namely invention and innovation [6]. The invention is a new way to produce an item, while innovation is a way to produce a new item that has an economic effect. Creating inventions can be done by making continuous improvements. However, to innovate requires a large amount of capital because innovation results in fundamental changes to the company's operations. The capital market provides an opportunity for investors who are willing to take risks to be able to fund these innovations. Furthermore, companies whose innovations are accepted by the market will be able to increase their market share.

This study looks at the capital market development in the period 2010 to 2021. Using existing data, demographic data, economic developments, technological developments, and capital market investor participation rates. Based on the views above, it can be seen that the capital market is not static. Capital market conditions change. The changes occurred in several ways, such as the number of investors, the types of assets traded, and even the way of trading. Therefore, looking at the various changes around the capital market can help explain the phenomenon of capital market development in Indonesia. As for the election year, there have been many phenomena that have prompted changes in the Indonesian capital market in the last ten years. In addition, the selection of the past ten years is to avoid extrapolating too long to the current phenomenon [3].

The research question is what factors affect the Indonesian capital market, and how can these factors explain the growth of the capital market in the period 2010 to 2021?

2 Literature Review

The Indonesian capital market has unique characteristics that need to be seen in the Indonesian context. As a developing country rich in natural resources, Indonesia experienced high economic growth from the eighties to the nineties. The development of the capital market does not accompany this rapid economic development. At that time, state funding came from exports of oil and gas, and Indonesia was still experiencing a surplus of oil. At the same time, private companies in Indonesia still receive various protections in Indonesia which are known as magic letters. The capital collection is done by using loans from abroad directly (corporate debt). In addition to using loan funds from abroad, the conglomerate company also raises funds through banks that are subsidiaries that are still affiliated with the conglomerate. In this era, prominent entrepreneurs emerged who had conglomerates and were associated with the highest power holders. This condition only ended when in 1998. A monetary crisis brought down power at that time and led to a more democratic era in Indonesia.

One point of view to see the development of the capital market in a country is to use the efficient market hypothesis, which looks at the level of market efficiency [10]. Ideally, the capital market is in an efficient condition. That is, information can be conveyed quickly to all investors in the market. However, in an underdeveloped capital market, information is moving slower so that investors who have prior information can exploit the information to gain abnormal profits. One of the challenges to improving market efficiency is access to investor information and knowledge. If these two variables increase, the market efficiency will also increase.

The capital market will be more efficient if more individuals join the capital market and investors are more well-informed or have adequate information. To have adequate information, information must be well distributed among the company, capital market regulators, and investors. The more information can flow quickly and the more transparent the information, the investors, will have adequate information. Consequently, investors will act with sufficient information so that asset prices in the market reflect their actual value. On the other hand, investors can make inappropriate transactions with insufficient information. Meanwhile, conservative investors will reduce the volume of transactions in the capital market until they have sufficient information. These two alternatives will ultimately encourage price mispricing in the capital market.

One of the ideal forms of capital markets is the capital market in developed countries. Companies can take the floor in the capital market and obtain funding to further expand into companies whose asset values double. Meanwhile, from the investor's point of view, many investors invest so that ownership is widely distributed so that no one party owns shares dominantly. The majority shareholder who has a large number of ownerships can take advantage of his position to gain profit at the expense of the minority shareholder. If the company's shares are owned by many investors so that there is no domination by one owner, the distribution of decisions will be more even and create more economic democracy.

Capital markets worldwide are related mainly thanks to the internet network that connects the markets. Thus, an investor can allocate capital to profitable assets in different capital markets [2]. The increase in capital markets outside the United States also encourages institutional investors in the United States to invest outside the United States capital market. These investments aim to create risk diversification and gain growth from capital markets outside the United States. However, capital markets outside the United States exist from the point of view of US institutional investors. Therefore, in calculating the level of risk, the systematic risk used as a benchmark is the level of risk in the United States plus the risk premium in the destination country.

Although diversification reduces risk and provides opportunities, asset allocation is not proportionally. There is a tendency for investors to invest more in the capital market where they are located. This action is a form of bias that afflicts investors, also known as the home country bias. However, due to a large number of funds available to be managed by institutional investors, even though the amount is proportionally tiny, these funds are relatively large compared to investment opportunities in developing countries. An example of a cross-border investment case study is the capital market in Seoul, South Korea. In the 1990s, thanks to the demographic dividend that occurred in South Korea, the South Korean economy experienced rapid growth. Profits from companies listed on the stock exchange in Seoul also increased. However, in terms of asset value, there is no growth as high as the level of economic growth. This condition implies the mispricing of asset values. American investors like Warren Buffet realized this and invested in the capital market in Seoul. Over time the information will spread, and the asset's value will reflect its intrinsic value. Investors like Warren Buffet, who buy when the asset is undervalued, will benefit from capital gains. This incident is one example of the form of convergence in the capital markets in the world.

One of the factors that encourage the creation of global market convergence is technology, especially the development of information technology. With high-speed computers and cross-oceanic fiber networks, information can flow freely in real-time. Apart from creating technological convergence, it also increases global wealth. Wealth is mainly produced in developed countries that are technological centers. However, developing countries can still enjoy the effects. Moore's Law states that the capacity of the microchip will be doubled, and the price will be lower. The internet also spreads in developed countries and to various parts of the world. The company has an interest in internet penetration. The more people connected to the internet, the bigger the market companies can reach through cyberspace. When the exchange of information becomes easier, it will also be easier for capital to flow to various capital markets in the world.

3 Research Methods

This study aims to find the factors that drive the recovery of the capital market in Indonesia. This study uses a qualitative approach to find factors that influence the development of the capital market. The qualitative approach in this research consists of several steps. The first is to determine the factors that influenced the development of the capital market in the past. The factor is searched through literature studies, especially literature originating from Indonesia. Second, by comparing the development of the capital market in Indonesia and the capital market abroad. This comparison is carried out by examining previous literature from Indonesia and international studies. The third step is to synthesize these factors to explain the condition of the capital market recovery after the Covid 19 Pandemic.

The synthesis process is carried out in several parts. The first part is to look at the internal factors of the capital market itself. This section shows how the settlement process, regulations, and various provisions related to buying and selling in the capital market have changed. The second part is to look at external factors. These external factors consist of three parts. The first is external factors related to macroeconomic and demographic conditions, and the second is external factors related to the development and adoption of technology. Furthermore, the third is external factors associated with the development of international geopolitical conditions. The development of international geopolitical conditions is included in this study because some of the funds in the Indonesian capital market come from foreign investors who are affected by both the political and economic conditions in Indonesia and the world's geopolitical conditions.

After doing a synthesis based on the factors above, the next step is to relate these factors to the Covid 19 Pandemic in Indonesia. Covid 19 is a systemic risk that occurs not only in Indonesia but in the world. However, as the name suggests, systemic risk is the risk that occurs in the system and, in this case, is the capital market system. Furthermore, by comparing the capital market conditions before and during the Covid 19 pandemic and after the Covid 19 Pandemic, it can be seen how the capital market in Indonesia has adapted to Covid 19.

4 Result and Discussion

This research discusses internal factors first and then external factors consisting of macroeconomic and demographic factors, technological factors and international geopolitical factors.

4.1 Market Operational Changes

In the period 2010 to 2021, there were several operational changes in the market. The regulator mainly made these changes to increase market liquidity and investor confidence. Some of these changes are fundamental, and some are technical. One of the fundamental changes was the establishment of a Capital Market Supporting Agency, namely the Indonesian Central Securities Depository. The Indonesian Central Securities Depository is in charge of storing securities owned by investors. KSEI takes over the role of broker in depositing securities. Another form of novelty is being shown to a bank to store customer funds. With the development of banking technology, banks can create and manage multiple virtual accounts without any problems. Regulators use this to ask banks to create virtual accounts for investors. Through this development, the broker's function was reduced from an intermediary and depositor of money and securities to an intermediary role. One of these is to prevent the misuse of customer money and investors' securities. The hope is that investors will have more confidence in the capital market with guaranteed securities and investors' money.

Apart from fundamental institutional changes, there are some technical changes. These changes include changes in the number of shares in lots. Before 2010, the number of shares per lot was five hundred shares. After 2010 the number of shares in one lot is 100 shares. This means it will be cheaper for investors to buy one lot of shares. This influence is mainly to encourage retail investors to transact. Retail investors with limited funds will have more options as the price per many shares decreases. Of course, the consequence is that the number of transactions on the stock exchange has the potential to strengthen, and the stock exchange must also increase its capacity to serve a more significant number of transactions. Another technical change is the change in settlement time. Before 2010, the time for settlement was H+3. The stock exchange has accelerated the settlement time to H+2. The hope is that accelerating settlement time will increase liquidity in the stock exchange.

4.2 Technology Changes

Technology plays a vital role in providing information for investors and shaping the investor community. After 2010 there was a shift from mainstream media such as television, radio, and newspapers to internet-based media. Mainstream media is sourced from one party for the segment of many people and is unidirectional. The existing content is general because the cost of producing content for the masses is not cheap in conventional media. On the other hand, alternative media such as blogs and YouTube can produce content at a more economical price. Content on media such as YouTube allows ordinary people to upload content to a specific and small target market. One of the criticisms given to alternative media such as Youtube is the emergence of pseudo-experts who speak as experts in this matter. The audience will judge which experts are and deserve to be trusted. However, this enormous amount of content also serves to promote the capital market [5].

Securities also began to use Youtube to provide information. Securities have analysts who usually provide equity analysis. If equity analysis is generally concise, then by usinsg media such as Youtube, a more extended explanation can be provided, and there is room for discussion. In addition to using Youtube, securities companies also gather their investors in Whatsapp groups. This group aims to establish an investor forum and a place for interactive discussion between securities and investors.

The result of more information and more investor access is that investors can now be better educated. Consequently, ideally, investors who have better knowledge will become better investors and are more willing to invest in the capital market.

One form of technological change utilized by the exchange is related to the registration of new investors. Now investors no longer need to fill out forms manually, open accounts at certain banks, and provide wet signatures. All of this can be done online. The hope is that more investors will join to invest by making it easier for investors to open accounts.

4.3 Demographic Changes

In the 2010s, there was a demographic change in Indonesia where the number of young people increased. This young population enters the working age, increasing the number of productive workers in Indonesia. The consequence is that productivity in Indonesia is increasing and increasing the middle class in Indonesia. In Indonesia, the middle class has the purchasing power and economic capacity [1]. Therefore, this middle class is a potential factor for regulators to become potential new investors.

In Indonesia, a person can become an investor when he already has a national identity on an Identity Card. This Identity Card is given when a person is 17 years old or married. Workers who have graduated from high school and university students are potential investors because they have met the legal requirements. These potential investors are digital natives or the generation born after the internet in terms of knowledge. Even though these digital natives have limited investment knowledge in terms of knowledge, the digital native generation can search for information more skillfully, and they are used to build online communities. These two factors make the digital native generation better able to adapt to something new, such as investment.

4.4 Lower Bank Interest in Indonesia

Before 1998, banks were the prima donna for putting money in. Banks in Indonesia provide relatively high-interest rates and are risk-free. What causes many Indonesian businessmen to take debts abroad is because of the high-interest rate in the country, which causes high-interest rates on debt. By borrowing in dollars, the entrepreneur will get a dollar interest rate. When the loan matures, there is an imbalance between the demand for dollars and the supply of dollars. This imbalance causes the dollar price to rise and the rupiah to fall. Due to the massive amount, caused a monetary crisis in Indonesia.

Since then, bank interest in Indonesia has started to fall. Several things push bank interest rates down [11]. The first factor is the increasingly stringent banking regulations. Bank Indonesia in the Indonesian banking architecture requires banks to have sufficient capital. In addition, Bank Indonesia also requires banks to diversify their loans and limit the amount of risk that banks can bear. By limiting the amount of risk, the amount of return that the bank gets will decrease. One form of strict restrictions from the government is through the Deposit Insurance Corporation. Banks that are members of the Deposit Insurance Corporation will not receive a guarantee if they provide interest that exceeds the upper limit of the Deposit Insurance Corporation. This is one of the motivating factors for banks not to give interest rates too high.

In terms of funding, banks are also experiencing competition with many banks in Indonesia, both local banks and affiliated foreign banks. From 1980 to 1990, the government promoted the national saving movement during the government period. Even elementary school children are asked to open savings through schools. This did not happen during the 2010 government era [4].

One of the changes in the macroeconomic context is the change in the benchmark interest rate. One of these benchmark interest rates is correlated with economic growth. In the early 1990s, Indonesia enjoyed the benefits of rising oil prices. At that time, Indonesia was still a net exporter, so the increase in oil prices became a windfall for the Indonesian economy. Nevertheless, Indonesia has turned into a net importer with the increasing number of Indonesians and many gasoline subsidies. In the 2010s, the Indonesian government continued to try to reduce fuel subsidies. When Indonesia's growth declines, the benchmark interest rate also falls, and bank interest rates are also pushed down.

4.5 Geopolitical and Economic Changes in the Southeast Asia Region

In the era after the 2010s, countries in the Southeast Asian Region began to integrate their economies. Several economic cooperation was carried out, and citizens in the Southeast Asian region were free to trade with other Southeast Asian countries. Organizations of Southeast Asian countries members of ASEAN have also expanded their membership by inviting countries such as China, Japan, and South Korea to join. This also affected the capital market. Capital can flow more easily through the capital market [7]. So that Venture Capital in Singapore can easily invest in startup companies in Indonesia. This high-risk and large-scale investment allows Indonesian startups to become unicorns or companies with a valuation exceeding one billion dollars in a short period.

4.6 Covid 19 Pandemic

Before the Covid-19 pandemic, the Indonesian capital market was one of the best-performing capital markets in Southeast Asia. The COVID-19 pandemic has forced everyone to impose restrictions and office workers to work from home. These workers are generally middle-class people who are used to commuting to the office. Workers now have free time and a budget to invest. With a sufficient level of education, these potential investors turn into novice investors. The joining of these domestic retail investors increased the amount of liquidity in the Indonesian capital market. In just one year and before the economy recovered from the pandemic, the capital market had reached a new high in history.

4.7 Tying Up Altogether

The Covid-19 pandemic is a time that provides momentum for increasing investors in the capital market. This momentum is not only due to retail investors joining the capital market but the accumulation of other factors. If Indonesia does not experience a demographic dividend bonus, then during the Covid 19 pandemic, there may not be many potential investors who have sufficient excess money to invest. In terms of technology, if the Covid 19 Pandemic occurred ten years earlier where the spread of the internet in Indonesia was not yet widespread, and there was no information related to the capital market on social media, the public's interest in investing would not be as high as in 2019–2020.

From the capital market side, after 2010, the stock exchange had a large capacity and could serve much larger transactions than in the previous decade. Suppose the capital market adopts no technological progress and there is no change in policy. In that case, when the number of investors increases, the stock exchange will not be able to serve this increase in the number of investments.

In 2022 technology companies start to take the floor in the capital market. This technology company is Bukalapak. This company can become a unicorn or be worth more than one billion dollars because there are investments from Venture Capital from Singapore and Japan that invest their capital. Thanks to this investment, the start-up company can grow big relatively quickly. And when the Covid 19 pandemic occurred, the start-up company already had a high valuation and was in the phase of public listing. Suppose these venture capitalists do not invest in Indonesia or delay their investment in Indonesia when the Indonesian capital market enters the right momentum. In that case, the start-up company is not yet eligible to conduct a public listing.

The commodity supercycle is one driving factor that increases the value of a company's shares in the capital market. Indonesia has an ample supply of mining goods. Indonesia is the number two producer globally for coal, gold and copper. Indonesia produces rubber, palm oil, cotton, and wood for paper from renewable resources. In 2022, during the Covid 19 pandemic, after commodity prices had dropped at the beginning of the pandemic, commodity supercycles occurred where commodity prices increased. The consequence of rising commodity prices is an increase in the company's income and further increases the company's value.

5 Conclusion

This study found several things that happened during the Covid 19 Pandemic. The first finding was the change in investor demographics in the capital market. The demographic changes of investors in the capital market occur rapidly. Before the pandemic, most of the funds in the capital market came from foreign investors. However, this composition has changed due to the Covid 19 Pandemic. Workers who work from home have time to get to know the capital market. The increase in interest is driven by the abundance of information related to the capital market. It also adds up to the convenience created by the regulator. With many young investors who are more familiar with technology, these new retail investors can quickly become novice investors.

The second finding is the decline in investment in banks which makes investors look for other funding. In the past, banks in Indonesia were able to provide high returns. However, currently, with low returns, investors need to find investment places that can give high returns, and are liquid with limited funds. Equity in the capital market is an asset class that meets these three criteria.

The third finding is that the entry of retail investors into the capital market during the Covid-19 pandemic is not a condition that occurs in Indonesia. Investors in developed countries are also starting to enter the capital market and other alternative assets such as cryptocurrencies. The difference is the recovery rate of the Indonesian capital market and how this recovery occurs in a relatively fast time vindicates a disparity between the financial sector and the real sector. However, this condition also shows the optimism of the Indonesian people, especially those represented by retail investors. In addition, the regulator's programs to increase capital market investors from year to year continue to show improvement. However, only the Covid-19 pandemic has become a momentum for retail investors to enter. This condition would not have happened if previously capital market players, both securities and regulators, had not adapted to using technology.

This study looks at the capital market condition during the Covid 19 pandemic that has not been officially completed in Indonesia. Furthermore, it can be investigated how the development of the capital market in Indonesia after the Indonesian government stated that Indonesia officially underwent normal conditions after Covid 19. Furthermore, further research can also see the capital market conditions after natural economic conditions have recovered.

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