

# Impact of reporting foreign exchange gains on capital market reactions (an empirical study of manufacturing companies listed on the Jakarta stock exchange in 2003-2004)

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## ABSTRACT

The purpose of this study is to test empirically the impact of reporting foreign exchange gains on market reactions. The results of previous studies state that there is a correlation between the exchange rate (exchange rate) and stock prices. Based on these studies, researchers are motivated to conduct this research. This study uses Abnormal Return and Trading Volume Activity as a proxy for market reaction and uses 41 manufacturing companies listed on the Jakarta Stock Exchange in 2003-2004 as samples. The sample selection used purposive sampling method. Market reaction to the reporting of foreign exchange gains is tested using the event study methodology. Researchers make corrections to beta to reduce the influence of bias on the Jakarta Stock Exchange. Correction for beta uses the Fowler and Rorke (1983) method with four leads and four legs. The statistical method used to test the hypothesis is multiple regression analysis. Before carrying out multiple regression analysis, a classical assumption test was first performed to obtain an unbiased and efficient estimator or Best Linear Unbias Estimator (BLUE). The results of this study indicate that there is a significant market reaction around the publication date of the financial statements reporting foreign exchange gains by the company. This study shows that the reporting of foreign exchange gains has a significant effect on market reactions as measured by Cummulative Abnormal Return. However, there is no significant effect from reporting foreign exchange gain on Trading Volume Activity.

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## 1. INTRODUCTION

The capital market is an institution that has a very important role for the economy of a country. The capital market acts as a means to mobilize funds sourced from the public to various sectors that carry out investments. Through the capital market, it is hoped that the business world will be able to obtain some or all of the required long-term financing. The rapid development of capital market activities has brought major changes to the demand for information quality. Information disclosure is a key

word in the capital market, this information disclosure is related to the process of delivering and receiving as well as digesting information by the public.

The speed with which a market reacts to information to reach a new equilibrium price is very important. If the market reacts quickly and accurately to reach a new equilibrium price that fully reflects the available information, then this market condition is called an efficient market. So in an efficient market, investors should only expect normal profits and obtain a normal rate of return for their investment. In an efficient market, a set of information is quickly and fully reflected in market prices.

An information is considered informative if the information is able to change or influence the beliefs of decision makers. The existence of a new information will form a new belief among investors which will change prices through changes in demand and supply of securities. Financial reports are one of the information needed by internal and external parties as a basis for making economic decisions. For external parties, especially investors, financial reports are used as a basis for making investment decisions in the capital market related to marketable securities, how extensively, and when it should be done based on the information they have. Gain and loss on foreign exchange is one component of accounting information. Foreign exchange gains and losses can affect earnings, because in most cases, these items are reported in the income statement.

Basic Framework for Preparation and Presentation of Financial Statements Paragraph 07, states that financial reports are part of the financial reporting process. Complete financial statements usually include a balance sheet, income statement, statement of changes in financial position (which can be presented in a variety of ways, for example, as a statement of cash flows, or a statement of flows of funds), notes and other reports and explanatory material that are an integral part of the financial statements. . Besides that, it also includes schedules and additional information related to the report, for example, financial information on industrial and geographical segments and disclosure of the effect of price changes.

Users of financial statements include current and potential investors, employees, lenders, suppliers and other business creditors, customers, government and other institutions, and the public (IAI, 2002). the needs of users, financial reports are prepared with the aim of providing information regarding financial position, performance, and

changes in the financial position of a company, as well as being an accountability tool for company management. The factors that influence the need for financial reporting information are based on the increasing need for decision making or monitoring of company performance. Financial report information is expected to contain information that has the potential to reduce uncertainty and has the suitability of competent sources of information.

## 2. METHOD

This research is an event study, namely a study that studies market reactions to an event whose information is published as an announcement. The population of this study are all companies listed on the JSE which are classified as manufacturing industries in 2003-2004. The manufacturing industry was chosen in this study because the manufacturing industry is the industry that contributes the most to trading activities on the JSX, besides that it is so that the characteristics of the manufacturing industry can be known. Determination of the sample in this study was carried out by purposive sampling, namely a sampling technique based on the criteria set by the researcher in accordance with the research objectives. Selection of research samples using purposive sampling method.

The considerations used in determining the sample selection method of this study are: Ease of application; Time speed and cost savings in the process of selecting and searching research data.

The research period in this event study includes 110 stock exchange working days consisting of an estimation period and a window period. The estimation period covers 100 stock exchange working days, while the window period is 10 days, namely 5 days before (pre-event) and 5 days after (post-event) the date of announcement of reporting gain on foreign exchange in the financial statements. The data used in this study is secondary data, namely research data obtained by researchers indirectly through intermediary media or data obtained and recorded by other parties (Supomo and Indriantoro, 2002: 147).

The data collection method used is the documentation method or also called the archival research method. There are two types of variables used in this study, namely the dependent variable in this study are Abnormal Return and Trading Volume Activity and the independent variable is foreign exchange profit. The independent variables are calculated by entering the EPS change, CF change, and income change (R) as control variables in the regression model. In other words, the use of the control variable is intended to control other components in the financial statements as well as the profit component other than foreign exchange gain with the independent variable EPS: is the amount of profit in a period available for each common share outstanding during the reporting period, CF : the cash flow used in this study is the change in cash flow from operating, financing and investing activities, R: the income used in this study is net sales. as well as with the analytical method using the multiple regression analysis model can be used as an estimation tool if the assumptions of the multiple regression model are unbiased and have a minimum variance have been met. In short, the multiple regression model meets the requirements of the Best Linear Unbiased Estimator (BLUE), namely the data is normally distributed, there is no multicollinearity, autocorrelation, and heteroscedasticity. To find out whether the BLUE requirements have been met or not, it can be tested using the classical assumption test before testing the hypothesis with multiple regression analysis.

### 3. RESULTS AND DISCUSSION

The results of this study began with the use of adequate samples, the samples of this study were manufacturing companies listed on the Jakarta Stock Exchange in 2003 and 2004. The data used for this study were obtained from the UNIBRAW BEJ corner database. Of the 153 companies listed on the BEJ in 2003, a sample of 26 companies was obtained that met the research criteria.

**Table 1.** Sample Selection Process

Information	2003	2004
Manufacturing companies listed on the JSE in 2003 and 2004	153	150
Companies whose financial reporting year does not end on December 31	2	2
Companies that use USD in their financial statements	3	3
Companies whose shares are not actively traded	63	65
Companies that do not report foreign exchange gains in their financial statements	85	74
The number of companies selected as the sample	25	16
AMOUNT	20	100 %

#### 3.1 Descriptive statistics

A sample statistical measurement that is useful for the purpose of drawing conclusions is a measurement of the central tendency of a series of sample data. This measurement is generally needed because it is able to describe the concentration of sample observation values and gives meaning to the measurement results.

**Table 2.** Descriptive Statistics of Research Variables

	N	Min	Max	Mean	Std Deviation
CAR (Y1)	41	- 93	27	-.0199	
ATVA (Y2)	41	.000	.019	.00323	.17583
Gain difference kurs(X1)	41	1.00	267639.00	30404.46	004510
ΔEPS(X2)	41	-.932.00	337.00	-38.0244	59963.36527
ΔCF(X3)	41	-.10	13	-38.0244	234.36569
ΔR(X4)	41	-1,77	90	.0084	.0490
Valid N (listwise)				.0490	.36776

Data Source: Processed secondary data

#### 3.2 Data Analysis

##### 3.2.1 Classical Assumption Testing

One of the requirements to be able to use the multiple regression equation is the fulfillment of the classical assumptions. In order to obtain an unbiased and efficient examiner value (Best Linear Unbias Estimator / BLUE) from one multiple regression equation with the Least Squares method, it is necessary to test it to find out the resulting regression model meets the requirements of the classical assumptions and the test used in this study. is the visible test results from the calculation

of the Kolmogorof-Smirnov Test already showing a normal distribution source in the model used so that regression can be carried out with Multiple Linear Models. To detect the presence of multicollinearity can be seen from the Value Inflation Factor (VIF). If the VIF value  $> 10$  then multicollinearity occurs and vice versa if  $VIF < 10$  then multicollinearity does not occur.

**Table 3.** Multicollinearity Assumptions Test Variables (X1, X2, X3, X4) Against Y1 and Y2

Variabel	Nilai VIF	Information
Gain on foreign exchange (X1)	1.139	There is no indication of intercollinearity explanatory variable
Gain on foreign exchange (X1)	-.0199	
$\Delta$ EPS (X2)	1.138	There is no indication of intercollinearity explanatory variable
$\Delta$ CF/Assets (X3)	1.013	
$\Delta$ R/Assets (X4)	1.034	There is no indication of intercollinearity
$\Delta$ EPS (X2)	-38.0244	

### 3.2.2 Interpretation of Hypothesis Testing Results

The results of testing the first hypothesis indicate that the market reacts to the publication of financial reports that report foreign exchange gains, which is indicated by the presence of abnormal returns around the date of publication of the financial statements. The results of the regression test succeeded in proving that the reporting of foreign exchange gains has a significant influence on cumulative abnormal return. These results support the research by Chandrarin and Tearney (2000), Ariyanto and Rata (2003), and Hidayat (2004) which states that there is a correlation between reporting profit (loss) on foreign exchange differences and changes in stock prices as a proxy for market reaction. The results of this study can support and complement the results of previous research conducted by Chandrarin and Tearney (2000) and Hidayat (2004), who in their research found a correlation between reporting foreign exchange losses and stock prices. The results of this study are also consistent with the research of Soo and Lisa (1994) and the research of Ariyanto and Rata (2003) who found that the market uses profit and loss information on foreign exchange reported in the income statement in valuing stocks. However, the results of this study are inconsistent with the research of Sumardana (2004). The inconsistency of these results may be due to the use of different research methods and samples.

## 4. CONCLUSION

This study aims to test empirically the effect of reporting foreign exchange earnings on capital market reactions, which in this study are proxied by Abnormal Return and Trading Volume Activity. The sample of this research is 41 manufacturing companies listed on the Jakarta Stock Exchange in 2003-2004. The statistical method used to test the hypothesis is multiple linear regression analysis. This study succeeded in proving that the reporting of foreign exchange gains has a significant effect on Cummulative Abnormal Return (CAR). Research also proves that there is a significant effect on changes in earnings per share (EPS) on CAR. That is, the capital market reacts to the financial information presented by company management. However, there is no significant effect on changes in cash flow divided by net assets and changes in revenue divided by net assets on CAR. The results of this study failed to prove that the reporting of profit on foreign exchange and changes in EPS have a significant effect on the Average Trading Volume Activity (ATVA). However, there is a significant effect on changes in cash flow divided by net assets and changes in revenue divided by net assets against ATVA.

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This study only uses a 2-year observation period, so the results of the study still cannot fully explain the market reaction to reporting foreign exchange gains, whether seen from Abnormal Return or Trading Volume Activity. Therefore, future research can extend the observation period. This research does not cover all types of industries listed on the Jakarta Stock Exchange. So the results of this study cannot be generalized to other types of industries. This study only uses an estimation period of 100 days. For further research, it is recommended to extend the estimation period so that the expected return calculation is more precise. This study does not include companies that do not report foreign exchange losses as a comparison sample and does not consider the different methods of reporting foreign exchange gains and losses used by each company. Future studies can include

companies that do not report foreign exchange losses as a comparison sample and consider the different methods of reporting foreign exchange gains and losses used by each company in order to provide more detailed results.

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