

CHAPTER I

INTRODUCTION

A. Research Background

“It is ideas that create wealth and what is wanted is more ideas,” mentioned Harrington Emerson, the founder of principles of efficiency (Wren, 1994: p. 152). Efficiency refers to the use of resources so as to maximize the production of goods and services (Wikipedia). Utilizing least resources or inputs to produce most outputs are efficient. The ability to create maximal output with available input is the expected measure of performance. Some principles of efficiency can be applied as follows:

1. Clearly defined ideals, the need for agreement among stakeholders on ideals and to pull in a straight line.
2. Common sense, manager must take a larger view of problems and their relationships and to seek special knowledge and advice wherever it could be found. For instance, when all other things equal then funds that cost more give less return to investors (Bogle and Bernstein, 2000).
3. Competent counsel, related with the development of competent staff.

4. Discipline, obedience and adherence to the rules in financial market.

Violation can result in charge of cost.

5. Fair deal, each investor receives the amount based on their proportion.
6. Permanent records, historical data is well stored for further evaluation.
7. Dispatching, the fund that is invested should be returned in any kind of form.
8. Standard and schedules, distribution activity needs to be performed at the right time.

When the efficiency measurement is conducted, an organization faces a situation to obtain optimal output with available input. Performance in mutual funds can be affected by many factors. Some factors that are recognized in general are risk, expense, type of fund, etc. for example. Without the presence of capital market, then the access to available fund will be less efficient. This will increase the chance of the company to carry the cost of capital burden, otherwise some operational activity eliminated. Capital market is able to allocate the fund to cover the cost of capital within the company. This works for individual investors too, the right investment will result in return that can cover their cost of need. The capital market allocates the fund through any sector that is considered productive and offer desired risk-return. Therefore, the fund will be allocated optimally.

Securities company performs the activity as the intermediary between fund manager and trader. Mutual funds act as the intermediary to compile the fund from investors in the society for further investment in portfolio by fund manager. Indonesia had a potential for foreign investors as well. This means Indonesia had a chance to increase the foreign direct investment and mutual fund is one of many institutions that will play a role. As the rate of Indonesian Bank decreases, the number of investor who search for more opportunity in mutual funds might increase. The important thing that the investors need to pay attention is past performance does not always guarantee future performance. Return is not the whole matter in investment. Instead choosing the fund that offer great return, investors need to create a good diversification and efficient performance on recent date.

Managed fund during 2009 grew approximately 3.98% on net asset value every month. The nation was able to record economic growth of 4.4% during that year in the ongoing global financial crisis. Low inflation rate during that year up to March 2010 only reached 3.43% year on year. Composite stock price index reached 2,885 until March 2010 with 6.5% referred interest rate. This indicated that Indonesia had an opportunity as a place for good investment in the middle of economic recovery. According to Sitepu (2010), this year the investment environment in Indonesia succeed to attract foreign investors. The interest of investors whether local or foreigners

for investment in stock, bond, or even just deposit make the capital market including mutual fund more passionate. In the end of 2009, the number of mutual funds reached 610 with net asset value (NAV) of Rp 113 trillion. This amount increased significantly compared with the end of 2008, which net asset value was Rp 74 trillion. The high interest of these investors comes along with the high return contributed from the investment instruments.

Stock investment as in October 5th, 2010 recorded fantastic return approximately 39.8% when referred to the rise of composite stock price index, while bond investment recorded yield ranged from 7 % to 18%. Here is the illustration of best five equity funds performance:

Table 1
Best Five Equity Funds Performance as in October 6th, 2010

Num.	Mutual Fund	NAV	1 year (%)
1	Panin Dana Maksima	46,624.23	92.57
2	Panin Dana Prima	2,363.88	65.82
3	Schroder Indo Equity Fund	1,490.65	44.15
4	Schroder Dana Istimewa	4,786.29	43.40
5	Big Bhakti Ekuitas	2,052.78	39.97

Source: Infovesta

The performance of best five equity funds as in October 6th, 2010 succeeds to pass the composite stock price index performance, where the average return of these five equity funds was 57.18% approximately.

Here is the illustration for best five fixed income mutual funds performance:

Table 2
Best Five Fixed Income Funds Performance as in October 6th, 2010

Num.	Mutual Fund	NAV	1 year (%)
1	Kresna Olympus	1,832.03	76.82
2	Investasi Reksa Premium	1,770.80	46.70
3	MR Dollar	1.9655	30.89
4	Lautandhana Fixed Income	1,868.61	28.26
5	Reksadana RIDO DUA	1,918.43	27.95

Source: Infovesta

Fixed income funds also shown a good performance. Best five fixed income funds exceeded the average performance of bond. Some fixed income funds recorded return that is comparable with equity funds instead.

Here is the illustration of best five money market funds performance:

Table 3

Best Five Money Market Funds Performance as in October 6th, 2010

Num.	Mutual Fund	NAV	1 year (%)
1	DPLK BRI Fix	1,288.16	11.64
2	DPLK BRI Pasar Uang	1,654.53	9.79
3	BIG Dana Lancar	1,000	8.87
4	AAA Money Market Fund	1,000	8.26
5	Trim Kas 2	1,000	7.75

Source: Infovesta

Performance of money market funds this year is good as well. Deposit income this year ranged from 5% to 7% is exceeded by money market funds. Gunawidjaja (2009) mentioned that the performance of money market fund during 2010 will have a nice prospect. The target of mutual fund is to grow 20%-30% in 2010 (Riyanto, 2010). Money market mutual fund had advantage compared with the other funds. It does not charged with fee during subscription and redemption. Subscription is the process of investors signing up and committing to invest in a financial instrument before the actual closing of the purchase. Redemption is the repurchase of a security such as a bond or preferred stock by the issuing company at maturity or before if it is cancelled

by the company. Money market fund is often used by investors for money transit before moving it to equity fund or fixed income fund.

Until August the net asset value reached Rp 121,464 trillion. If the interest of investors to invest increase constantly then it is not impossible that the net asset value reach Rp 150 trillion in 2011. As in September 30th, 2010 Tjoajadi (2010) mentioned that mutual fund in 2011 will have a managed fund about Rp 145 trillion. This estimation exceeded current year estimation which is about Rp 130-Rp 140 trillion. Stable inflation rate and Indonesian Bank rate can be the indicator, the growth of mutual fund also inseparable from targeted national economic growth in 2011 which is 6.4%. This condition stimulates investors to invest in capital market including mutual fund, besides conventional products from bank. According to Tjoajadi (2010), the growth of asset under management (AUM) in 2011 is inseparable from stable inflation rate and Indonesian Bank rate that stood in 6.5%. Though the Indonesian Bank rate next year will possibly rise as the national economy grow, but it is still in fair amount so that interest from bank still low. This will not attract investor to place fund in savings, instead allocating it in capital market. Liquidity flow of foreign capital is estimated to keep running in 2011 that leads to an increase in net asset value in the future, besides from domestic capital. Currently foreigners still see Indonesia as one of the countries that will still experience good growth in the future, this makes many foreign

companies allocate their funds into investment portfolio in mutual funds (Widjaja, 2010). Most of these companies invest in long-term horizon.

The choice of mutual fund depends on investors' characteristics, investment objectives, investment horizon, and the capacity to tolerate risk. Before deciding to invest in mutual funds, it is better for investor concerning some risks of investment so that the investors do not unaware with the uncertainty in the market. Some common investment risks are:

1. Interest Rate Risk

The risk that an investment value will change due to a change in the absolute level of interest rates. The movement of interest rate depends on the inflation rate in the nation. When inflation goes up then interest rate goes up as well.

2. Reinvestment Risk

The risk resulting from the fact that interest or dividends earned from an investment may not be able to be reinvested in such a way that they earn the same rate of return as the invested funds that generated them. For example, falling interest rates may prevent bond coupon payments from earning the same rate of return as the original bond.

3. Exchange Rate Risk

The risk that an investment value will be affected by changes in exchange rates. If money must be converted into a different currency to make a certain investment, changes in the value of the currency relative to another currency will affect the total loss or gain on the investment when the money is converted back. It can also affect individual investors who make international investments, also called currency risk.

4. Inflation Risk

The possibility that the value of assets will decrease as inflation shrinks the purchasing power of a currency. Inflation causes money to decrease in value at some rate, and does so whether the money is invested or not.

5. Default Risk

The possibility that a bond issuer will default, by failing to repay principal and interest in a timely manner. Bonds issued by the government generally immune to default compared with bonds issued by corporations.

6. Liquidity Risk

The risk that arises from the difficulty of selling an asset. Sometimes an investment need to be sold quickly. An insufficient secondary market may prevent the liquidation or limit the funds that can be generated from the asset.

7. Volatility Risk

The risk that holder of an option is exposed to based on the potential for the volatility of the underlying security or the market's perception of that volatility to change.

The reason of choosing fixed income fund is because this type of fund attracts investors from the utilization aspect of bond as the majority part of investment. The advantage of bond investment is there is no tax charge coupon interest received (Pratomo and Nugraha, 2002). Though this type of mutual fund has higher risk than certificate of deposit, but in the long term it can provide higher investment value.

1. Problem Statement

After reviewing the described background, the author formulated the problem in this research as follows:

Are fixed income funds performance observed in this research considered outstanding or underperformed compared to Indonesian Government Debt Indices?

2. Scope of the Research

In order to limit the discussion on the issues and acquire clearer direction for researcher in this research, some boundaries are made on the following issues:

1. The mutual funds selected for this research is the active fixed income funds and listed in BAPEPAM-LK in 2005-2009.
2. Net asset value is recorded monthly starts in 2005-2009.
3. Fixed income funds denominated in foreign currency are excluded from the research.
4. The products selected are those that still exist in the end of the period.
5. Variables used for this research are input and output variables.
6. The software to do this research is Efficiency Measurement System (EMS).

3. Originality of Writing

The author compiled this research on his own. There are no duplicated or manipulated elements except from the previous research studies and references by others. All writing, analysis, and conclusion in this research are performed and explored by the author.

B. Objective and Benefit of the Research

1. Objective of the Research

Based on the problem statement, the objective of the research is to find out whether fixed income mutual funds performance observed in this research considered outstanding or underperformed compared to Indonesian Government Debt Indices.

2. Benefit of the Research

This research will give several benefits to:

a. The Investors

The research will encourage investors to learn more about mutual funds and concern other things on investing besides return for optimal

result. Investors will have a broader view to choose which mutual funds to invest based on their needs.

b. The Author

This research will give more education for the author regarding mutual funds performance especially fixed income funds.

c. The Other Researchers

Other researchers can use this research as the reference for further research and try different things that the author had not included in this research.

d. The Readers

Readers will receive more knowledge on capital market by reading this research especially in mutual funds.

C. Writing Systematic

CHAPTER I INTRODUCTION

This chapter consists of background of the research, problem statement, scope of the research, originality of writing, objective of the research, benefit of the research, and writing systematic.

CHAPTER II THEORETICAL BACKGROUND AND PREVIOUS RESEARCH

This chapter consists of theoretical background, previous research, and hypothesis development.

CHAPTER III RESEARCH METHODOLOGY

This chapter describes sample, data and data gathering, variable and variable measurement, and method of analysis and hypothesis testing.

CHAPTER IV DATA ANALYSIS

This chapter provides and presents the analysis of data, also discusses the result obtained from the observation.

CHAPTER V CONCLUSION AND SUGGESTION

This chapter consists of conclusion, managerial implication, limitation of the research, and suggestion for further research.