# INVESTOR RESPONSE TO ANALYST RECOMMENDATION IN STOCK TRADING IN MANADO

*RESPON INVESTOR TERHADAP REKOMENDASI ANALIS DALAM BERTRANSAKSI SAHAM DI MANADO*

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***Abstract****: Analyst show how important their role in stock trading and some previous researches show their recommendations give high return to the investor who follow it. But not all investors follow their recommendation; it is all depend on investor behavior and their trust to the analyst. This is interesting to learn how investor in Manado gives response to their recommendation. We investigate investor through interview to find out how the investor response to the recommendation given by the analyst. The population of this research is all investor in Manado with 10 Informants using purposive sampling method. Based on analysis preference, investor using technical analysis shows no response to the recommendation. Investor also show less attracted to the recommendation because of trust issue. The result shows that Manado investor has low response to the analyst recommendation. We recommend the analyst to have clear standard recommendation and for the investor to take all recommendation into consideration, give some weight to the recommendation into investment decision.*

***Keywords:*** *investor, analyst recommendation, stock trading*

**Abstrak**: Analis menunjukan pentingnya peran mereka dalam transaksi saham dan beberapa penelitian terdahulu menunjukan bahwa rekomendasi mereka memberi keuntungan yang tinggi kepada para investor yang mengikuti rekomendasi mereka. Tetapi tidak semua investor mengikuti rekomendasi para analis; itu tergantung dari bagaimana kebiasaan investor dan tingkat kepercayaan mereka kepada para analis tersebut. Ini menarik untuk mempelajari bagaimana investor di Manado memberi respon terhadap rekomendasi para analis. Kami meneliti investor lewat wawancara untuk mencari tahu bagaimana respon mereka terhadap rekomendasi yang diberikan para analis. Populasi dari penelitian ini adalah para investor di Manado dengan 10 informan menggunakan metode purposive sampling. Berdasarkan preferensi analisis, investor yang menggunakan teknikal analisis tidak memberi respon terhadap rekomendasi. Investor juga kurang tertarik kepada rekomendasi karena masalah kepercayaan. Hasilnya menunjukan investor di Manado memberikan respon yang rendah kepada rekomendasi analis.  Kami merekomendasi para analis untuk memberikan standar rekomendasi yang jelas dan untuk para investor untuk mengambil rekomendasi menjadi pertimbangan, memberi tempat bagi rekomendasi dari analis dalam mengambil keputusan investasi.

***Kata kunci:*** *investor, rekomendasi analis, transaksi saham*

## INTRODUCTION

**Research Background**

Investors have the opportunity to choose from a wide range of investment from different companies, but up to now research in the field of how they use the tools and preference to predict the price still some. This is important as the consistent and specific ways to help them in their successful financial future. Since the financial decisions have become more and more complex and risky, investors have to make they are safe from all possible difficulties may occurred in the stock markets. Additionally, they have to be well informed, have better acknowledgement and properly trained on how they are running their financial in capital markets.

Investors utilize a variety of source for information and advice. One source on which individuals rely is the advice or recommendations contained in reports by an analyst. Analysts gather and process a variety of information about different stocks, form their beliefs about the intrinsic stock values relative to their current market prices, and finally rate the investment potential of each stock. Analysts play a useful role in our capital markets. For example, by doing in-depth research for their large institutional clients and employers, analysts can help substantial sums of capital be directed to more productive uses in our economy. Soffer and Soffer (2003:287) conclude two types of analyst; Buy-side analysts are professionals who analyze securities and make buy or sell recommendation for their firms' funds and sell-side analysts who work for brokerage firms, which execute trades on behalf of individuals and institutional investors.

Stock analysts (e.g., brokerage firms, banks, private researchers) play indispensable roles in financial markets because they gather and process information about a firm and issue recommendation and forecast to investors (Chen and Matsumoto, 2006). Some analysts are unaffiliated; they sell their independent research to financial or investing institutions, banks, insurance companies or private investors on a project or subscription basis. But a large number of analysts are employed by institutions whose financial stake in their recommendations may go well beyond their accuracy. The prior literature on analyst recommendations shows that analysts in general make informative stock recommendations. Stickel (1995) and Womack (1996) find that share prices respond significantly to recommendations and prices continue in the direction of the recommendation for several months. Barber et al. (2001) extend earlier studies on analysts and examine whether investors could profit from analysts' recommendations after controlling for transaction costs.

Manado is a capital city of North Sulawesi Indonesia and now in an industrial development. Trading stock is still in introducing stage in Manado. There are about 1400 investors in north Sulawesi until late 2013; most of them are new investor, with fewer funds in their trading account. Compared to the amount of Manado people which is categorized as consumptive society, the total investors are less than the potential population. PIPM Manado recorded investor in Manado to grow about 30% - 40% every year and there are 5 Brokerage Firms already in Manado. Information must be very important for every investor, about the market condition, company's profile and other information related to stock market in order to make decision to trade stock. Another option to help making decision in trading is through the information given by the analyst. Some of previous researches investigate that analyst recommendation gave investor high return from the stock trading. Knowing how investor in Manado's response to analyst recommendation is interesting to explore.

**Research Objectives**

The research objectives of this research is to analyze Investor Response to Analyst Recommendation in Stock Trading

## THEORETICAL REVIEW

**Investment**

Francis (1991:1) defined investment as a commitment of money with an expectation of generating additional money, by requiring a present certain sacrifice for future uncertain benefit which is quite risky to do. Reilly and Brown (2012:4) defined investment as the current commitment of dollars for a period of time in order to derive future payments that will compensate the investor for (1) the time the funds are committed, (2) the expected rate of inflation during this time period, and (3) the uncertainty of the future payments.

**Analyst Recommendation**

Reilly and Brown (2012:491) defined analyst as highly trained individuals who possess expertise in financial analysis and background in their industry. Penman (2010:12), divide equity analyst into two types, buy-side analyst, analyst who perform equity research for money managers, mutual funds and increasingly hedge funds and sell-side analyst, analyst who provide the research to support retail investor through their brokers.

**Previous Research**

Juergens (1999) found that analysts' recommendations have a substantial and immediate impact on market returns. Analysts' recommendations have investment value to investors who follow them. Mikhail, Walther & Willis (2007) found that both large and small traders react to analyst reports. Wen et al. (2005) found that small traders, thus, seem unwilling or unable to respond to unfavorable firm-specific news even when the investment implications of the news are reasonably obvious. Erdogan, Palmon & Yezegel. (2010) found that the stock recommendation from the analyst do not exhibit superior stock picking ability.
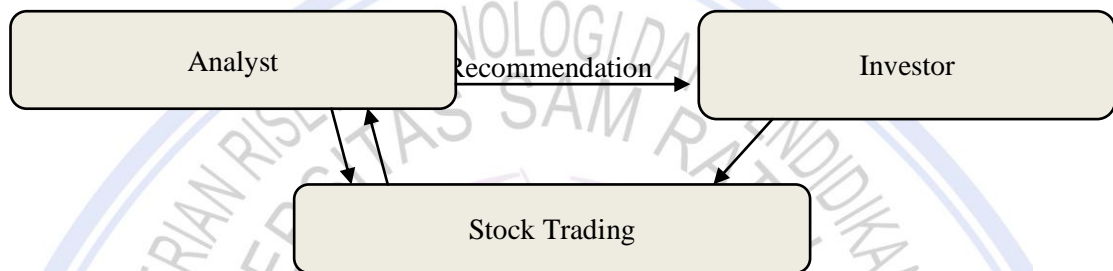


**Figure 1. Conceptual Framework**

**RESEARCH METHOD**

**Types of Research**

Qualitative approach is used for this research. By using an Informant viewpoint to describe and obtain the explanation from Informant, this research belongs to descriptive research. The objective is to obtain the result of data analysis from Informant perspective to get the accurate and real data.

**Place and Time of Research**

This research is conducted in Manado, North Sulawesi. The time of research being conducted is on January – February 2014.

**Population and Sample**

Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate (Sekaran and Bougie, 2009:262). In this research, the population of this research is all the stock investors in Manado, which according to Indonesia Stock Exchange Manado are 699 people, as counted in June 2013. A sample is a subset of the population, comprises some members selected from it. Sampling begins with precisely defining the target population (Sekaran and Bougie, 2009:267). The sample of this research is chosen by using purposive sampling method, 10 investors with experiences less than 10 years in trading.

**Data Collection Method**

This research used a primary data, which is information that gathered first-hand by the researcher (Sekaran and Bougie, 2010:180). The data needed for this research is gathered through interview, based on the list of question prepared. Sekaran and Bougie (2010:186) stated that interview is a useful data collection method for exploratory research. This research also used secondary data as complimentary. Those data are taken from books, journals, and relevant literature from library and internet.

## Data Analysis Method

### Qualitative Method

Mundar, Matotek & Jakus (2012) state that generally, qualitative methods do not use statistical or other quantitative methods to derive a conclusion. According to Hancock (1998), case study research is used to describe an entity that forms a single unit such as a person, an organization or an institution. This type of qualitative type describes the information that has been gathered. This research use the case study as qualitative type of research, which is in this research, the obtained information will be described one by one.

### Reliability and Validity Test

Triangulation is one of the common ways in maximizing data reliability and validity in qualitative research. The idea behind triangulation is getting the same result from different methods or sources (Sekaran and Bougie, 2010:385). There are several types of triangulation based on Sekaran and Bougie (2010:385), which are: (1) Method triangulation: Using several different methods in gathering and analyzing data; (2) Data triangulation: Using data that gathered by several different sources and/or at different time period; (3) Researcher triangulation: Using several researchers in gathering and analyzing data; and (4) Theory triangulation: Using several different theories to analyze and interpreting data.

### Data Reduction

Data reduction consists of data coding and categorization which are: (1) Coding. In coding, the data that gathered by doing interview are reduced, rearranged, and integrated to form a theory. It helps in drawing meaningful conclusion about the data. The result from doing coding is called codes; and (2) Categorization**.** In categorization, the codes that previously have done in coding process are organized, arranged, and classified. In this process, the patterns and relationships between the data are started to be noticed (Sekaran and Bougie, 2010:372-375).

### Data Display

Data display process, the reduced data are displayed in an organized and condensed manner adding graphs, matrices, charts, diagrams, or drawing are often presented in order to help organizing the data (Sekaran and Bougie, 2010:382). It also helps to discover patterns and relationship so the conclusion is eventually facilitated. After doing through data reduction and data display, the final step in data analysis in this research is drawing conclusion. In drawing conclusion, the research question that previously presented is going to be answered.

## RESULT AND DISCUSSION

### Result

### Interview Result

Informant 1 is a 30 years old male, work as a doctor and has been investing in stock for five years. Informant 1 is in long-term plan. Informant 1 has allocation fund, about 40%, to be invested in stock investment. Informant 1 chooses a stock from property industry for his long-term plan. Before deciding, he learns carefully the company's financial statement, especially from the income statement side, earnings, dividend and revenues. For informant 1, analyst recommendation is a price forecasting given by the analyst using financial statement from the company. Informant 1 doesn't attract to analyst recommendation, because of trust issue, but Informant 1 always followed the news about stock investment from newspaper and television.

Informant 2 is a college student. Informant 2 is a technical analyst. Informant 2 is in short-term plan. Informant 2 relies most on the chart. He believes in his own technical analysis to predict the future price of a stock. Informant 2 knows analyst recommendation as a signal of good stock to buy from the analyst given to the investor to help them in making decision. Informant 2 doesn't trust on analyst recommendation because informant 2 said that sometimes analyst give unclear ratings on the signal. Informant 2 always checks the market condition through online news to get updated information, where noise in the market also important for Informant 2.

Informant 3 is an entrepreneur. This 43 years old man has involved in investment for 4 years and Informant 3 chooses stock investment because Informant 3 thinks it's popular and easy one to play with. Informant 3 relies on the chart to forecast future price. Informant 3's timeframe for buy and sell is long-term. Informant 3 chooses the stock from mining, food and bank industry which listed in LQ45, Informant 3 said that all those stock listed there are surely good and profitable, and mostly share dividend. Informant 3 said that analyst recommendation is the stock price forecasting from the analyst given to investor, about the good stock and also the business trend in the market. Informant 3 sometimes listening to the analyst but still prefer to believe in own prediction, because informant 3 said sometimes it's hard to understand the command from the analyst in the execution to buy or sell the stock.

Informant 4 is 41 years old, married and works in a food company. Informant 4 has long-term plan. Informant 4 chooses stock from food industry because Informant 4 thinks it is stable and even tends to increase. To choose the stock, Informant 4 use the financial statement to make sure the company has healthy financial statement. Informant 4 has allocation fund every month that Informant 4 spent in stock. Not only for saving, but Informant 4 also wants the dividend from the company. Informant 4 said that analyst recommendation also another way to choose stock, but sometimes their recommendation didn't clear in strong or weak command to buy or sell, so informant 4 doesn't give response to analyst recommendation. Informant 4 always watches the market news from newspaper and television.

Informant 5 is a government employee, 31 years old. Informant 5 is both in short-term and long-term plan. Informant 5 chooses stock from LQ45 list. Informant 5 said that all the stocks there are good and on top performance. Dividend is the first thing Informant 5 considers. Informant 5 checks the financial statement of the company. For informant 5, analyst recommendation is an analysis of a good stock to buy or sell by the analyst, to help investor in trading decision. Informant 5 sometimes listens to the analyst for stock recommendation, just to get daily information about good and profitable stock. Rely most on the news, to get the latest news of what will affect the company's stock price.

Informant 6 is 22 years old, begin trading in early 2010. Informant 6 allocated 10% of his monthly fund to spend in stock investment. Informant 6 is a long-term investor, because Informant 6 think long-term will be more profitable than short-term. Informant 6 didn't choose any specific industry, but Informant 6 chooses stock that share dividend. Informant 6 chooses those stocks based on allocated funds. After that Informant 6 read the graph of the stock. Informant 6 said that analyst is a professional that hired by an institution and their recommendation mostly profitable. Informant 6 listens to their recommendation for stock selection. Informant 6 didn't pay much attention from the news but Informant 6 sometimes relies on the information from the analyst.

Informant 7 is 27 years old works as a salesman in a private company. Informant 7 has periodically fund to be allocated in stock investment. Informant 7 read chart to decide stock before buying it but mostly, Informant 7 rely on analyst recommendation for a choice. Informant 7 said that the recommendation usually gives stock in good performance and profitable and giving the situation of economic around the market, very helpful in making decision. Informant 7 always consults with the broker for the newest information and some suggestion for stock choices. For the first, Informant 7 consults with the broker about some good-performance stocks. After Informant 7 gets some stocks suggestion, Informant 7 screens the best stock by reading the chart. Informant 7 is in short-term plan. Informant 7 uses the analyst recommendation a lot as and didn't watch news or pay much attention for other issues.

Informant 8 is an entrepreneur, owner of a drink beverages company. Informant 8 is a long-term investor, where Informant 8 involved in investment to save money in profitable ways and also to have the ownership of the company. Informant 8 chooses stock from construction industry, where Informant 8 thinks that building and construction is an important thing his country now and the future chance is good. In choosing the stock, Informant 8 rely most on the company financial statement, to determine if the company financial is health or not and profitable. Informant 8 looks mostly in company's income statement and the dividend is most important for Informant 8, the company has good income means the company profitable and always gets revenue. Informant 8 said that the recommendation from the analyst is another preference that informant 8 choose, because it's a good signal given by the analyst about the coming profitable stock price movement. So informant 8 sometimes gives response to the analyst for their stock recommendation and suggestion. Informant 8 watches the market daily news from the internet. Noise in the market also important and Informant 8 also pays

attention to government's regulation which also an important thing to consider because Informant 8 said that a government policy will give huge impact to the market, company regulation and price movement.

Informant 9 is 23 years old and a last year college student.  Informant 9 is a long-term investor. Informant 9 chooses some BUMN stocks because Informant 9 believes that most BUMN companies have good future. Informant 9 uses financial statement to determine the company's value. Informant 9 said analyst recommendation is a signal about stock price forecasting using financial statement by the analyst that hired by an institution, but informant 9 didn't rely much on analyst recommendation, because Informant 9 doesn't trust analyst. Informant 9 also pay much attention to the market news where market euphoria also important thing to watch as other issue that may affect the fundamental decision.

Informant 10 is a 54 years old man, retirement and spent days in stock trading. Informant 10 is a short-term investor. Informant 10 is good enough in technical analysis due to years of experiences in stock trading. Informant 10 said that analyst recommendation is a research from an analyst about good stock and recommend it to the investor to help investor in making decision, also draw of the economic situation and market condition. But informant 10 doesn't listening to the analyst because informant 10 doesn't trust enough analyst, Informant 10 also doesn't listen to media and Informant 10 didn't followed news too. So Informant 10 just focused on the technical analysis.

### Discussion
#### Perception about Analyst Recommendation
Perception about analyst recommendation may affect the investor to response the analyst recommendation. Research analyst is a financial professional who researches investments and makes recommendations. Despite of what the books say about analyst recommendation, it is important to find out about the perception from investors about the analyst recommendation itself. Investor's perception about analyst recommendation might lead to the findings of how investor's interest in analyst recommendation. Based on interview, all investors have their own understanding about the analyst recommendation. Some investors understand the recommendation mostly profitable or giving high return, but most of the investors didn't give response to the recommendation, showing investors have less response to the recommendation.

**Table 1. Investor Perception to Analyst Recommendation**

| | |
|---|---|
| Investor perception of analyst recommendation | 1. Signal about the coming benefit stock price given by an expert hired by institution. |
| | 2. Stock price forecasting by using financial analysis from analyst. |
| | 3. A research from analysts, studies about companies and draw on economic and business trend information to help investor make better investment decisions. |

*Source: Data Processed, 2014*

### Trading Preferences
Every investor has own preference in choosing stock and make price forecasting. There are two analysis that commonly used by investor to forecast the stock price movement. Fundamental analysis, examines company's earnings and dividend prospects, expectation of future interest rate and future evaluation in order to determine proper stock price (Bodie, et al., 2005:377) and technical analysis, used to find the recurrent and predictable pattern in stock price (Bodie, et al., 2005:373). There are connections in the preference used by the investor to how they response to analyst recommendation. By knowing the trading preference, then how investor response to the analyst will be seen.

According to finding, most investors tend to use technical analysis. Informant 1, Informant 4, Informant 5, Informant 6 and Informant 7 choose stocks with both fundamental analysis and technical analysis. All of them stated that financial reports are showing companies' performance.  Informant 3, Informant 5, Informant 6, Informant 7 and Informant 8 give some interest in analyst recommendation, but not all response to their recommendation. The only one that showed high response to the analyst is Informant 7. He also used fundamental and technical analysis in his decision making process, but he trusted more from the analyst, in fact,

he rely most to the analyst. According to findings, it could be seen that most of the investor tend to choose technical analysis as their own price predicting. By using technical analysis, investor tends to believe their calculation than listening to the analyst.

**Response to Analyst Recommendation**

The perception from the investor, they already understand the role of analyst recommendation and have knowledge about them. But according to interview result, most investor tends to not listening to the recommendation. Informant 1, informant 2, informant 9 and informant 10 have same reason for not listening t the analyst, because of trust issue. They don't believe analyst for some reason. Informant 2, informant 3 and informant 4 also have same reason not listening to the analyst because of the information or the recommendations that come from the analyst aren't clear. Informant 5, informant 6 and informant 8 give some weight to the recommendation to their investment decision but not much, they just take the stock recommendation given but didn't solely rely on the recommendation. The only investor who rely most to the recommendation is informant 7, where he takes all information and recommendation, making the recommendation is the only preference used to make investment decision.

**Table 2. General Findings**

| Manado investors' response to analyst recommendation | Reasons |
| --- | --- |
| **Low-Response** | 1. Investor tend to use own stock price forecasting<br>2. Based on preference used, investor with technical analysis less attracted to analyst recommendation<br>3. Lack of trust from the investor |

*Source: Data Processed, 2014*

The interview result that previously discussed, resulting to the low-response of investors in Manado to analyst recommendation. This statement gives answer to research problem which is asking about how investors in Manado give response to analyst recommendation.

## CONCLUSION AND RECOMMENDATION

**Conclusion**

This research finds that not all the investors give response to analyst recommendation. Investors do not get attracted enough to the analyst recommendation. Based on references used, investors using technical analysis didn't give any response to analyst's recommendation. Most investors tend to believe in prediction rather than following the analyst recommendation. The good-predicting investors don't pay much attention to the analyst recommendation because they believe in their decision. Trust issues also a reason from the investor to be less attracted to the analyst recommendation. Only less investor in Manado have their trading decision affected by the recommendation provided by the analyst. This summary that investor in Manado show low response to the analyst recommendation.
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**Recommendation**

Although most of research found that analyst recommendation gave high return in stock trading, but the investor in Manado still have less interest to them. Analyst should give a clear standard recommendation and for Investor should be given more information about the forecast given by the analyst and to add more interest to analyst recommendation, give some weight to the recommendation as a preference to investment decision. For the next research, it may also be helpful to examine whether response of investor or various trader groups to analyst recommendations varies systematically with other aspect or specific part of investing. Research leaves the pursuit of these questions to future research.

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