CHAPTER I

INTRODUCTION

1.1. Background

There are many aspects of a company that an individual needs to look into before finally making their investment decision. Marfuah and Nindya (2017) stated that one of the factors influencing company value is financial performance. By looking into a company's financial performance, investors are able to get a deeper insights into company's financial health. As stated in Marfuah and Nindya (2017) paper, "Financial performance of a company shows a fairly close relationship with an assessment of the health or unhealthiness of a company." A company's good financial performance increases the company value; Thus, attracting more investors and increasing the company's share prices. Surely when the financial performance of a company is bad, the stock prices will then decline.

Financial Performance is an important factor for investors to put their money on to invest. One of the measurements of financial performance is the Return On Assets. The Return On Assets (ROA) ratio represents the internal earnings aspect analysis of financial performance. The ROA ratio shows the ability of the management to manage available assets to obtain net income (Kuncoro and Suhardjono, 2002). The greater ROA ratio shows the level of achievement of greater profits as an indicator of operational efficiency. But we have to understand that ROA is affected by many factors, such as good corporate governance. Corporate governance generally can increase investor confidence because it reduces the risk that may be done by managers with decisions that benefit themselves. In short, the implementation of corporate governance can increase the value of the company and increase the company's financial performance (Tjager et al. 2003). For the corporate governance itself, we are only focusing on CEO competencies, managerial ownership, the proportion of independent commissioner board and number of audit committee.

Which characteristics define a good CEO for the company? CEO's decision-making process and CEOs decisions could affect the survival and direction of the company; Thus, they are burdened with a huge responsibility for the whole economy because “a small leak will sink a big ship” (Radlach et al. 2008). Education is power, and can be achieved both from school and certified institution. It is presumed that when better education and experiences are merged, there is a high tendency of acquiring a greater managerial skill and thereby delivering the organization even during the hardest times. “Education and experience are two inseparable quality of a good manager with high entrepreneurial drive”, said Robinson and Sexton (1994). The CEO's educational background is vital for a firm given that such background may influence the way business problems are perceived and the mental process which they use in the decision making process (Fligstein, 1990). While this topic is not completely new in the area of research, but a little findings and certain aspects makes this study different. King et al. (2016) find that a master degree more significantly affects firm performance than another degree like undergraduate and doctoral. Aaron et al. (2010) found no evidence in support that firms managed by a CEO who has an MBA degree had better performance.

Theorists and scholars remain divided and have provided little evidence to support which competencies CEO attributes are essential for firm performance. Hence, we would like to find out how can the CEO's competencies in Indonesia listed companies could affect the financial performance.

Every company has a goal to create value for shareholders by maximizing the owner's wealth (Gitman, 2006) in Imanta and Satwiko (2011). However, owners have limitations in managing company and triggers the owner to hand over responsibilities to manager. Managers as professionals are expected to act on behalf of the shareholders' welfare, many scholars identified them as an important role therefore many theories about them have been made as well which includes 'stakeholder theory' and 'agency theory'. Following Freeman (1984), stakeholders include any person, group, or organization which affects and is impacted by an organization's decisions. stakeholder relationships for the collaborative initiative are complex, involving multiple stakeholders with varying interests and goals. Rowley and Moldoveanu (2003) argue that stakeholders are motivated not only by rational interests (both material and nonmaterial), but are also mobilized to preserve their identity. In addition, managers are often tempted to improve their own well-being, this issue is also known as the 'agency problem'. Managerial ownership is considered an important governance mechanism to help control agency problem (Jensen & Meckling, 1976) and place greater effort to enhance firm wealth. Managerial ownership works as direct incentives for managers to act in line with shareholder interests (Weisbach, 1988). The greater the stock owned by top managers, the more likely managers will make decisions that are consistent with maximizing the shareholder wealth as the managers will feel a direct benefits of each decision also the losses that arise when making a wrong decision. Thus, we suspect that an increase of managerial ownership helps to connect the interest of shareholders and lead to better decision making and higher financial performance.

In Indonesia, based on UU No. 40 of 2007 about limited company, the executive director's role is run by the board of directors, while the non- executive directors role/function is held by the board of commissioners. The board of commissioners generally represent the shareholders of the company. It has two main functions: (1) monitoring function, that can be related to agency theory; (2) providing resources function, that can be related to resource dependence theory. According to the agency theory, the board of commissioners hold the responsibility to monitor the management in the name of shareholders to avoid conflict of interest between principal and its agent (Hillman & Dalziel, 2003; Lefort & Urzúa, 2008) i in Hidayat & Utama (2016). Whereas according to resource dependence theory, the board of commissioners' role is to enhance the company's reputation, build external relations, and provide advice and consultation to management (Zahra & Pearce II, 1989) in Hidayat & Utama (2016). It is interesting to know how significant is the effect of proportion of independent boards commissioner towards financial performance.

The primary roles of audit committee includes overseeing the financial reporting process, monitoring the management, and increases validity and reliability of financial statements. "Audit committees play an important role in overseeing and monitoring a company's management, with the aim of safeguarding the interests of the owners," says Kallamu and Saat (2015). In a research journal by Alqatamin (2017), audit committees were established as a part of accounting reforms to improve corporate governance practices, restore investors' confidence in listed companies and promote stock market reform in the country. Zahirul-Islam (2010) argues that an audit committee is one way to reduce the management incentive problem - such as manipulating financial statements to get higher bonuses. This is because effective audit committees enhance the quality and credibility of annual audited financial statements. Meanwhile, a research did in French (2018) by Bouaine and Hrichi shows that the number of audit committee have no significant effect on the financial performance.

In contemporary global and competitive environment, the survival of a firm not only depends on how one can efficiently and effectively pursue for its financing and investing opportunities in national and international financial markets' but also how one is managing the financial and operational affairs of the firm. Cash conversion cycle is a comprehensive performance measure used for reviewing the ability of companies in managing their capital. Cash conversion cycle indicate the efficiency of management of current assets. Shorter the time of cash conversion allows the firms to generate more sales from the amount invested, which shows that business utilized their resources for generating maximum profit (Moss & Stine, 1993). Moss and Stine (1993) asserted that the analysis of cash conversion cycle give more explicit insights for efficient management of firm's short term assets and liabilities that will assure about the proper level of liquidity needs. Previous research of Syarief and Wilujeng's (2009) study found no significant empirical evidence regarding the relation of cash conversion cycle on profitability of the manufacturing industry in Indonesia. While Dong and Su (2010) in Vietnam, Vural et al, 2012 in Turkey, Malik and Bukhari (2014) in Pakistan, and Yazdanfar and Ohman (2014) in Sweden found a significant effect of cash conversion cycle on profitability.

The research of Putri and Suwitho (2016) found a positive influence of ROA on financial performance. However, a study conducted by Susianti and Yasa (2013), found that ROA did not have a significant effect on financial performance, but good corporate governance was able to moderate ROA on firm value. That is why this research is crucial in educating society in regards to identification good financial performance of company, and we would like to emphasize it through finding on our variables.

Data used for this study will include manufacturing chemicals and basic industry companies listed in Indonesia Stock Exchange during the period of 2014 - 2018. To reduce the effect of unique characteristics of each respective sector to its financial performances, only manufacturing with chemical and basic industry companies are being observed. Period observed limited to 2014 - 2018 because writers believe that the period chosen is relevant with the period the study is conducted since it represents latest company profile.

For this study set, researchers entitled it as **THE EFFECT OF CEO COMPETENCIES, MANAGERIAL OWNERSHIP, PROPORTION OF INDEPENDENT COMMISSIONER BOARD, NUMBER OF AUDIT COMMITTEE, AND CASH CONVERSION CYCLE TOWARDS FINANCIAL PERFORMANCES.**

1.2. Research Problem

Based on the background of the research described previously, the formulation of the problem in this study are as follows:

1. Does CEO competencies influence the Return on Assets?
2. Does managerial ownership influence the Return on Assets
3. Does the proportion of independent commissioner board influence Return on Assets?
4. Does the number of audit committee affect Return on Assets?
5. Does the cash conversion cycle influence Return on Assets?

1.3. Research Objective

The objective of this research is to find out whether CEO educational background, certification and their experiences in the field is related to provide additional value to the financial performances. We would like to know whether the mental orientation of CEO in the way they perceived organizational problems and business challenges can gives an advantage and can improve firm performance or not. Furthermore, additional variables such as managerial ownership, independent commissioner board and number of committees are useful tools that can support the claim that it can drive the corporate governance to perform better result accordingly. We also added cash conversion cycle to see the effects to financial performance of the company by analyzing the companies engaged in manufacturing chemical and basic industry that have been listed on the Indonesia Stock Exchange for the period 2014-2018 based on the measurement of financial performance using Return on Assets (ROA) calculations.

1.4 Significance of the study

This research is expected to provide benefits for:

1. Writer

Hopefully, the study could provide deeper knowledge regarding the issue being discussed, experience, and the application of knowledge gained during the process of learning in university.

2. Universitas Pelita Harapan

The result of this study hopefully may give additional information about application of theories taught during the process of learning, as well as additional consideration of depth of material to be taught in the process of learning at class. Additionally, hopefully the study conducted may be proper addition to literature collection of Johannes Oentoro Library.

3. Next researchers

The result of this study could be material inputs to improve the next similar research. This research aims to add to the corporate governance literature in behavioral finance especially in the area of board directors, commissioner, auditor and its impact on financial performance

4. Company

This research is expected to be used as an input material in making decisions related to the company's annual report. For managers, this research will give an insight regarding cash conversion cycle on its impact on increasing the financial performance of their company. It also helps them choose the right CEO based on the right competencies moving forward.

5. Regulators

This research may provide a contribution to a qualification of a CEO in board's policies, rules and regulations. This research can build awareness regarding the standard of becoming a CEO, so every company will not freely choose their CEO . Everything needs to be done according to rules and requirements applied in a certain period of time.

6. Stakeholders

Hopefully, this study could provide new perspective for investors in their decision to invest in a company, where they invest not only by monetary measures alone, but also by the internal process resulting in the monetary values. Hopefully, this research leads to further understanding on competencies of a CEO in leading their company and to know the impact of cash conversion cycle itself in decision making to invest on the company .

1.5 Scope of the study

Limitation of the scope of research is intended it more focused and in-depth. The scope of this study focuses on the influence of good corporate governance as proxied by CEO competencies, managerial ownership, the proportion of independent commissioners, and number of audit committees; and Cash Conversion Cycle (CCC) on financial performance as measured by profitability ratios using Return On Assets calculations in the chemical manufacturing and basic industry both partially and simultaneously. Details can be described as follows:

1. Effect of CEO competencies on Return On Assets
2. Effect of managerial ownership on Return On Assets
3. Effect of the proportion of independent commissioner boards on Return On Assets
4. Effect of number of audit committee on Return On Assets
5. Effect of cash conversion cycle on Return On Assets

The independent variable in this study is Good Corporate Governance measured through managerial ownership, the proportion of independent commissioners, the number of audit committees and the cash conversion cycle which is measured using profitability ratios measured using Return On Assets (ROA). The data used as the basis of analysis in this study are secondary data sourced from annual reports and audited financial statements. The research analyzes the performance of the company by analyzing data of manufacturing chemicals and basic industry company listed in Indonesia Stock Exchange. Financial performance will be represented by return on asset at the reporting period. The annual report that are used in this research are 5 years of annual report from 2014 to 2018.

1.6. Systematic Discussion

The research paper systematically divided into five chapters as follows.

CHAPTER I - INTRODUCTION

This chapter will explain about the problem background, research problem, research objective, significance of the study, limitation as well as systematic discussion.

CHAPTER II - THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

This chapter contains related theories and concept definition, related literature review, conceptual framework, and the hypothesis development that are used to analyze the problems in this study.

CHAPTER III - METHODOLOGY

This chapter explains the method of research used in the study, which includes the population and sample, the empirical model, operational variable definition, and method of data analysis.

CHAPTER IV - ANALYSIS AND DISCUSSION

This chapter describes the discussion of the results of the test hypothesis to answer the problems in this study that described in the chapter on problem formulation, using foundation theories and research methods discussed in the previous chapter.

CHAPTER V - CONCLUSIONS

This chapter presents conclusions that can be drawn based on results the analysis and discussion described in chapter IV and recommendations for further research.