CHAPTER I

INTRODUCTION

1.1. Background

At the beginning establishment of a company, the owner will usually execute and manage the businesses. The owner will perform the selling activity, production activity as well as funding. As time goes on, the company will enter a growth phase; this growth phase can be seen from the increase of sales, profit, cash flows and so on. The growth phase will bring much complexity in the business and the company will encounter a competitive competition among companies (Simamora, 2013). The company is required to be able to analyze the current situation and the future, in order to develop and persist in a competitive competition (Kurnia, 2010).

Manager is one of resources, used by the company to face the environmental changes who usually has a personal skill to develop and overcome problems in the company. Management's roles are as follows:

1. Interpersonal Role: managers must be able to deal with other parties.
2. Informational Role: managers must able to transmit information about an organization and its goals to the people outside it.
3. Decision Role: managers must able to solve problems that occur in company and generate new ideas which are best to be applied in company.

Those skills are very important for managers in order to run a company, to encounter the problems occurring during the daily activities in the company. Since, one of the keys of a company's success is the existence of managers who are managed to design the business process that is efficient and effective, and able to make decisions that create value for the company. Besides, managers also have an obligation to communicate the company's performance to the outside parties (stakeholders) who are interested with the company. The most appropriate way for manager to communicate the company performance is through financial reports that are reported at certain period (Isnugrahadi and Kusuma, 2009).

Financial report is a picture of the company's financial condition that are analyzed with a financial tool analysis, so it is easier to understand whether company is in a good or bad condition at a certain period of time (Ermayanti, 2009). A manager, who is capable, will usually have an accurate judgment. Accounting standards board allows manager to use judgment in making financial reports with the aim that the report will in accordance to the real condition of the business process in the company which will increase the value of an accounting as a form of communication (Isnugrahadi and Kusuma, 2009).

Healy and Wahlen (1999) give some forms of manager judgments, for example in the financial report, in the estimating events that have an economic value for the future as the estimated age of economical and residual value of long-term assets. Manager must also choose an accounting method allowed for reporting economical transactions like the use of a straight line methods in recording the acceleration of depreciation, or choose First in First out (FIFO) in recording the inventory. Manager must also choose to impose or suspend expenses like research and development (R&D).

In order to make an accurate judgment, manager is required to have expertise. To get the expertise, manager usually has a high level of education. Besides, the level of a manager's experience also determines his/her managerial ability. Managerial ability is a skill or personal characteristics that help the performance achievement in management duty (Sulastri, 2009). Indonesian companies should have qualified or capable managers who can increase firm market value. A manager who has adequate skills is considered as an expert in his field (Ruba'i, 2009). Besides, manager who has adequate skill is considered to be more capable of estimating the policy taken towards the company.

A qualified or capable manager is believed can manage company well, which will result efficient company performance that can be seen or reflected through the financial report. Information contained in a financial report will be used by certain parties as investors, a creditor, manager, employees, the government and the community which for sure have different purposes.

To assess the achievement of a company, company usually needs certain measurements. The usual measurement used is financial ratios. These ratios help the user to understand better about the financial condition in a company. Financial report is very important for a company, because this financial report is expected to give positive signal to investor. Any information can be said " it has value to investors if the information provides a response to the transaction in the capital market".

According to Signaling theory (Leland and Pyle in Scott, 2012:475), the company can raise the value of the company by sending signals through its annual report. Because of that, it is expected that investor will consider information in the company's financial report to make investment in it.

The more efficient the company performance is, it will increase the level of credibility of investors towards the company. By having this high level of credibility, investors will certainly give a positive response towards the company. If the supply remains the same, the demand of shares of the company will increase, which is resulted with the movement of share prices are likely to rise. These rising of share prices, will increase the company's firm market value.

Research in managerial ability is relatively new, and because of difficulties in managerial ability's measurement (Isnugrahadi and Kusuma, 2009), there is not many research about managerial ability. The first measurement of managerial ability is introduced by Demerjian et al. (2010), using Data Envelopment Analysis (DEA) their research is about managerial ability and earnings management.

There are three previous researches related to managerial ability in Indonesia. First, according to Isnugrahadi and Kusuma (2009), managerial ability has positive impact on earning management. Second, Djuitaningsih and Rahman (2011) states that managerial ability has positive impact on financial performance which is measured by using earning per share (EPS). The last, according to Simamora (2013), managerial ability has positive impact to firm value and strengthens the impact of managerial ability towards firm value.

Demerjian et al. (2010), Isnugrahadi and Kusuma (2009), and Djuitaningsih and Rahman (2011) suggest that managerial ability should be connected to other variables. From the suggestion, thus the research will test the impact of managerial ability towards firm market value.

1.2. Research Question

Based on the research background, the research question in this research is formulated as:

Does managerial ability have positive impact on firm market value?

1.3. The Objective of Research

This research has an objective to prove empirically the impact of managerial ability towards firm market value.

1.4. The Contribution of the Research

This research is expected to give contribution as follow:

1. Academic

   This research can be used as new literature in examining the relationship between managerial ability and market performance, as well as can be used as a reference for next research.

2. Shareholders

The investors can use this research as consideration to decide the proper firm that they will invest in. The result also can be used to know the firms’ investment behavior.