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The Influence of Managerial Ability on Future Performance

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ABSTRACT

The establishment of a single market in the ASEAN which is termed the ASEAN Economic Community (MEA) allows a country to sell goods and services easily to other countries throughout Southeast Asia, thus competition is getting tighter. Every firm should be more innovative in order to have a competitive advantage to win the competition in the industry which is reflected by its performance. Managers with a high ability are believed to be able to make projections of future business conditions, thus they can design the right strategy for the procurement and optimization of the firm's resources utilization in producing output which can lead the firm to has a good performance in future. This study analyze the influence of managerial ability to future performance. Some control variables are used in this study, including firm size, financial leverage, market to book ratio, sales growth, and market share. Hypothesis testing in this study used multiple linear regression analysis to analyze data from 291 manufacturing companies listed on the Indonesia Stock Exchange during the 2008-2010 period. The result prove that managerial ability has a positive effect on future performance up to five years later, but the longer time the influence become weaker.

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INTRODUCTION

The establishment of a single market in the ASEAN which is termed the ASEAN Economic Community (MEA) allows a country to sell goods and services easily to other countries throughout Southeast Asia, thus competition is getting tighter. Every firm should be more innovative in order to have a competitive advantage, thus it can win competition in the industry. In this case, the managers have an important role because of their responsibility for running the firm's operational activities effectively and efficiently, so they can provide benefits for the firm. In order to carry out these duties and responsibilities properly, managers should have special skills which is known as managerial.

The reliable managers, or in this case is managers who have managerial ability, are believed to be able to make projections of future business conditions, so they can design the right strategy for the procurement and optimization of the firm's resources utilization in producing output which can lead the firm to has a good performance in future. In addition, reliable managers are also believed to be able to properly manage the diverse interests of stakeholders to gaining their supports to meet the going concern assumption. This is confirmed by Andreou, Ehrlich, Karasamani, and Louca (2015) through the results of his study which revealed that managers with good abilities can make the right decisions so as to improve firm's performance, while Francis, Huang, Rajgopal, and Zang (2008) actually proves that the capabilities possessed by reliable managers may not necessarily improve firm performance.

Economic conditions that change easily over time cause the ability of managers to predict business opportunities to be limited in the short term. Therefore, future performance assessed in this study is the firm's performance for five consecutive years after the research period on managerial ability to find out how far the manager's ability to influence the firm's future performance. In this study, several variables that also influence the performance of the firm, especially the firm's performance in the future (future performance), will be controlled to ensure that the firm's performance in the future is not influenced by variables other than managerial skills. These variables include firm size, financial leverage, market to book ratio, sales growth, and market share.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency Theory

In large-scale firms with complex conditions, owners (or shareholders) have limitations in managing the firm directly, so they need other competent parties to manage the firm. Agency relationship arises when a person or group of people (principal) appoints another person (agent) to do something that represents him with some authority of decision-making (Jensen & Meckling, 1976). As an agent, managers bear high expectations from the principal to be able to manage the firm well. Managers should have managerial ability to meet principal expectations, which are indicated by the good performance. Reliable managers are expected to be able to improve the firm's present performance and make projections or forecasting of future business conditions to keep the firm's future performance in line with the expectations of the principal.

Stakeholder Theory

Freeman (1984: 25) defines stakeholders as groups and individuals who can influence or be influenced by the process of achieving organizational goals. Corporate stakeholders are divided into two groups, namely internal stakeholders and external stakeholders. Internal stakeholders consist of shareholders, managers, and firm employees. While external stakeholders consist of suppliers, consumers, government, and the general public.

In stakeholder theory, companies should pay attention to all parties that can influence the value of the firm (Jensen, 2001). In other words, the different interests of each stakeholder should be managed properly to obtain support from stakeholders, thus the firm have good performance, both in the present and the future, and be able to survive in the industry. To meet the interests of stakeholders, the firm can improve the efficiency of its operational activities by optimizing its resources. The manager's ability is very important in managing these interests to encourage firms in achieving success that can be measured by firm performance.

Managerial Ability

Managerial ability indicate the efficiency level of managers in managing firm resources to produce output Peter Demerjian, Lev, and McVay (2012) The reliable managers, or in this case is managers who have managerial ability, will be able to manage resources efficiently to produce optimal output, thus opening up opportunities for firms to outperform their competitors. This can lead the firm to have a good performance. In addition, reliable managers should have the ability to make projections of future business conditions, so they can design the right strategy for the procurement and optimization of the firm's resources utilization in producing output which can lead the firm to have a good performance in future. As revealed by Andreou et al. (2015), managerial skills can improve firm performance. However, to meet the going concern assumption, good performance in the present period is not enough, the firms should have good performance, both in the present and in the future.

Based on those descriptions, the hypothesis is:

H1: Managerial ability have a positive effect on future performance.

METHOD

Research Variables

Managerial ability (ability).

Managerial ability measured by Data Envelopment Analysis (DEA) that uses the concept of efficiency or productivity which is calculated by the ratio of total output to total input. Efficiency means the ability of managers to utilize certain inputs to produce optimal output. This study adopted an efficiency model developed by Peter Demerjian et al. (2012) with total sales (sales) as an output indicator. As for input measurement, the Cobb-Douglas production function reveals that production inputs consist of labor and capital. Therefore, this study combine the efficiency models revealed by Peter Demerjian et al. (2012) with the Cobb-Douglas production function, thus the input indicators used include Cost of Goods Sold (COGS); Selling and Administrative Expenses (SG & A); Property, Plant & Equipment (PPE), Intangible Assets (Intangible), and Capital Expenditure (CapitalExp).

Future performance (FP).

Future performance in this study is measured by net income of the next several periods. Net income will be compared to its total assets to measure how efficient the firm is in managing its resources in gaining income. The higher net income indicates the better firm's ability to manage its resources.

Firm size (Size).

Firm size is measured by total assets, because total assets describe the firm's ability to carry out its operational activities.

$$Firm\ size\ = \ln ln\ total\ asset$$

Financial Leverage (Lev).

Financial leverage describes the proportion of debt to funding the firm assets (Sudana, 2011:20). Therefore, financial leverage is measured by:

$$Financial\ leverage\ = \frac{Total\ debt}{Total\ asset}$$

Market to Book Ratio (MTB)

Market to book ratio is an indicator that is widely used by prospective investors to ensure the feasibility of shares of a firm to be owned. A well-managed and efficient firm will have a higher market value than its book value.

$$Market\ to\ Book\ Ratio\ = \frac{Market\ Value}{Book\ Value\ of\ Equity}$$

Sales Growth (SG)

Sales growth is an important indicator of market acceptance of the firm's products and/or services (Swastha & Handoko, 2001).

$$Sales\ growth\ = \frac{Sales_{(t)} - Sales_{(t-1)}}{Sales_{(t-1)}}$$

Market Share (MS)

Market share is a ratio that describes the part of the market that can be controlled by a firm compared to competitors in the industrial sector, thus it can be seen the position of the firm in the market.

$$Market\ Share\ = \frac{Firm\ Sales\ x}{Total\ Sales\ of\ the\ Industry}$$

Data Type and Population

The data type in this study is quantitative data obtained from the Indonesia Stock Exchange (IDX) website in the form of financial statements of manufacturing firms listed on the Stock Exchange in the period 2008 to 2010, and the firm stock prices obtained from www.finance.yahoo.com. The population in this study are manufacturing firms listed on the Stock Exchange in the 2008-2010 period which published financial statements during the 2008-2015 period. The effect of managerial ability in the 2008 period will be examined on the firm's performance in the 2009-2013 period. While the effect of managerial ability in the 2010 period will be examined on the firm's performance in the 2011-2015 period. Therefore, this study requires the financial statements during the period of 2008-2015. Manufacturing firms were chosen because this firm relied on efficient design processes and added value to obtain maximum profits. Sample selection is done by using purposive sampling method, which is the technique of determining the sample using certain criteria (Anshori and Iswati, 2009:105). Based on these criteria, 291 firms were selected as sample of this study.

Data Analysis Technique

Data Envelopment Analysis (DEA)

Data Envelopment Analysis (DEA) is a mathematical program that is used as a measure of efficiency to assess the performance or productivity of a group of organizational units known as Decision-Making Units (DMU) (Mantri, 2008: 15). The aim of this analysis is to determine the efficiency of firm resources usage to produce outputs. A DMU is considered efficient if the ratio of the ratio of output to input is 1 or 100%. Conversely, a DMU is considered inefficient if the ratio of output to input is <1 or less than 100%, which means that there is a waste in the use of firm resources to produce outputs. Therefore, the higher level of firm efficiency in the same industrial sector indicates the more capable the manager's ability is (Isnugrahadi & Kusuma, 2009).

Classic assumption test.

Regression analysis requires that a data should meet the classic assumption test in order to obtain an efficient and unbiased judgment value. Classic assumption tests used include normality, heteroscedasticity, and multicollinearity tests.

Multiple Linear Regression Analysis

To test the hypothesis which states the managerial ability have a positive effect on future performance over the next five years, the data is processed using multiple linear regression analysis. Influence testing over the next five years requires the data to be processed five times using multiple linear regression analysis with the following equation:

$$FP_{t+x} = \alpha + \alpha_1 ABILITY_t + \alpha_2 SIZE_t + \alpha_3 LEV_t + \alpha_4 MTB_t + \alpha_5 SG_t + \alpha_6 MS_t + e$$

To see how far the influence of the independent variables individually in explaining the dependent variable, statistical t-tests are carried out (Ghozali, 2013: 98). This test is used to determine the significance level of each independent variable on the dependent variable by assuming the other independent variables are constant. This testcomparing the value of the probability or significance t count with the following conditions:

1. If the probability value or t count significance > 0.05 then H0 is accepted.
2. If the probability value or t count significance <0.05 then Ha is accepted.

RESULT AND DISCUSSION

Classic Assumption Test

To get an unbiased result, the data should pass the classic assumption test, including normality, heteroscedasticity, and multicollinearity tests. After doing all three tests, it can be ascertained that the available data has met the requirements for testing the hypothesis.

Test of Determination Coefficient

Table 1. Test of Determination Coefficient

Future Performance	R Square	Adjusted R Square
1st Year	0,360	0,345
2st Year	0,371	0,357
3st Year	0,348	0,332
4st Year	0,326	0,310
5st Year	0,257	0,238

Based on the results of the determination coefficient test in the Table 1, it is known that the adjusted R square value has increased from the first year to second year. This indicates the better ability of research model in predicting future performance. But after the second year, the adjusted R square value of the model decreases, so it can be concluded that in the longer time, the ability of the research model to predict future performance is getting weaker.

Hypothesis Testing

The results of hypothesis testing can be summarized in the Table 2:

Table 2. Result of Hypothesis Testing

Variable	1st year			2nd year			
	Beta	t	Prob value (Sig.)	Beta	t	Prob value (Sig.)	Beta
(Konstanta)	-0,437	-4,891	0,000	-0,292	-3,512	0,001	-0,122
ABILITY	0,343	8,855	0,000	0,287	7,723	0,000	0,236
SIZE	0,008	2,539	0,012	0,005	1,740	0,083	0,000
LEV	-0,080	-4,615	0,000	-0,112	-6,943	0,000	-0,114
MTB	0,004	4,871	0,000	0,006	5,501	0,000	0,010
SG	0,006	1,318	0,189	-0,002	-1,792	0,074	-0,001
MS	0,164	0,913	0,362	0,098	0,575	0,566	0,286

DISCUSSION

The test results of the influence of managerial skills on future performance in the 1st year to 5th year which show positive beta values and significance values of t test below the 0.05 prove that managerial skills have a significant positive effect on the firm's future performance in the first to fifth year. Beta value in the 1st year is 1 of 0.343 continues to decline until it reaches a beta value of 0.102 in 5th year, this means that the influence of managerial skills in improving future performance decreases in the longer time.

The results of this study prove that reliable managers have the ability to make projections of business conditions in the future, so they can plan the right strategy for the procurement and optimization of the firm's resources utilization in producing output, thus the firm is able to outperform its competitors and has a good future performance. However, the beta value that continues to decline from 1st future performance to 5th future performance shows that the longer the manager's predictive power becomes weaker. Economic conditions that is easy to change limit the manager's predictive ability over business opportunities in the future, thus the longer the manager's ability to influence future performance becomes weaker.

In stakeholder theory, the firms have to pay attention to all parties who have an interest in the firm. As an agent who is responsible for managing the firm, managers also have to be able to manage stakeholder interests properly. When the interests of diverse stakeholders can be managed properly, the firm will get support from stakeholders, thus the firm can have a good performance in the present and in the future to meet the going concern assumption. This is in line with the research of Demerjian *et al.* (2012) which revealed that reliable managers can improve a firm's future performance.

The results of this study also support the research of Andreou *et al*. (2015) which shows that manager's ability to understand and utilize firm resources effectively is very important to produce competitive advantage for the firm. Managers with good abilities can make the right decisions to provide benefits for the firm. This shows that managers have an important role in achieving the success of a firm. Therefore, the firm have to choose the best, reliable, and highly competent managers in carrying out the firm's operational activities and determining the right strategy, thus the firm can achieve good performance and has advantages in competing with other companies, both now and for the future.

CONCLUSSION

The results of hypothesis testing and analysis prove that there is a significant positive effect of managerial ability on future performance. This indicates that reliable managers have the ability to make projections of business conditions in the future, so they can plan the right strategy for the procurement and optimization of the firm's resources utilization in producing output, thus the firm is able to outperform its competitors and has a good future performance. Economic conditions that is easy to change limit the manager's predictive ability over business opportunities in the future, thus the longer the manager's ability to influence future performance becomes weaker.

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