CEO TENURE, PROFITABILITY, CAPITAL STRUCTURE, AND STOCK PRICE: AUTOMOTIVE AND COMPONENTS LISTED FIRM ANALYSIS

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ABSTRACT

Research on the determinants of stock prices has been widely carried out in various countries, although the results are still mixed. There is a lot of literature that describes stock price movements as a result of internal company factors such as CEO tenure, profitability, and capital structure. The discussion about the relationship between CEO Tenure and Share Price is not as much as other internal factors, so it is interesting to analyze along with profitability and capital structure variables. The study aims to determine the company's internal factors (CEO Tenure, Profitability, and capital structure that have a powerful influence on the stock prices of automotive and components listed firms in the Indonesian capital market for the period of 2013–2019. The present study using 11 automotive and components listed firms as a sample that was selected by using a specific criteria technique. All the data used in this study is secondary data gathered from the official website of the capital market and other related sources. Data panel regression method used to analyze the relationship between independent and dependent variables. The result indicates that only CEO tenure has a negative effect on the share price, while profitability and capital structure do not affect the stock price. This finding confirms that CEO tenure is one of the main concerns of investors in making investment decisions.

Keywords: CEO tenure, profitability, capital structure, stock price, listed firm

I. INTRODUCTION

Every company aims to maximize the welfare of its shareholders. Shareholder welfare can be rectified through company performance, where company performance is the company's competence to achieve company goals through efficient use of resources (Daft, 2010. Company performance is a description of the financial status of a company which is analyzed using financial analysis, so it is often referred to as financial performance (Combs, Grook, & Shook, 2005. The financial performance of a company is one indicator of changes in financial conditions. The company's financial status and the results of personal decisions made by management based on financial data issued and formulated following applicable financial accounting principles (Carton, 2004. In addition to improving financial performance, every company will also try to upgrade the value of the company, because when it is high, investors will be more interested in investing in the company. Management will take various ways to increase the company value, one of which is by increasing shareholder benefits as reflected in stock prices (Brigham & Joel, 2006. When the company's performance is getting better, the value of the stock will increase, which in turn will provide the expected return to investors (Weston & Copeland, 1997. The main factors that can influence an investor in carrying out an investment activity include the rate of return on shares, risk, and development of stock prices. Consideration of stock prices is the basis for an investor because stock prices reflect the firm performance and potential in the future. The movement of stock prices can be seen through the movement of the stock price index. The stock price is used by investors as one of the important information before carrying out an investment activity because it can be used to predict capital gain that will be obtained by analyzing the company's financial statements. Then, the value of the company can also be assessed from its stock price which is stable and has increased continuously in the long term. Rising high stock prices make the value of the company also high. The higher the value of the company, it indicates prosperity for shareholders. The stock price in the capital market can be formed to refer to the demand and supply by investors so that the stock price is fair (Hasnawati, 2005.

The stock price movement of as a result of internal factors such as CEO tenure. In companies business activities, the task of coordinating the directors is doing by the CEO. The CEO is a top executive who plays a prominent role in making decisions related to the company's strategic planning. Therefore, the CEO is expected to carry out their function so that the company's goals can be achieved. If individuals have different opinions, then the distribution
of decision-making power within the company can influence by the decisions made. These managerial decisions may or may not, affect firm results but if they do, both executive characteristics and organizational variables can affect firm performance. Then, the second internal factor is Profitability. Profitability can be used to measure the company's ability to earn a profit. One measurement of profitability is Return On Assets (ROA). Harahap (2015: 299 reveals that ROA is a ratio that can show the ability of a company to generate returns on the company's assets. Capital Structure is also predicted to have a strong connection with the stock price. According to Sabardi, (1994, the capital structure shows the level of the company's ability to meet its needs with debt. The higher of debt in the firm capital structure, the higher the risk of a company. This is because most of the company's funds are obtained from debt. On the other hand, a decrease in the value of debt in the firm capital structure can attract investors to invest because it has a relatively low risk. Iskandar (2016; Vermeulen et al., 2020; Potts et al., 2020; Yazici, 2020 reveals that investment financing using debt is part of the capital structure so that the risk of returning decisions when investing can be known. Financial position and stock prices are influenced by both the good and the bad of capital structure, so this is an important issue for the company. The company has a key role in determining the capital structure for the company because it is so closely related to the profits and possible losses that will be faced by the company's shareholders.

This study was conducted to determine stock price movements as a result of internal company factors such as CEO tenure, profitability, and capital structure. These factors have been used by some previous researchers (Murtiani, 2016; Fatmawati, 2021; Saprudin, 2019; Dwi and Hidayat, 2019; Indahsafitri et al., 2018; Nur Ulfi Zakiah, 2020; Erry Ramadhan, 2016. This research is different from another study because the discussion about the relationship between CEO Tenure and Stock Price is not as much as other internal factors, then it uses variables that are commonly used to explain stock prices in general so it is interesting to analyze together with profitability and capital structure variables.

II. HYPOTHESES DEVELOPMENT

CEO Tenure and Stock Price

The CEO is holding the highest position in a company's operational activities and responsible for company plans and strategic decisions made by the company as well as dealing with internal and external parties of the company. In Indonesia, the CEO is generally referred to as a president director. There are several characteristics of CEOs, one is tenure. CEO tenure for private companies and state-owned companies is different. CEO tenure for state-owned companies maximum 5 years and can add for the next 5 years depending on companies needed. CEO tenure can influence all decisions taken and every action taken by the company. The tenure of a CEO or director in a company shows how many years the CEO has served to analyze and make decisions about the company being analyzed.

The new CEO of a company is still being monitored for his abilities, so the market reaction is uncertain, even though it is promoted by the company's internals (Gibbons and Murphy, 1992. New CEOs are considered to have an aggressive way of working when compared to CEOs with long tenures so that they can face uncertain conditions and encourage an increase in company revenues (Geertsema, et. al., 2015. If the new CEO has poor work quality, the market will react negatively which causes the company's stock price to fall (Geertsema, et. al., 2015. CEOs with long tenures are often unable to adapt to the development of business challenges that cause the company's confidence to decline, as well as the market. CEO tenure can have a positive or negative relationship with stock price depend on CEO performance. For companies that are in a stable condition, the CEO's performance is reflected in the increase in company performance and tends to increase along with the length of the CEO's tenure (Henderson, Miller & Hambrick., 2006. 

H1: CEO tenure has a negative relationship toward firm share price

Profitability and Stock Price

One of the company's goals is to generate profits both in the short and long term. According to Tias (2014 profitability is a ratio that reflects the company's overall ability to generate profits. The company's ability to generate profits is measured by all company funds invested, including the company's capital. One of the indicators used by the company in measuring the company's ability to obtain profitability is the return on assets which measures the ability to generate profits (Wiagustin, 2014.)
Profitability provides clues to managers and investors in the form of how efficient the company's management is in using its assets to generate income. The greater the ROA denote the better of company's performance that will attract investors to buy firm shares. In way to achieve high profitability, the company is required to allocate its investment to assets owned which are considered more profitable (Tandelilin, 2010. To drive increased profitability, companies need to manage and allocate their investments to the profitable asset. Some previous research tries to analyze the relationship between profitability and share price. A number of study found that profitability has a positive connection with stock prices (Darmaji, 2006; Murtiani 2016; Fatmawati, 2021; Saprudin, 2019; Dwi and Hidayat, 2019; Indahsafitri et al., 2018.  

H₂: Profitability has a positive relation with share price

Capital Structure and Stock Price

The company's decision in determining the right capital structure for the company has a central role because it is closely related to the achievement of profits and possible losses that will be borne by the owner of the company. The capital structure describes the combination of debt and equity used by the company to finance its assets (Titman & Wessels, 1988. Modigliani and Miller, 1958 stated that the use of debt in the company's capital structure can increase investor confidence which can encourage an increase in the company's stock price. The use of debt in the company's capital structure can make the company lower in paying taxes because of interest costs (Park & Jang, 2013. However, the company still has to determine the maximum debt limit for the company by taking advantage of tax benefits and bankruptcy costs. The use of excessive debt because they want to get tax benefits is sometimes not worth the cost of financial difficulties that the company will face. To create an optimal capital structure to increase company profits, companies sometimes exchange tax benefits for the cost of financial difficulties which of course can harm the company and cause the company to go bankrupt (Kraus & Litzenberger, 1973; Myers, 1984. The capital structure will improve the company's performance if the benefits from the additional use of debt are greater than the costs of the financial difficulties that will be faced. On the other hand, the capital structure will have a negative effect on the company's performance if the benefits from the additional use of debt are less than the costs of financial difficulties. The use of debt in the company's capital structure will have a positive influence on stock prices if management is optimistic to generate positive cash flows in the future and increase company earnings. Some of the study point that capital structure has a positive connection with firm stock price (Chemutai, et. al., 2016; Zakiah (2020, Erry Ramadhan (2016.  

H₃: Stock price affected by capital structure positively

III.  RESEARCH METHODOLOGY

This research is an applied study using quantitative data. The data used in this study came from the official website of the Indonesian capital market. The data needed for this paper is the company's financial statements and annual reports. The data used in this study is secondary data obtained from financial reports, annual reports, and other related information from companies registered in the automotive and component sectors during the 2013-2019 period. The data used in this study is cross-section and time-series data or better known as panel data. The population in this study is the automotive and component sectors listed on the Indonesian capital market for the period 2013 – 2019, which consists of 13 companies. The number of samples taken to fulfill the purpose of this study was 11 companies that were selected based on certain criteria. The variables used in this study consisted of CEO tenure, profitability, and capital structure as independent variables and stock price as dependent variables. Table 1 below describes all the variables used in this study:

<table>
<thead>
<tr>
<th>Variables</th>
<th>Symbol</th>
<th>Measurements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Price</td>
<td>STPR</td>
<td>Closing stock price at end of December for the years studied</td>
</tr>
<tr>
<td>CEO Tenure</td>
<td>CEOT</td>
<td>The amount of years as CEO in the firm</td>
</tr>
<tr>
<td>Profitability</td>
<td>PROF</td>
<td>Net Income/Total Assets</td>
</tr>
<tr>
<td>Capital Structure</td>
<td>CAPS</td>
<td>Total Liabilities/Total Asset</td>
</tr>
</tbody>
</table>
The panel data regression model used in this study to answer the proposed hypothesis is:

\[ STPR = a + \beta_1 CEOT + \beta_2 PROF + \beta_3 CAPS + e \]

In the way to test the model that has been formed, the classical assumption test consists of multicollinearity and heteroscedasticity tests first. Furthermore, a model test will be carried out to ensure that the model form is following the statistical provisions. After all the above tests are met, then a hypothesis test will be carried out to answer all the research hypotheses that have been proposed with a significant level of 5%.

IV. RESULT AND DISCUSSION

Research Result

The results of the multicollinearity test show that there is no multicollinearity problem between the independent variables, or it can be said that all the independent variables in the regression model of this study are independent of each other because of the variance inflation factor (VIF < 10. The results of the heteroscedasticity test show that the P-value obs* R-square > 0.05, which means that there is no heteroscedasticity problem.

The random effect model is a panel data regression model that is appropriate to explain the purpose of this study based on the Chow, Hausman, and Lagrange multiplier tests. The results of the panel data regression test are shown in Table 2 below:

<table>
<thead>
<tr>
<th>Variables</th>
<th>Result</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO Tenure</td>
<td>-0.045304***</td>
<td>1.051873</td>
</tr>
<tr>
<td>Profitability</td>
<td>-0.630912</td>
<td>1.139257</td>
</tr>
<tr>
<td>Capital Structure</td>
<td>-0.164185</td>
<td>1.089578</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.070836</td>
<td></td>
</tr>
<tr>
<td>F-statistic</td>
<td>2.931,314</td>
<td></td>
</tr>
<tr>
<td>F-statistic Sig.</td>
<td>0.039141</td>
<td></td>
</tr>
</tbody>
</table>

*** sig. at 1%

Source: Financial & capital market statistical report, data processed

The statistical test results indicate that the regression model made is fixed which can be seen from the Prob F-statistic value <0.05, which means that there is a linear relationship between the independent variables (CEO tenure, profitability, and capital structure) and the dependent variable (stock prices. The coefficient of determination test shows that the ability of the independent variable to explain changes in the dependent variable is 7.08%, the remaining is 92.92% explained by other variables not used in this study. The results of the hypothesis test (t-test denote in table 2 above explain that the CEO tenure variable has a negative effect on the stock price. Other variables, namely profitability and capital structure do not affect share prices.

Discussion

The term of a CEO tenure is a description of the length of time a person has served as CEO in a company. A longer CEO tenure will make the CEO commit to the previous paradigm, with the company playing it safe, so that it will result in not increasing capabilities and less adapting to the company's external environment which can encourage declining company performance. At the beginning of the year of the CEO's tenure, the CEO will tend to learn faster and be willing to take risks to improve company performance. The empirical testing result denotes that CEO tenure has a negative effect on stock prices of the automotive and components industry listed on the Indonesia Stock Exchange. This finding point that the CEO will have a better performance at the beginning of his tenure as CEO which also increases investor confidence and encourage the company's stock price. A longer CEO tenure will play it safe and have limitations in solving problems, especially during unstable conditions. Usually, CEOs will do better at the beginning of their tenure to get more compensation and performance tends to decrease as their tenure is longer, which pushes stock prices down as well. This study results in line with some of the previous research results (Geertsema, Lont & Lu, 2015; Harper, Johnson, & Sun, 2020; Gusni, Siti Komariah, & Devi M.P, 2020.
Profitability has a central role in the company and is one of the determinants of the company's sustainability. High profitability reflects management's performance as well as an indication of their efficiency in using assets to generate revenue. Statistical results denote that profitability has no connection with the stock price. Which means that the high or low level of company profitability is not a determinant of investors in making investment decisions, so it does not affect stock price movements. Investors believe that management will always be committed to achieving company profitability, so it is not their main concern in making investment decisions. A high level of profitability does not guarantee that investors are interested in buying company shares, and vice versa. This study found not suitable with some of the previous research results that found a positive relationship between profitability and stock price (Darmaji, 2006; Murtiani 2016; Fatmawati, 2021; Saprudin, 2019; Dwi and Hidayat, 2019; Indahsafitri et al., 2018

The capital structure is a combination of debt and own capital that will be used by the company's management to finance assets. The capital structure decision has an important role because it will relate to the level of profit and possible losses that the company will face. Empirical study finding is capital structure has no effect on the stock price. This finding implies that Capital structure is not the main concern of investors in the capital market in making investment decisions. Investors believe that the use of debt in the company's capital structure will be properly regulated by the company's management to improve company performance and prevent the company from potential losses. Investors will always observe the development of the company's performance, but do not focus on the use of debt in the company's capital structure when making investment decisions. This finding not in line with the study performed by Chemutai, et. al., (2016; Zakiah (2020, Ramadhan (2016).

V. CONCLUSION

This paper aims to determine the internal factors, namely CEO tenure, profitability, and capital structure that affect the company's stock price and found the powerful variables that have a relationship with the firm stock price. This study is using automotive and components industry listed as unit analysis during 2013–2019. In the way to achieve study purpose, this research using a panel data regression model. The research finding point that CEO tenure has a positive relation with the stock price, meanwhile profitability and capital structure have no connection with the share price. This empirical finding describes that CEO tenure becomes the main focus of investors in making investment decisions. Investors believe that the new CEO has a better performance when compared to the CEO who has a long tenure in advancing the company and dares to face business challenges amid uncertain conditions. CEOs with long tenures are less positively responded to by the market because their performance tends to decline as the CEO tenure increases and they prefer to play it safe, so they are not compatible with the increasingly high business competition in an uncertain environment. Meanwhile profitability and capital structure not a concern of investors. Investors believe that the company's management will always try to increase the company's profitability following company goals and will regulate the use of debt in the company's capital structure for the company's sustainability in the future.

This study still has some limitations both in terms of the variables used, the research period, including the unit of analysis used. To improve the results of this study to contribute to the financial literature, it is recommended for further researchers to use more variables that have a strong relationship with stock prices, a longer research period to be more accurate, and more units of analysis, so that the results are better.

REFERENCES


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