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CEO Power and Stock Price: An Emperical Study of Indonesia Automotive and Components Listing Firms

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Abstract: *Relationhip between CEO power and stock price* is still an interesting issue in the literature of corporate finance. The purpose of this study is to indentifies the effect of CEO power on the firms stock pricing. *The study also interested to show factors that investors rely on to take their investment decisions in the automotive and components firms listed in the Indonesian capital market. This research using secondary data gathered from the official website of Indonesia Capital Market. In the way to fulfill the research objective, this study using a panel data analysis method in which the sample was taken from 12 firms by using a purposive sampling technique. The research finding was denoted that CEO power has strong effect on the firms stock price. Our finding important for the investor as information and consideration in making invstment decisions.*

Keywords*: CEO power, stock price, automotive and components industry, capital market.*

I. INTRODUCTION

Stocks are an interesting investment alternative for investors. Investors expect the shares purchased can be re-sell at a higher price in the future to get capital gain. A Stock price is one indicator of the success of company management. The Firm's ability in making a profit will provide attractiveness to the investors. The stock prices always change from time to time due to the demand and supply of shares in the capital market. When demand for the stocks is higher, then the stock price will move up, on the contrary, if the supply of stocks is higher and demand is low, then the stock price will move down (Muflih, 2012). The stock prices will change at every trading day that can be influenced by various factors, such as CEO Power, company performance, dividend policy, capital structure and etc., which is useful for the investors in analyzing whether the company's condition is good or not for investment activities (Andreou, Louca, and Petrou, 2016; Malhotra, 2013; Bahreini, Baghbani, & Bahreini, 2013).

The role of the CEO power in influencing company performance has been debated in the financial literature. The CEO has an important role in the firm with a unique background and knowledge that can influence various company policies (Serfling, 2014). Malekzadeh, et. al., 1998, mention that CEO power is a force that able to influence the Board decisions and form a strategy of the organization. CEO power indicates the ability of the CEO in influencing boards decision (Pathan, 2009). The quality and ability of the CEO to manage and increase the company's earnings will affect the company's stock price (Geertsema, Lont, & Lu, 2015). The investors can value a company is by knowing the company's CEO. CEO power by using CEO tenure shows that at the beginning of managing a company, the market tends to be uncertain about the capabilities of the CEO and the market will react more to the company's earnings reports because it reflects the CEO's ability to manage the firm (Ali & Zhang, 2015). During their beginning tenure, CEOs tend to learn faster and are willing to take risks that can improve firm's performance (Wu, et. al., 2005) and driving up the company's share price. The longer-term of CEO tenure, the CEO tends to commit to the outdated paradigm, play safe, not improve ability and less adapt to the external environment which can cause a decline in the company performance (Levinthal and March, 1993) and decrease the

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firm's stock price. Harper, Johnson, & Sun (2020), found that CEO tenure has positive effect on stock price crash risk. Henderson, et. al. (2006) mention that CEO tenure has negative effect on the firm performance then will push reduction of firm share price.

CEO power by using CEO age shows that preference level for risk and risk-taking behavior is influenced by the age of the CEO, but the result still mix. Young CEO tend to play safe due to lack of reputation as high quality managers (Zwiebel, 1995; Holmstrom, 1999). A different opinion was expressed by Prendergast and Stole (1996), mention that young CEOs tend to invest aggressively and take more risks. If the action taken by the young CEO fails, it will push the stock price to decrease. Andreou, Louca, and Petrou (2016), mention that companies managed by young CEOs are more likely to experience a share price decline. This research result support by Harper, Johnson, & Sun (2020), found that there is negative relationship between CEO age with share price crash risk, it's mean CEO age has positive effect on the share price. The objective of this study is to determine the effect of CEO power measured by CEO tenure and CEO age on stock prices and using capital structure as control variable. The use of CEO tenure and CEO age as CEO power measurement was adopted from the study conduct by Ali & Zhang, 2015; Andreou, Louca, and Petrou, 2016; Amedu & Dulewicz, 2018, Harper, Johnson, & Sun, 2020.

This research is different from other studies because it uses CEO power as measured by CEO tenure and CEO age which are still rarely studied in Indonesia, besides that, it also using the automotive and components industries that are still new studied. The results of this study are expected has contribute to the development of financial literature, especially related to the relationship between CEO power and stock prices.

II. HYPOTHESES DEVELOPMENT

CEO Power and Stock Price

CEO power has a relationship with stock prices. CEOs is a person who holds the highest position in the firm operational activities. CEO's power sourced from structural power, ownership power, expert power, and prestige power which are non-financial information that used by investor as information to assess the company's prospects in the future (Finkelstein, 1992). One of prominent issue in corporate governance is the power of CEO to affect board decision and design organization strategy (Malekzadeh, et. al., 1998). Larcker and Tayan (2012) in their research mention that positive or negative effect of powerful CEO on the organization is still unclear. A number of studies show that CEO power has a negative influence on organizational behavior, performance and market valuation. Bebchuk et al. (2011) perform research on the effect of CEO power on company behavior, performance and market valuation, and found that CEO power has a negative effect on the company's operational performance and market valuation (Saudi, 2018). This research finding indicate that the higher of CEO's power will lead more agency problems. Liu and Jiraporn (2010) mention that companies that have powerful CEOs tend to get low bond ratings that will affect investor interest in buying firms stock. Jiraporn et. al. (2012), mention that CEO power has negative effect on debt financing and firm performance. Powerful CEOs tend to propose less brave performance targets in their work contracts (Abernethy et. al., 2015). When the external business environment is more risky or unstable, powerful CEOs tend to have poor performance compared to other CEOs (Han et. al., 2016). Mamun et al. (2019), find the negative relationship between CEO power and stock price. All the previous studies indicate that powerful CEO will lead more agency problem, low firms performance and negative market valuation. There are quite a lot of CEO power indicators, but used in this research are CEO tenure and CEO age.

CEO Tenure and Stock Price

The relationship between the CEO tenure and the share price is very closely related to the ability and performance of the CEO in carrying out the company's operational activities. In the initial year of CEO appointed by the principal, the market is usually uncertain about the new CEO's ability, although promoted from within the firms (Gibbons and Murphy, 1992). New CEO in challenging conditions will lead to higher stock prices compared with CEOs that has longer tenure due to their

ability to solve problems in uncertain conditions by providing news about good company earnings (Geertsema, Lont, & Lu, 2015). If new CEOs produce bad income news, then share price will go down on average as result of new CEOs performance valuation (Geertsema, Lont, & Lu, 2015). Market perception on CEO ability is a valuable asset because it is closely related to the CEOs compensation in the future, including reappointment and freedom in managing firms operations (Hermalin and Weisbach, 1998). Incentives will make the new CEO work better at the beginning of his/her appointment compared to the period afterwards to produce better performance that can increase investor confidence, so that stock prices will be increase (Holmstrom, 1982). A number of research shows that negative relationship between CEO tenure with stock price (Geertsema, Lont, & Lu, 2015; Harper, Johnson, & Sun, 2020). Other study show that the company will perform good performance in the beginning of their jobs and the company's performance will decreases along with the CEO's tenure for the unstable computer industry. While for the stable food companies, the company's performance will increases along with the increase in CEOs tenure (Henderson, et. al., 2006).

Hypothesis 1: CEO tenure has a negative effect on the otomotive and components listing firms stock price

CEO Age and Stock Price

CEOs age related to CEOs ethical behavior refer to psychology literature. Someone will be more ethical and conservative as they age, older CEOs tend to involved in aggressive earnings management and hence related to the high quality financial reporting (Sundaram & Yermack, 2007). Hess et. al., 2005, mention that age differences in cognitive social functions and find evidence that older individuals are more likely to draw consistent conclusions than younger individuals. The use of output as an assessment for the ability and level of wages of workers has made superior performance affect the value of managers in the labor market and cause an increase in compensation in the future, this condition causes young CEOs try to show superior performance even by covering up the poor performance in the way to get high compensation that will they enjoy in the longer period (Gibbons & Murphy, 1992). Boschen et. al. (2003), show that young CEOs will be more sensitive to improve their performance achievement due to closely related to the increase in value of the manager's market, therefore excess performance has a positive relationship with the financial benefits of CEOs. Younger CEOs more costly compare to older CEOs (Gibbons & Murphy, 1992). Investors expect better firms performance that can increase investor trust about the company's future, therefore if investors hear bad news about the firm, then investors' expectations to the company will decrease which triggers a decline in the company's stock price (Jin & Myers, 2006; Callen & Fang, 2015). Research conduct by Andreou, Louca, and Petrou, 2016; Harper, Johnson, & Sun, 2020, found a positive relationship between CEO age and stock price.

Hypothesis 2: CEO age has a positive effect on the otomotive and components listing firms stock price

Capital Structure and Stock Price

Capital structure has strong relationship with stock price. Financial managers will try to use optimum debt in their capital structure to increaase the value of firm and firms stock price. Discussion about capital structure and firm value explain by Modigliani & Miller (1958, 1963) that mention there are relationship between firms financing decision with firm value, the use of debt in the company's capital structure can increase investor trust and the company will benefit from tax reduction. The use of high debt in the company capital structure will encourage management optimistic related to cash flow in the future, that can increase firms share prices. A number of research show that there is positive relationship between capital structure and firm stock price (Chemutai, et. al., 2016). Muthukumaran, 2012, found that capital structure has effect on the stock price.

Hypothesis 3: Capital Structure has a positive effect on the otomotive and components listing firms stock price

III. RESEARCH METHOD

This research type is applied research with a quantitative approach. The data used in this study is taken from the official website of the Indonesian capital market. The type of data used is secondary data sourced from IDX statistics, financial

statements and company annual reports. This research also uses additional information that is needed obtained from articles, journals, text books and so on. This research uses a combination of cross-section data with time-series data or also called panel data. In the way to achieve the research objectives, otomotive and components industries listed on the Indonesian capital market during the period 2013 - 2017 use as population with total 13 companies and selected as samples is 12 companies, which are met the sample criteria with purposive sampling techniques.

The variables used in this research consist of dependent variable (stock price) and the independent variables (CEO power: CEO tenure and CEO age), also control variabel (capital structure). All variables used in this research and its measurements can be seen in the following table 1:

Table 1. Research Variables, Symbol and Measurements

Research Variables	Symbol	Measurements
Variabel dependen		
Stock price	SP	*Closing stock price at end of December for the years studied*
Variabel Independen		
CEO tenure	CEOT	*The amount of years as CEO in the firm*
CEO age	CEOA	the age of CEO in a given year
Capital structure	CAPS	Long term debt/total equity

Source: Harper, Johnson, & Sun (2020); Andreou, Louca, and Petrou (2016); Mouamer (2011).

Panel data regression model used to answer the research hypotheses with the following regression equation:

$SP = a + \beta_1 CEOT + \beta_2 CEOA + \beta_3 CAPS + e$

where a is a constant, β1, β2, β3 are parameters, and SP, CEOT, CEOA, and CAPS are the dependent and independent variables used in this study and have been described in table 1 above.

Panel data regression testing begins with the classic assumption test which consists of multicollinearity test and heterokedasticity test. The aim is to ensure that the formed regression equation model has accuracy in estimation, unbiased and consistent. The next step is test the model which consists of the F test and the coefficient of determination test to find out whether the model formed is fixed and the independent variables used in this research are able to interpretation the changes in the dependent variable. The last test carried out was the hypothesis test (t test) to find out whether each independent variable used in this study had an effect or not on the dependent variable with an error rate of 5%.

IV. RESULT AND DISCUSSION

Research Results

Classical assumption test consist of multicollinearity and heterokadasticity test. Multicollinearity test results illustrate that there are no multicollinearity problems between independent variables or it can be said that all independent variables in the regression model of this study have been mutually independent because the value of Variance Inflation Factor (VIF) <10 (see table 2). Heterokedasticity test results by using Breusch Pagan Godfrey (BPG) showed that P-value obs * R-square of 0.1368 > 0.05, which means there is no heterokedasticity problem.

The results of the regression model test using the chow, hausman and langrange multiplier tests indicate that the random effect model is the most suitable for this study because it uses more cross section data than the time series data (Nachrowi and Usman, 2006). The panel data regression result can be seen in the following table 2:

Table 2. Panel Data Regression Test and Multicollinearity Test Results

Independen Variables	Regression Coefficient	Multicollinearity (VIF)
CEOT	-0.1003***	2.586

CEOA	0.0664***	2.463
CAPS	-0.9089	1.201
Adjusted R^2	0.1516	
F-statistic	4.5164	
Prob F-statistic	0.0066	

*** significant at 1%

Source: Financial statements, data processed

Statistical test results show that the regression model is fixed which is seen from the Prob F-statistic value <0.05, meaning that there is a linear relationship between the independent variables (CEOT, CEOA, and CAPS) with the dependent variable (SP). The coefficient of determination test explains that the ability of the independent variables in interpreting changes in the dependent variable is 15.16% (adjusted R^2), the remaining of 23.19% is explained by other variables not used in this study.

The results of the hypothesis test (t test) as seen in table 2 above illustrate that the CEOT has a negative effect and the CEOA has a positive effect on the stock price. Control variables, namely capital structure has no effect on the stock price of otomotive and components listed firms in the Indonesian capital market.

Discussion

CEO tenure describe the length of time someone has served as CEO in the firms. The longer-term of CEO tenure tend to lead CEO commit with the outdated paradigm, play safe, not improve ability and less adapt to the external environment which can push company performance going down. Different with the beginning tenure of CEOs that tend to learn faster and are willing to take risks to increase firm's performance. Hypothesis test results indicate that CEOT has a negative effect on the stock prices of the automotive and components industry listed on Indonesia capital market. This research result shows that CEOs will have better performance in the beginning year of their appointment as CEO that can increase investors trust and drive stock price. Longer tenure of CEO tend to play safe and has limitation in solving problem, especially in the unstable condition. Generally, CEO will work better in the beginning to get more compensation and their performance will decline along with their longer tenure, that push stock price going down.

The results of this study are consistent with the research conducted by (Geertsema, Lont, & Lu, 2015; Harper, Johnson, & Sun, 2020), mention that CEOT has a negative influence on the company's stock price.

The age of CEO has strong relationship with CEOs ethical behavior refer to psychology literature. Older CEOs tend to involved in aggressive earnings management, more consistent and has high loyalty. Young CEOs tend to play safe due to lack of reputation as high quality managers. Hypothesis testing results indicate that CEOA has a positive effect on the automotive and components firms stock price. This result show that older CEOs has better ability in running company operational activities compared to young CEOs. Young CEOs strive to achieve better performance in order to obtain financial benefits and and sometimes cover up poor performance to get their ambition. Investors expect better firms performance that can increase investor trust about the company's future, therefore if investors hear bad news about the firm, then investors' expectations to the company will decrease which triggers a decline in the company's stock price. This research result inline with research conduct by (Andreou, Louca, and Petrou, 2016; Harper, Johnson, & Sun, 2020) found that CEOA has a positive effect on the firms stock price.

Capital structure as control variable show that there is no relationship with firms stock price. This condition illustrates that investors do not consider capital structure as one of impotant information in making investment decisions. Investor trust that company will always set the optimal capital structure in order to improve company performance. This research result not in line with study conduct by (Chemutai, et. al., 2016; Muthukumaran, 2012).

V. CONCLUSION

The purpose of this study was to determine the effect of CEO power as measured by CEO tenure and CEO age on the automotive and components firms listed in the Indonesian capital market stocks prices by making capital structure as control variable. The research results describe that CEO tenure variable has a negative influence on the company's stock price and CEO age has a positive relationship with the company's stock price. Control variable used in this study is capital structure that has no effect on the company's stock price. This condition illustrates that CEO power has a very strong relationship with share prices in automotive and components firms listed in the Indonesian capital market. While capital structure as a control variable has not yet come to the attention of investors in making investment decisions. CEO power indicates the CEO's ability to improve company's performance with a unique background and knowledge that can influence various company policies.

This research still has a number of limitations that might have an impact on the research results. First, this research only using the automotive and components firms listed in the Indonesian capital market with a limited number of samples during the 2013-2017 period. Second, this study still use limited independent variables. Therefore suggest to the other researchers to use a wider sample and more independent variables in accordance with the theory and previous research.

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