CHAPTER 1
INTRODUCTION

For the preparation of bonus demographic phenomena in Gold Indonesia 2045, the Indonesian government has a big concern in raising foreign investment to support national development. National development today become important to generate future employment so that in 2045, Indonesia can maximize economic development by pushing the amount of unemployment. To elucidate the commitment of investing supports, the government issues Work Creation Law (UU Cipta Kerja) to convince the investor with easier permission of the business. Investment ministry or BKPM (2020) declared that after the issuance of the regulation, about eight hundred thousand Indonesian workers in the investment project had been created. As seen in Figure 1.1 (appendix 1), the World Bank and BKPM record that Indonesia has had a positive growth of Foreign Direct Investment to the industries in the last five years. The graphic elucidates that Indonesia’s firms got huge funds supported by foreigners. This condition will be influenced by several factors, such as macroeconomic, politics, security, diplomatic relationship, etc.

As the investment provide valuable opportunity to the company, discretion in providing investment decision is crucial. In a company level, Investment decision is categorized as one of management strategic decision. Investment decisions are part of the company's financial strategy that must be considered comprehensively because it affects the company's operations in the long term (Hayes, 2021). Investment in capital expenditure will motivate the company to propose a bank loan or issue debt bonds to fund the procurement of the new fixed assets. Furthermore, the company have to consider the current and future cash flows for the acquisition and its debt interest, the company should look at the regulation related to the asset procured, including future financial regulation and macroeconomic policy (Julio & Yook, 2012).

In accordance with agency theory, the CEO and the other management members act as representatives or agents that were set by the stockholders or investors (Ross, 1973). International Finance Corporation (2018) guides that as a part of the board of directors, the CEO is elected in the general meeting shareholder after being nominated by the board of commissioners. In nominating the board of directors' member, the board of commissioners will follow the qualification set by the regulation, corporate governance guidance, and corporate nature. Maintaining good corporate governance may support the avoidance of critical agency problems because qualified executives are affiliated with better firm performance, investment efficiency and environmental financial disclosure (Bhutta et al., 2021) (Gan, 2019) (J. Chen & Chen, 2020).

Because of the importance of CEOs roles, prior research specified that there are some manager features that affect to firm's economic outcomes, finance, accounting, and management and positively contributes to researches and practices such as ability, talent, reputation, power, expertise, or managing style (Bertrand & Schoar, 2003) (Demerjian et al., 2012) (Hamidlal & Harymawan, 2021). In their study, Demerjian et al. (2012) quantify the qualification of managerial ability using the measurement of firm efficiency and managerial ability score. The total firm efficiency is measured using a modified model of data envelopment analysis (DEA) and the managerial ability score is quantified from the residual of firm efficiency Demerjian model estimation.

DEA is a statistical tool for assessing the relative efficiency of separable entities. It uses decision-making inputs (DMUs) as a converter in the input-output process within a company (Banker et al., 1984). In the last decades, DEA is already used in various disciplines (Demerjian et al., 2012). DEA is used to measure the efficiency of several firm's factors such as marketing efficiency, the relative efficiency of insurance companies, etc. Those factors are attributed to the development of DEA as an alternative to total firm efficiency score measurement that indicates the quality of management. Prior researchers are using DEA because they can have two key advantages, such as (1) ability to get ordinal ranking of relative efficiency compared to the more conventional model of estimation, and (2) the avoidance of using an explicit set of ratios that can support getting more focus and comprehensive value of efficiency.

Prior research justified that CEO managerial ability contributes to better forecasting of earnings that help them consider strategic decisions under the possibility of future economic changes (Trueman, 1986). In our focus, the CEO managerial predicted to be able to make a more reasonable investment decision, especially in facing the uncertainty environment. Corporate investment decision will affect the long-term company cashflow (CFI, n.d.). In addition, investment in capital expenditure gives the company greater future earnings projection.

Conversely, managerial ability is not always providing an advantageous impact on the company. Doukas & Zhang (2020) found that CEOs with better managerial ability is probable to use their competencies to smooth companies' earnings. CEOs become more opportunistic and provide lower earnings quality because they want to preserve their reputation. Lower earnings quality affects on management relationship with shareholders and increase the agency costs. The increase in costs will deduct the company's income and lower the shareholder's wealth.

In this research, the author adds political election as a moderating variable that influences the relationship between CEO managerial ability and investment decision. This variable is chosen because, under the political election period, firms are entering environmental uncertainty. When the election is held, firms will be difficult to predict the new governmental policy that will be taken by the new government structure. The new government structure will be fulfilled based on the result of the election. The issue resulting from the new structure of government is the uncertainty of political movements that influence governmental policymaking. The irresolution about the new policies and regulations that will be made by the new, in place, government structure is defined as political uncertainty (Baker et al., 2016).

On the other side, one of the biggest questions in the business field, especially management study, is about how firms face the circumstance in which they hard to predict future events influencing the firm's performance (Amore & Corina, 2021). In this environmental uncertainty condition, the company become harder to gather relevant information that should be considered when they want to make decisions, especially for those strategic ones.

Previous research justifies that during an election, companies are inclined to reduce corporate investment significantly under the political uncertainty circumstance (Amore & Corina, 2021). Based on Harvey's (2017) research, a company should be able to manage political risk because their study found that it can significantly impact the lower foreign investment into the firms. There are objectives measures of political risk used by prior research, such as 1) electoral uncertainty, 2) conflict risks, 3) social unrest, 4) corruption, 5) political Instability, 6) quality of the institutions in the host country, 7) sovereign debt default risk, and 8) market imperfections.

In figure 1.2 (appendix 1), data from The World Bank elucidates that there are falls and flat on government net investment excluding financial assets growth. We can see that during the political election in the years 2004, 2009, and 2014, the graphic elucidates a fall or flat trend of capital expenditures. In 2024, the investment fell from 68 trillion in 2003 to 60 trillion. In 2009, the trend became flatter because the rise is not so significant. During 2014, investment in nonfinancial assets fell again to 154 trillion from about 180 trillion in the previous year. In a governmental context, we can conclude that investment in nonfinancial assets is not a focus of expenditure during the political election year. Indeed, we cannot say that the case in governmental investment will be the same as what happened in the firm-level investment trend during the election.

The author argues that the use of political elections is important because as businesses still operate in a democratic country, Indonesia’s firms will never be able to avoid the risk of an uncertain environment. Risk management studies formulate four (4) types of risks treatment: risk avoidance, risk mitigation, risk acceptance, and risk transfer (Frame, 2003). As political uncertainty is unavoidable, stockholders and stakeholders must maintain proper risk acceptance and focus overcome the negative effect of the risk. One of the alternative solutions that the author suggest is maintaining a CEO with high managerial ability.

From the statements above, the author would like to figure out the implication of CEO managerial ability and corporate investment decision. Moreover, the author is interested to examine the moderating role of political election towards CEO managerial ability and corporate investment decision relationship. In this research, CEO managerial ability will serve as the independent variable, while corporate investment decision tends as the dependent variable. In addition, the political election will serve as moderating variable. The unit of analysis is the listed companies in IDX from 2011 to 2020. This research has two key objectives. First, understanding whether CEO managerial ability has a positive relationship with corporate investment decisions. Second, understanding whether political elections provide a negative effect on the relationship of CEO managerial ability towards corporate investment decision.

This research provides a contribution to the existing literature in some ways. There are studies that found a positive relationship between CEO managerial ability and corporate investment decisions. Even though, there is still no previous study that tests the moderating influence of political election towards CEO managerial ability and investment decisions relationship. From the result of the study, the thesis reader will have another view about the consideration of CEO managerial ability and the effect of political elections. This study will be useful for academicians, investors, and stakeholders in different ways. It will complement the current study related to CEO managerial ability, support future related research, and provide additional consideration of CEO election and strategic investment decision.