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Could the Manager Create The Value?

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Abstract

The manager occupies a central place in the modern financial theory. However, these last characteristics evolved simultaneously with the emergence of new economic theories aiming at explaining the operation of the firm. The value creation passes by the implication of all the levels since those which define the strategy until those which, by their daily action, build or erode the return and the turnover of capital. The value creating manager will be able to insufflate in his organization and at the level of the individuals the reflexes bringing to this creation, while installing the measurement tools checking the progression of the value creation. In this article, we, initially, presented the various theories which study the place of the manager in the firm such his role in the creation of the shareholder value. Secondly, we carried out an empirical validation made on the French firms listed forming the CAC 40 index. Our results conclude the significant impact on the value created by the firm of the analysis criteria of the manager participation in the process of value creation: the size of the firm measured by the logarithm of the total assets (LTA) and the dual position of the manager (DUAL).

Keywords: Manager, Value Creation, Signal Theory, Agency Theory, Entrenchment Theory.

Introduction

The manager is a person acting as a mandatory, i.e. carrying out actions in the name of another person. Here, the mandator is no one other than the group of the shareholders, the owners of the firm capital. Owing to this relation mandator/mandatory, the manager is supposed to take decisions true to the interest of the mandator. This difficulty of control and supervision of the managerial discretion carried out by the shareholders and their representatives proves, nowadays, to be difficult, and makes reappear the agency theory and its derivatives.

One of the derivatives of the agency theory is the entrenchment theory. This latter reconsiders the need for installation of structures of approached control in the theory of the agency to measure all the limits and, in particular, that inherent in the risk of manager entrenchment. Thus, the theory of the entrenchment highlighted the strategies implemented by the managers to reinforce their power and, thus, to increase the cost of their replacement. This theory raises the question of the strategies interest of the entrenchment of the managers for the shareholders. Besides to these two theories, we find also the signal theory which makes it

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possible to apprehend the evaluation of the firm under a new angle thanks to the managers who are better informed that whoever on the potentialities and the future prospects of their firms, the firms can make share to the whole of the financial community of their anticipations on their becoming by the emission of the signals. Which signals make it possible to the investors to correct their anticipations and to evaluate the shares of the firms significantly. Therefore, The signaling by financial variables allows to reduce informational asymmetry on the financial markets.The rest of this paper is organized as follows. Section 1 provides a review of the existing literature where we present the signal theory, the agency theory and the entrenchment theory. Section 2 details methodology where we describes model, data and sample. We present our results in section3. Section 4 concludes the paper.

I- THEORETICAL FRAMEWORK

A- The signal theory:

The signal theory which is based on the idea that, contrary to the assumptions retained within the framework of the efficiency of the markets, information does not circulate perfectly and without cost. This latter is asymmetrical because the managers of the firms have necessarily the information privileged on the market of the firm which they manage. The financial variables handled by the managers to report the real value of their firm can be of different nature.

There are several models of indication of the real quality of the firms.

a- The signaling by the importance of capital held by the manager:

Leland and Pyle (1977)[2] estimate that the firms (manager-shareholders) can signal the good quality of their investment projects while taking a significant part in the capital. Accordingly, these authors advance the idea that the managers are the only ones whose know which is the true value of the projects which they undertake. Thus, they will seek to make known some quality at the market so that the contributors of capital agree to be implied in the operation.

➧ Fraction of the capital held by the managers ↗ ➧ more the value of the project ↗ ➧ expected return of the firm↗.

b- The indication by the choice of a debt policy:

For Ross (1977)[3], the financial structure of the firm can be a variable of signaling, on condition that we adopt a system of incentive and penalties leading to a balance. This system should be as the managers are encouraged to deliver good information. They must be penalized when they seek to emit a false signal, i.e. when they emit a signal tending to the belief that the firm they manage is good whereas it is bad. On the other hand, if they say the truth, they must be rewarded. Thus, the managers communicate the characteristics of their firm by the means of the firm structure.

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[2]- Myers et Majluf (1984), « Corporate financing and investment décisions when firms have informations that investors do not have », Journal of Financial Economic, vol. 13, 1984
[3]- Barnea, A. , Haugen, R. A. and Senbet, L. W. (1980), “ A rationale for debt maturity structure and call provisions in the agency theoric framework”, The Journal of Finance, Vol. 37, December 1980.

➧ More the level of debt ↗ ➧ more the value of the firm↗.

c- The indication by the policy of the dividends:

In 1961, Miller and Modigliani launched the controversy on the role played by the policy of the dividends, by affirming that in absence of a difference between the tax rates of the dividends and the capital gain, this latter had no effect on the value of the firm. Consequently, there was no need to worry about it: the level of the dividends was only one by-product of the decisions taken for investment and debt. The served dividend is an increasing function of the forced-sale value of the firm and the needs for liquidity of the shareholders.

B- The agency theory:

The article of Jensen and Meckling (1976)[4], providing the foundations of the application of the agency theory in finance, brought a new vision of the firm. This one is only a node of contracts between many stakeholders who are the shareholders, the lenders, the managers, the workers like all the other external partners. In theory, all share the same objective: the survival of the firm. But, it can happen that conflicts occur. According to Charreaux (1987)[5], the developments produced on this question based on the managerial theory of the firm which rejects the classic model where the entrepreneur, who is at the same time owner and manager, seeks the maximization of these profits, systematically. The conflict between managers and shareholders, drifting of the separation of the ownership and the control of the firm, is explained by the fact that the first are the mandatory of the seconds. We can primarily raise two sources of conflicts. The first arises from the fact that the managers insufficiently controlled by the shareholders who are less presented, seek to grant various advantages to the detriment of the owners. In this context, Jensen and Meckling (1976) show that to maximize its function of utility, the shareholder - manager is brought to benefit from his situation privileged within the firm by granting additional incomes in pecuniary form (on wages…) or not pecuniary (advantages of all kinds at work…). The second source of conflict comes owing to the fact that the managers, risk averse, are not naturally inclined to make decisions which would lead to increase the variability of the cash-flows, therefore, the risk of the firm. To resolve this conflict, we can retain three great ideas. The first is that of the installation of an incentive system. To encourage the managers to act best to the interest of the shareholders, it is necessary that they have their own interest to that the market value of the firm increases. It is such an incentive system that Rappaport (1990) proposes when he suggests binding the wages of the managers to the increase in the cash-flow and the value of the firm, rather than with to the traditional accounting criteria. However, nevertheless the installation of an incentive system, the market of the goods and services, the market of job and the financial market constitute mechanisms which force the managers to take care of the interests of the shareholders. Thus, Manne (1965)[6] explains that a bad management is reflected on the value of the actions of the firm and, then, the management team runs the risk to be replaced after an investor took the control of their firm. Fama (1980)[7] insists on the role of the job market where the managers are evaluated on the basis as of performances which they carry

[4]- Jensen et Meckling (1976), « Theory of the Firms Managerial Behavior, Agency Costs and Ownership Structure », Journal of Financial Economics, vol.3, octobre 1976.
[5]- Charreaux, G. (1987), « La théorie positive de l'agence : une synthèse de la littérature », in Charreaux et al, Economica, De nouvelles théories pour gérer l'entreprise.
[6]- Shleifer, A and Vishny, R. W (1996), " A survey of corporate finance", NBER Working paper 5554, April 1996.
[7]- Fama, E. and Jensen, M., (1983), " Separation of ownership and control", www.ssrn.com.

out in charge of the firms they manage. Hart (1983)[8] underlines that the competing character of the markets of the goods and services constrained the managers of being competitive to avoid the disappearance of their firm and the loss of their job. The second idea to be retained is more original: it is based on the increase in debt. Jensen and Meckling (1976)[9] suggest that more the firm has an important level of debt, more its risk of bankruptcy is tall and thus, more the managers are threatened to lose their job and the privileges which are attached there. That would be then a sufficient reason to encourage them to have a rigorous management, tending towards the maximization of the value of the firm. But, we can think that because of their aversion for the risk, the managers are not inclined to increase the debt. However in the absence of a sufficient level of debt, the market will suppose that the objective of the managers is not the search for a maximum value of the firm. Thus, the share price will decrease and the managers will lose there if, however, an incentive system is dependant there. On the contrary, if the market considers the level of debt as being sufficient to make weigh a risk of bankruptcy, he will interpret this threat as the sign which the firm is correctly managed and will take account in the valorization of the actions. Lastly, the third idea to be retained is that of the incidence of the distribution policy of the dividends. Easterbrook (1984)[10] suggests that a ratio of high distribution of dividends forces the managers to resort more frequently to the capital growths subjugating them, thus, regularly to the sanction of the market. Indeed, the recourse to the financial market constitutes an effective means to control the activities of the managers. During a shares emission, the managers have to report the last performances of the firm and justify the use which will be made from the funds of the investors.

C- The entrenchment theory:

The manager, as an agent, tries to be better entrenched to reduce the risk of being dismissed by making it more difficult and more expensive for the shareholders. This entrenchment presupposes that the tools of the manager control and incentive are not perfectly effective within the firm, and also that the manager is an opportunist potential. First of all, it is advisable to approach the process of entrenchment, i.e. the strategies implemented by the manager to be necessary. Since the power of nomination and revocation of the executive directors lies, in priority on the administrators, and through them, on the shareholders, the process of entrenchment can be defined as the process which allows the manager to be freed from the supervision of its board of trustees, even of his shareholders. For the manager himself, the entrenchment corresponds to the concern of preserving his position, of increasing his liberty of action and/or of increasing his additional remuneration and its advantages[11].

For the shareholders, the entrenchment is perceived:

- Whether as prejudicial when it involves costs of obtaining information higher than necessary or when it leads to non optimal investments (underinvestment or over-investment)

[8]- Hart, O.D., (1983), " The market mechanism as an incentive scheme", Bell Journal of Economics, Autumn

[9]- Jensen et Meckling (1976), « Theory of the Firms Managerial Behavior, Agency Costs and Ownership Structure », Journal of Financial Economics, vol.3, octobre 1976

[10]- Easterbrook, F.H., (1984), " Two agency cost explanations of dividends", American Economic Review, 74

[11]- Charreaux, G., (1996), « Pour une véritable théorie de la latitude managériale du gouvernement d'entreprise », Revue Française de Gestion, Nov/Dec, n°111, p.50-64

- Whether as beneficial when it translates the contribution with the firm of vital relational networks to ensure its development or even quite simply its survival.

In this level, the question issued is the following: is the entrenchment only one process, or is it also an outcome, a quasi-total enfranchisement of the internal mechanisms of control?

We should observe two contrary phenomena:

- While seeking to constitute relational networks, the manager increases his share capital. The firm profits from it through, either of better commercial performances, or a better social climate and a greater productivity of the personnel, or even a better coordination as well interns as external.

- As his entrenchment, the manager by freeing himself from the mechanisms of internal control and his incentive to increase the performance of his firm will fall with the profit of other objectives such as those to increase his personal satisfactions.

Therefore, we can estimate that the impact of the process of the entrenchment east can be, meanwhile, favorable and unfavorable to the interests of the shareholders. It would not be favorable in any way for the firm to reduce too much managerial discretion, and not to tolerate an under-performance. Following to the presentation of this theory, we could ask the question to know if the shareholders are conscious of the managers' behavior, and why they do not support a faster rotation of their managers to avoid the fatal consequences of this process of entrenchment.

Three principal explanations can be advanced:

- The managers' processes of control work defectively (cross participations)

- There exist high costs of revocation (loss of the relational networks)

- The administrators and the shareholders do not have relevant information at the appropriate time to appreciate the opportunity the manager change..

II. THE METHODOLOGY

The objective of our study is to test empirically the role of the manager in the process of value creation.

A- Model and data description:

To achieve this goal, we will test the following linear regression:

$$Q_{Tobini} = a_0 + a_1 LTA_i + a_2 Var\ CA_i + a_3 TXEND_i + a_4 Age_i + a_5 DUAL_i + a_6 ADMEXT_i + \varepsilon_i$$

With;

Q_{Tobini}: The Tobin Q ratio, it is one of measurements of the value creation of the firm. It is measured as the ratio of firm market value to firm book value.

Market value = market value of outstanding common equity + book value of long term debt.

The tobin'Q is the variable to be explained. For other variables, following the example of the classification made in our basic article[12], we can divide them into explanatory variables and variables of control. For the explanatory variables, they are four.

* TXEND = financial Debts / shareholder equity;

* Age: measure the manager's age;

* DUAL: it is a dummy variable, that takes the value 1 if the manager of the firm is at once a Chief Executive Officer and a chairman of the board, and 0 otherwise;

*ADMEXT: measure the percentage of the independent external administrators within the board directors. The Independence is examined according to the criteria of the button report.

For the variables of control, they are among two

* VarCA: Variation of the turnover = $(CA_{it} - CA_{it-1})/CA_{it-1}$.This variable measures the growth of the firm.

* LTA: Decimal log of the total assets. This variable measures the size of the firm.

B- The Sample:

The sample of our study is constituted by all the firms composing the CAC40 index, is managers' sample of firms quoted in the Paris Stock Exchange. In our sample, we drew aside the firms belonging to the financial sector for several considerations. At first, the majority of the empirical studies testing the contribution of the manager in the value creation of the firm carries out their investigations on industrial or commercial firms, or of service. Therefore, our choice was done for reasons of comparison. Further, the financial institutions represent different characteristics, from which we wanted to have a homogeneous sample. Moreover, the financial statements of the firms belonging to the financial sector have particular specifications. So, after having drawn aside from our basic sample, the financial institutions and the firms of which the data are non-existent or incomplete, we obtained a final sample of 30 firms. The data are available on the site: www.ernstrade.com.

[12]- « Comment analyser la contribution du dirigeant à la création de valeur ? Une analyse empirique sur le marché français », www.google.com

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III- RESULTS

Table 1: Linear regressions of the value creation

VARIABLES	COEFFICIENTS	T for H_0 Parameter = 0	Prob > ∣ T ∣
Constant	-1.921 (1.811)	-1.061	0,301
LTA	0.337 (0.179)	1.88*	0,074
VarCA	2.56E-02 (0.021)	1.205	0,242
TXEND	-0.186 (0.185)	-1.005	0,326
Age	-6.88E-03 (0.012)	-0.554	0,585
DUAL	0.364 (0.188)	1.939*	0.066
ADMEXT	-4.32E-03 (0.005)	-0.839	0.411
DW	1.447	-	-
R^2	34.20%	-	-
R^2adjusted	15.40%	-	-

* Significant at the 10% level. The figures in parentheses are the standard errors.

The analysis of this model enables us to release the following remarks:

- The size of the firm measured by LTA is a significant variable. It has an important and positive effect on the process of value creation. In other words, more the firm is large, more the contribution of the manager on the value creation is important, this is explained by the fact that when the firm is large, the remuneration of the manager, normally, is raised, from which this last is financially motivated to make his best to improve the financial position of his firm in order to increase its stock on the market. Thus, to create shareholder value and thereafter to improve its remuneration.
- The growth of the activity measured by VarCA, has no influence. Hence, the adoption by the manager of a strategy increasing the turnover is similar to the adoption of a strategy involving its reduction. Thus we cannot conclude on the role of the manager in the improvement of the value of the firm starting from the examination of the activity growth.
- The policy of debt adopted by the manager measured by variable TXEND has a negative relationship with the creation of value although it hasn't a significant influence.

According to the signal theory, the manager can emit a signal via the choice of a debt policy.

According to Ross (1977)[13], the financial structure of the firm can be a variable of indication. thus, the managers communicate the characteristics of their firm by the means of this structure. By saying the truth, the signal will be well perceived by the market. Thus, the creditors believe in the quality of the firm. By imagining such a system, Ross (1977) shows that the value of the firm increases with the value of the debt.

- There is no significant relation between the age (Age) of the manager and the value creation. Although the effect of this variable is not significant but it is negative. Hence, we can raise the following remark: more the manager is old less he is anxious to create the value. This idea matches the entrenchment theory which supposes that a manager near to the retirement does not seek to be entrenched anymore and thereafter he seeks no more to maintain the specific investment which can have a positive effect on the value of the firm.
- The DUAL variable has a significant and positive effect on the process of value creation. This develops the dual position of the manager, which is in conformity with Stewardship Theory[14] which stipulates that the corporate government must install mechanisms not of control but of knowing how the organization will help the manager to exert his power and its responsibilities.
- The percentage of the independent administrators within the board of directors hasn't any significant impact on the value creation of the firm.

IV- Conclusion

In the limits relative to the model that we have already developed, it turned out that a link can be established between the manager and the value creation. LTA and DUAL is the principal variables which validated empirically the idea under tending the contribution of the manager to the shareholder value creation. From the methodological point of view, the size of our sample and its nature enforces us to be careful on a possible generalization of the results to other types of firms. Our study could have been richer if we integrated other variables such as the experience of the manager in a similar position, his academic formation, the fact that he is of internal or external origin and if we widened the sample.

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