

UDC 33

DOI: 10.34670/AR.2020.94.4.003

Agency problems and transfer along life cycle for Russian enterprises

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Abstract

Research on corporate characteristics and the ownership structure is relevant due to the need for improving corporate governance and reducing the possibility of corporate conflicts. The article points out an increase in the protection of shareholders in Russia, which attracts potential investors. The features of agency relations, behavioural factors are significant generators in the development of corporate strategies. To stimulate the development of an enterprise, it is necessary to solve the priority internal corporate tasks, increase the convergence of interests, and take into account the quality characteristics when developing strategies. It is reasonable to use a complex approach to choose capital sources on the basis of the analysed constraints – financial, institutional and agency factors. To investigate a set of factors that are usually not taken into account in the traditional agency model, it is necessary to use the complex of indicators for different stages of an organisation's life cycle. The approach to modelling a company's development as a dynamic system is explored on this basis. Empirical research focuses on an enterprise's transition along the life cycle curve. The author builds logit-regression models on the basis of Russian panel data and creates the life stage matrix illustrating an enterprise's transition to a new stage of the life cycle due to risk and growth dynamics. Thus, the article deals with crucial indicators influencing a company's transition along the life cycle curve.

For citation

Krasil'nikova E.V. (2020) Agency problems and transfer along life cycle for Russian enterprises. *Ekonomika: vchera, segodnya, zavtra* [Economics: Yesterday, Today and Tomorrow], 10 (3A), pp. 25-32. DOI: 10.34670/AR.2020.94.4.003

Keywords

Agency relations, ownership concentration, managers, source of capital, life cycle, growth.

Introduction

The control over enterprise is usually separated from the ownership. The owners transfer a part of their functions to managers. And managers operate firm assets as they want. They can use firm resources according to their own ideas [Berle, Means, 1932]. A manager's activity is difficult to supervise; owners can't check the quality and optimality of their decisions. Managers and owners-shareholders pursue the opposite targets. Owners focus on the increase in dividends and growth of the enterprise value. Managers inspire to accelerate current cash flows, which they can directly operate, the wages and bonuses. Such activity may decrease a firm's efficiency. Thus, agency theory explores agent – principal relations, where an agent is a manager, and a principal is an owner. The solution of the problems with opportunistic behaviour was associated with an increase in the interest of management, the convergence of its interests with the owners. This is achieved by endowing a company's stocks. But it leads to another problem with management entrenchment [Morck, Shleifer, Vishny, 1988].

Traditionally high ownership concentration is determined as a deteriorate factor that undermines activity. Moreover, large owners can discriminate minority shareholders. For example, there is an empirically confirmed positive effect of a low concentration of ownership at the growth stage, but after a critical value of over 50% it reduces the performance indicators, Q-Tobin [Stepanova A.N., Balkina E.A. (2013)].

The main part

Although for Russian enterprises high ownership concentration has been the defense from unstable institutional environment, the presence of long run motivated owner to improve agency relations, mitigate agency problems. Eventually ownership structure is an advantage of corporate performance.

According to the World Bank Doing Business study in 2020, the Russian Federation has strengthened the protection of minority investors by increasing shareholder rights and their role in key corporate decisions [Ease..., www]. An increase in shareholder protection in Russia has been established. However, the responsibility of managers and directors remains low.

Variability of preferences and interests of the large lenders was found as elements and as a part of corporate relations, influences the development of an enterprise. Different empirical results relate to the non-equal samples and data, environment. In advanced capital markets, ownership concentration reflects potential problems and in emerging ones – protection.

General patterns and specific characteristics of Russian corporate relations and differences between the economic agents interests and the impact of these differences on the strategy and the effectiveness of financial and economic activity were identified on the basis of the results of the research on national and global trends in corporate governance and the development of enterprises.

Focused on Russian and foreign models of the ownership structure impact on the development of enterprises, also based on the results of empirical analysis of the project of the features of corporate relations in the non-stationary economy, I see the significant influence of agency factors and the interactions of the key actors of innovation activity in the investment and innovation strategy enterprises and the results of financial and economic activity. The essential role of these factors in the formation of internal innovation environment significantly affects activation of innovative processes at the macro and micro level, especially in terms of external risks, internal instability, imperfect market and regulatory environment.

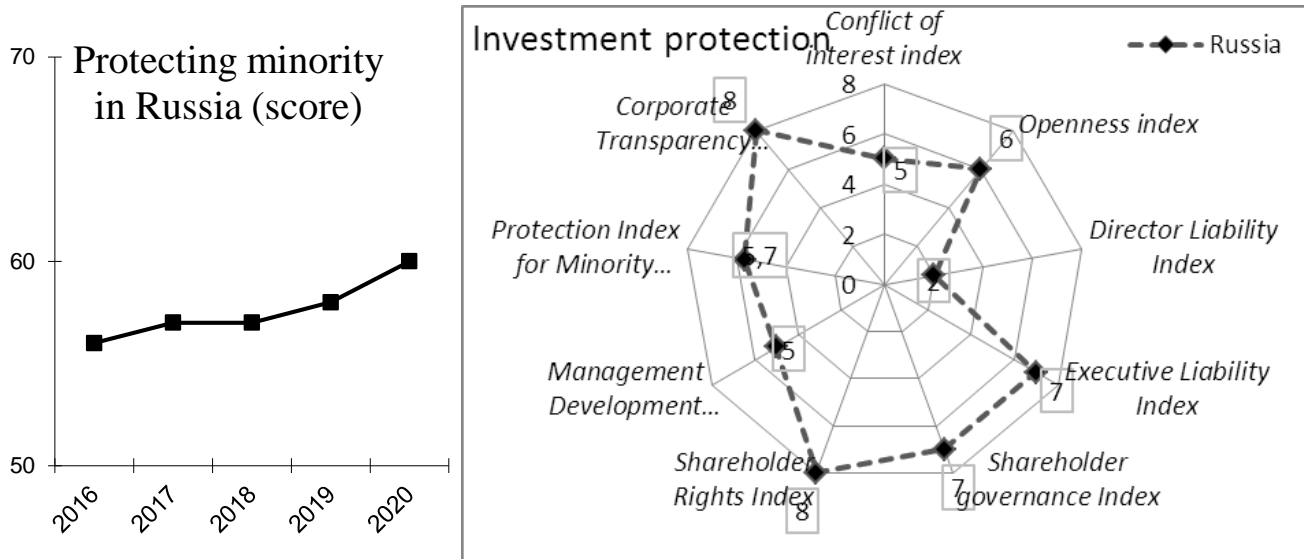


Figure 1 - Agency protection¹

To investigate a set of factors that are usually not taken into account in the traditional agency model, it is necessary to use the complex of indicators for different stages of an organisation’s life cycle, which reflects the preferences of stakeholders and characterises an organisation’s performance for different economic agents. The approach to modelling a company's development as a dynamic system is explored on this basis.

H1: A decreased interest and involvement in an enterprise lead to the emergence of agency conflicts, slowing the pace of development. It is established that the account of behavioural characteristics helps to reduce the asymmetry of information between participants in economic activity, is reflected in the adoption of weighted investment and strategic decisions. The influence and characteristics of decision-makers and managers have been studied, and empirical validations have been carried out. Concentration of Russian enterprises can be viewed as a forced measure of the protection of owners in an unstable environment.

H2: The features of agency relations, behavioural factors are significant generators in the development of corporate strategies. To stimulate the development of an enterprise, it is necessary to solve the priority internal corporate tasks, increase the convergence of interests, and take into account the quality characteristics when developing strategies.

Agency conflicts decrease when ownership rises in Russian enterprises. But there is a variance level of ownership, when agency conflicts strengthen.

The analysis of an enterprise’s activity and the study of economic performance often lead to not exact, sometimes contradictory results. One of the reasons for such discrepancies is determined by the difference in the activity and strategies for companies with significant distinguishing in corporate and internal relations. Other things being equal, internal, corporate relations are significant factors influencing the development of strategies, decisions, and challenge to growth.

A real example was used to identify the key development targets of large domestic private, foreign and institutional owners. It is shown that in the scenario, development is a convergence of interests of

¹ According to the World Bank Doing Business.

minority and major shareholders, and opposed to institutional shareholders objectives. A strongly interested owner is one of the key factors for Russian companies. A reduced interest in the activities of a company leads to the appearance of agency conflicts, slow down the rate of development. Short-term and long-term motives and their reflection in the preferences of the owners were studied in the context of the ownership structure of the dynamics of a national enterprise, operating in the Russian retail industry. Revealed preferences and interests of participants of corporate relations help to identify and characterise the dynamics of the preferences of a large owner-founder of a company. Agency relations are explored not only in the principal – agent concept, but also in the study of internal connections at each stage, highlighting the nature of corporate relations, the role of stakeholders at the micro and meso level. I identify and characterise positive trends in agency relations for domestic companies associated with an increase in the protection of shareholders, the improvement of Russia's place in country comparison.

Corporate behaviour and preferences have an effect on developed strategies, like the priority source of capital. Raising capital is a necessary condition for sustainable growth. Sources of capital structure depend on the life cycle stages, which helps to reduce the costs of financial instability in the context of strategy formation. The cost of capital is determined by the required rate of return, risk premium that takes into account company-specific risk. It has been explored that the risk rate is connected with a company's size, sector of activity; and the risk premium of raising capital varies during different life cycles of an organisation.

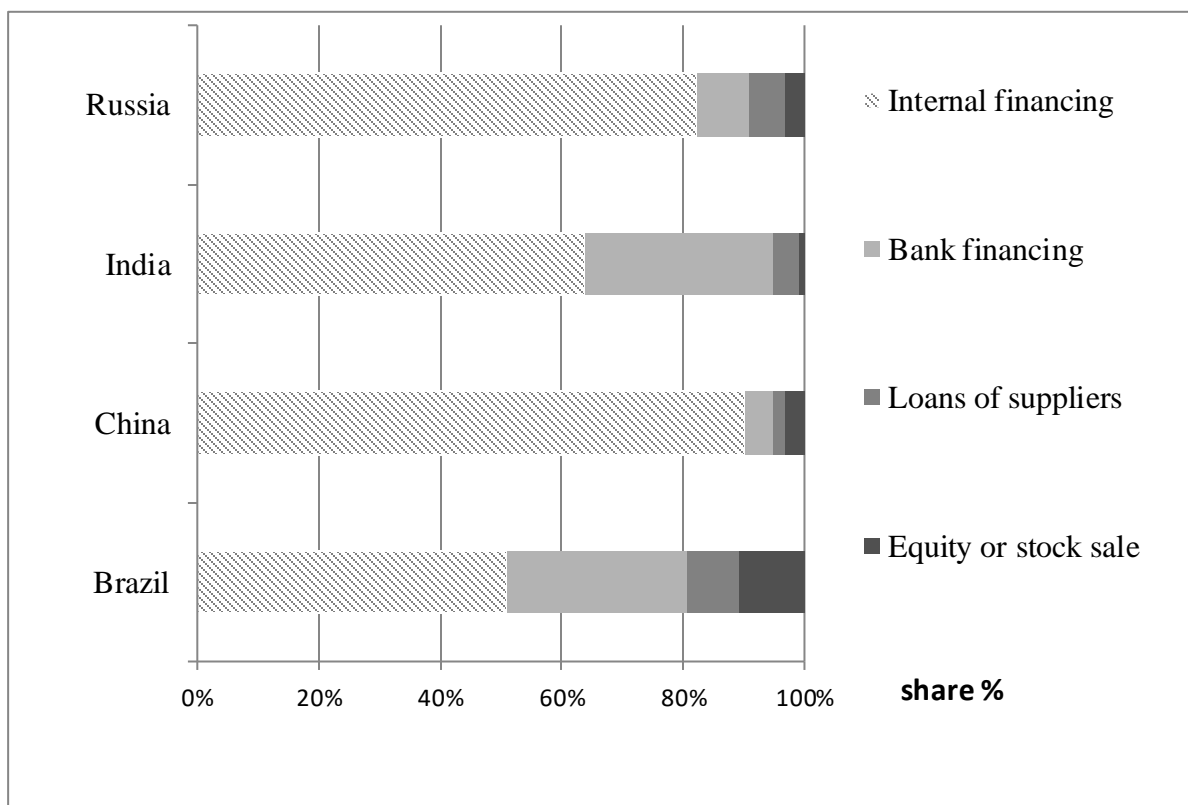


Figure 2 - Sources of financing investments in 2012-2019 for SMEs²

² According to the World Bank data.

The development of young and mature companies is not the same. My results of testing of economic and mathematical models have shown that young companies mainly use internal sources, throughout the development – raise bank loans. Structuring potential sources of capital for every level of an organisation can help to support its sustainable growth.

Firstly, I have tested the impact of the life cycle on capital structure in general on the basis of Russian panel data.

Stages: Slow growth => Boost => Maturity => Decline

$$Finlev = a + b_1 * opm_{it} + b_2 * cr_{it} + b_3 * mc_{it} + b_4 * ne_{it} + b_5 * stage_{it} + \varepsilon_{it}$$

I found that at the boost and decline stages enterprises have high leverage, but at the maturity and slow growth ones it is lower.

Then I built a probability model on the basis of Russian panel data for determining the relation between a source of capital (reflecting in capital structure) and a company's development. The results of economic-mathematical probability modelling using logit-regressions demonstrate the significant role of different factors at the life cycle stages.

$$p = F(Z) = \frac{1}{1 + e^{-Z}}$$

$$Z = a + b_1 * opm_{it} + b_2 * risk_{it} + b_3 * mc_{it} + b_4 * ne_{it} + b_5 * cr_{it} + b_6 * finlev_{it} + b_7 * ind1 + b_8 * ind3 + b_9 * ind3 + \varepsilon_{it}$$

p – probability that an enterprise belongs to the explored stage compared with the baseline stage;

opm – operating profit margin;

risk – risk premium;

mc – market capitalisation;

ne – number of employees;

cr – current ratio;

finlev – financial leverage;

ind – industry, dummy variable.

In previous research, I found that probability to stay at the boost stage regarding slow growth increases according to the rise in leverage [Krasil'nikova, 2018]. In the present article I determine the special matrix, reflecting life cycle distribution in terms of quadrants: leverage and margin, growth and risks.

If an enterprise has high leverage and an operating profit margin, it is at the boost stage. When high leverage is constant and the margin reduces, so transfers from the boost stage to decline.

The highest specific risks of an enterprise are risks that can't be eliminated through diversification, which corresponds to the decline stage, the lowest point – to the slow growth stage. It means the following: if a company's specific risk goes up, the probability to stay at the boost stage decreases than that at the maturity stage. The company's highest growth obviously occurs at the boost stage. So, if an enterprise suffers high risk and poor growth, it mostly transfers from maturity to the decline stage.

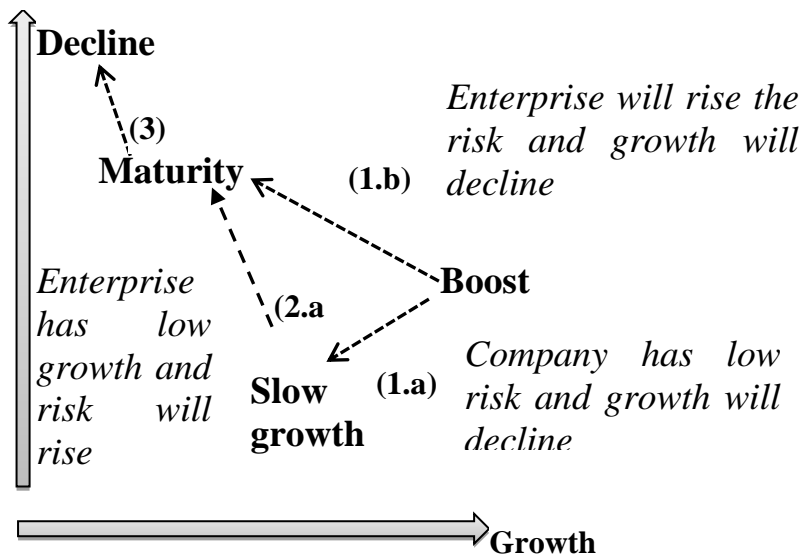


Figure 3 - Crucial obstacles and drivers to transfer along the life cycle curve

In the case of the constant level of risk, a decrease in growth reflects a rise in the probability to transfer to the slow growth stage (1.a.). And if risk goes up and growth decreases, a company will transfer from the boost stage to maturity (1.b). If these changes are drastic, a company transfers to the decline stage, passing maturity. Thus, crucial obstacles and drivers to transfer along the life cycle curve were found.

Conclusion

To encourage an enterprise's development, it is necessary to solve the priority internal corporate tasks, increase the convergence of interests, and take into account the quality characteristics in creating strategies. Research on corporate characteristics and the ownership structure is relevant due to the need for improving corporate governance and reducing the possibility of corporate conflicts. However, Russia improved its position in minority protection. Ownership concentration could be a strategic achievement in poor institutional conditions and influence forming strategies, decisions. Not only agency relations, but also the key factors change at different life cycle stages. The presented matrix indicates enterprise transition along the life cycle curve. If an enterprise performs a high growth and operating margin, significant leverage, actively attracting debt, it belongs to the boost stage of life cycle. When the profit margin remains high and leverage decreases, an enterprise transfers from the boost stage to maturity. The same approach is applied to risk and growth.

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Агентские проблемы на различных стадиях жизненного цикла российских предприятий

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Аннотация

Повышение уровня защиты акционеров в России привлекает потенциальных инвесторов. Особенности агентских отношений, поведенческие факторы являются значимыми генераторами при разработке корпоративных стратегий. Для стимулирования развития компании необходимо решать приоритетные внутрикорпоративные задачи, повышать конвергенцию интересов, а также учитывать качественные характеристики при разработке стратегий. Целесообразно использовать комплексный подход к выбору источников капитала, исходя из анализируемых ограничений. Для исследования совокупности факторов предложен комплекс показателей для различных стадий жизненного цикла. На основе этого исследуется подход к моделированию развития компании как динамической системы. Эмпирическое исследование было сосредоточено на кривой жизненного цикла предприятия. На основе российских панельных данных были построены модели логистической регрессии, которые представляют вероятность остаться на определенном этапе по сравнению с базовым этапом. В результате была составлена матрица этапов жизненного цикла, которая иллюстрирует переход предприятия на новый этап жизненного цикла. Было доказано, что важнейшие показатели влияют на переход по кривой жизненного цикла.

Для цитирования в научных исследованиях

Красильникова Е.В. Agency problems and transfer along life cycle for Russian enterprises // Экономика: вчера, сегодня, завтра. 2020. Том 10. № 3А. С. 25-32. DOI: 10.34670/AR.2020.94.4.003

Ключевые слова

Агентские отношения, концентрация собственности, менеджеры, источник капитала, жизненный цикл, рост.

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