Consequences of the conflict among Manager and Shareholders in the Return on Investment (ROI). A System Dynamics approach.

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Abstract

This paper is part of the doctoral thesis that is being developed by Enrique Rubio trying to show the need of the Business Plans in the companies, specially smalls and mediums-sized enterprises (SME). In the development of this paper, with the collaboration of Juan Martín, they are observed the appearing of some important elements that basically are: 1. The need of Business Plans, 2. The juncture, 3. The financial knowledge of managers and shareholders, 4. The management of the power, 5. The sales that they will derive in accumulated sales, 6. The income that will form the capital, 7. The management towards the growth and the ROI, and 8. The ROI's creation. All those factors explain the usual relation among managers and enterprise's shareholders and were used to build the first version of the model that has been used for this analysis.

Keywords: Business Plan, ROI, Shareholder, Manager, System Dynamics, Model.

1. THE PROBLEM

The purpose of Business Plans is to make possible the achievement of objectives and goals of an enterprise, organization or corporation: Business Plan has special relevance in a turbulent, uncertain and competitive world. The utilization of a Business Plan can minimize the risks of all levels in the business management and more especially in the companies of new foundation. Right now about 90% of the new companies do not surpass three years of existence, and for this reason the Business Plan is important in order to determine the endogenous factors that can affect the company's growth.

All Business Plan try to obtain some kind of profits, perhaps social, environmental, or purely chrematistic, and in all of them at least we try to obtain the Return of Initial Investment (ROI) as soon as possible in order to generate new resources and projects.

In the economic world, especially in small and medium-sized enterprises (SME) the ROI's creation allows to minimize the risk of no success, especially in enterprises of new foundation, during the first three years of existence.

A. Formulation of the problem.

Business plans are the interactive projection that we do of the possible futures, external and internal, in order to try designing in advance, some groups of action that possibly lead us to reach the objectives.

The Business Plan will not turn bad ideas into good business, but it will allow to realize on time, and avoiding bigger setbacks. If the good ideas turned into good business plan, it will generate the best business, and they will be the base to initiate a strategic reframing more ambitious... when circumstances require it.

Determining the minimal necessary variables for the formulation of Business Plans may allow to the small-size enterprises appraising initially its economical viability running the return of investment (ROI) during first years and thus ensuring its implementation.

In this reference mode, we can see some times the conflict of interests among managers and shareholders that is the base of the model that will be exposed.

B. Justification

Having in mind the creation of a new company or in other case the management of a small and medium-sized enterprise, the implication of resources of distinct nature has importance, some of them are:

- Monetary resources of partners in the form of capital investments.
- Institutional help resources for the creation of new enterprises to: creation of brooders, platforms, trampolines of new enterprises, subventions, the tutelage during his gestation and another supports.
- Creating new jobs or changes in stable jobs.
- Psychological relationship among enterprisers and team of collaborators.
- Conflictive situations among managers and shareholders.

This short list of factors is basic to start the creation of an analysis in depth to manage the personal, institutional, and all-nature resources and personal relationship, with an obvious objective, to get the better return to the society, or in a monetary aspect when we are managing a companies or in a social aspect when we manage public or private institutions.

2. REFERENCE MODE

We divided this part in several parts:

2.1 Importance of the Business Plan

The importance of plans are evidently confirmed by P. Drucker, Kaplan, Michael Porter and many other authors of the management; but, a curious fact is that this plans are going to be used also in other areas of knowledge, for example: Medical themes in the development of a service of anticoagulation presented by Jennifer L. Wilson Norton (R.1). It can also be observed worldwide than Business Plan's theme affecting all countries, as explain Young Ho Nam (R.2).

2.2. Importance of the small-sized business:
Many references have identified it:

- Case of differentiation factors for micro enterprises in Boston, said by John H. Friar, Marc H. Meyer (R.3).
- Case of manufacturing enterprises by Charles Jabani Mambula (R.4).
- Success of new enterprises by Josef Brüderl (R. 5).
- In enterprise's processes of the brooder centers by I. Pena (R.6), or
- In another cases shown by Tomas O. Koh (R.7).

2.3. Correlation among small-size business and Business Plan:
These possible correlations become exposed or picked up from distinct views:

- The manager's objectives not always are defined explicitly; Paul Greenbank (R.8)
- Kon Karakasidis (R.9) presents the formulation of plans for reconvert small-size enterprises with the need to embrace business plans.
- Roger Brooksbank (R.10) refers that has written plenty of about plans for large enterprises and that he understands that principal keys of Business Plans can be also applied to small-size enterprises, so step by step, we can construct its business plan.
- The need that companies have business plans for exportation as been described by Peter G. Graham (R. 11) when indicates that for Australian small-size enterprises is a key aspect in a global economy.

2.4. The entrepreneurial failures also are explicit in:
In an academic perspective seen from the positive angle:
Paul D Hannon and Andrew Atherton expose textually:

> “There is an ongoing debate within the academic literature about the value of the business plan in the development of the small firm. On closer inspection of the research, there appear to be clear benefits in the use of business planning as a process within the smaller business.” (R.12).

Amir M. Hormozi, Gail S. Sutton, Robert D. McMinn and Wendy Lucio they affirm the importance of the plan in new or small business.

> “Planning plays an important role in determining the degree of success realized by a new or small business. Essential elements to business success are identification of goals, followed by development of strategies to meet those goals. A business plan is an effective tool used by businesses to organize these goals and objectives into a coherent format“ (R. 13).

In the newspapers this some information is exposed, showing the social and economical losses produced with the disappearance of small-size enterprises:

USA. Europe Press January 07, 2003

> The economical package, that Bush will announce in Chicago, will include the acceleration of generalized rate reductions, immediate tax allowance for married couples and families with children and bigger incentives for small-size enterprises to invest in new equipments.

Mexico. El Financiero February, 2004

> THE INDUSTRY BECOMES SMALLER; 300 thousands TURN OFF 600 COMPANIES IN 2003.

Galicia, Spain. El Faro Vigo

> Over the 50% of the micro and small-size enterprises of Galicia and north of Portugal close before reaching the first three years of life. (Young People's Association Businessmen 2003).

3. BASIC INFORMATION

A. Theoretical Fundamentals.
Trying to obtain some recent information, we have initiated the investigation with some articles, the most relevant are:

British Academy of Management, 2002. Authors: T Fuller and J. Lewis. Show the significance of the relations among managers and shareholders with the differences of the significance of the strategic implication in his firms were investigated. For this they utilized a 36 businessmen's valid sample of distinct sectors with personal interview. This article concludes saying that the trajectory of small-size enterprises is interrelated with business and also with the external environment.

The starting point that we are interested in this investigation is based in "Understanding the small business sector" by Storey D. J. (1994). Routledge London (1994), this paper suggests that are three factors that theoretically have union with the growth of the companies, and those are: The entrepreneur (motivation and experience), the company (internal structure), and the company's strategy (like one mixture among structural external positioning and directive resources). This view is complemented with the exposed by Hodgetts and Kuratko (1992). "Effective small business management" by Dryden Press and Fort Worth (1992, p. 36), that suggest them small companies successfully can be classified in four areas: The existence of opportunity (external structure); Adequate financial capital (resources); The team's modern methods of business (internal structure) and ability directive.

The authors determine five factors in businessmen and director's relations with the stakeholders that they are: Relational networking's strategy among clients and suppliers, relational strategy of contract, strategy of the personal relation, relational strategy on service and relational strategy of strategic development.

In this investigation we will focus in utilize the referred factors in the aforementioned article in order to create our working hypothesis.

The other article is developed by Felix M. Edoho (Lincoln University. Missouri, USA) where the author affirms that in front of large companies or conglomerates, where everything seems to revolve around them, the small-size enterprises exist that represent the 90% of the American economy. But we can’t forget that this level of failure is the same as indicates Steinhoff, D and J.F. Burgess (Small Business Management Fundamental. 5th ed. NY: McGraw Hill, 1989). The causes of failure have two dimensions: External factors and personnel. The external factors include commercial cycles, interest rates, and interruption of supplies. The personal factors include lack of experience, mismanagement, a commercial philosophy scant and missing of planning. Less of formal owner's half they had planning before starting business. Many initiated his planning after initiating the business, indicate Shuman, J.C. and J.A. Seeger, in "The Theory and Practice of Strategic Management in Smaller Rapid Growth Firms" (American Journal of Small Business, Vol. 11, No. 1 (1986): 7-18).

In summary, the article reaffirms the necessity that small-size enterprises need to understand and to appreciate the value of strategic management and its pertinence of it. The important problem in this process is the convenience to anticipate and planning for the change. Small businesses without strategic plans are vulnerable to the anticipated change. Small businesses are not immune to worldwide changes. The changes in global economy have ramifications for small businesses as well as for large companies. The globalization of American economy has turned on increasing quite a number of domestic markets to the competitive foreigners. The small businesses must estimate this tendency that is appearing. The strategic direction will equip small businesses to adapt dynamic environments better.

B. Elaboration of hypothesis.

Hypothesis 1. It is relevant that conflicts among managers and shareholders affect the creation of Business Plans.
Hypothesis 2. It is relevant than conflicts among managers and shareholders affect the creation of ROI and therefore to companies' continuity.

4. METHODOLOGY OF CREATION OF THE MODEL

4.1. THE MODEL'S STRUCTURE

Based in the articles of T. Fuller and J. Lewis British (Academy of Management, 2002) and by Félix M. Edoho (Lincoln University, Missouri), exposed previously.

It is necessary to say previously that this is a model for people no initiated in the characteristics of the used methodology, and for this reason it should have priority the simplicity about any other consideration. This model is thought to show in a simple and transparent way the effects of conflicts that exist inside the SME among the shareholders and the manager. SME's shareholders are person that loves the product that his company offers, and hence it is his principal purpose to achieve the bigger diffusion and sale of the product. On the other hand the company manager, with a good monthly remuneration, professional status and several perks, desires basically staying in his job long time and it only can achieve if the company generates the necessary revenue to assure its viability on a regular form.

This conflict of interests can be modeled valuing the power that has each one of them in the decisions that are taken in the company; so that the shareholders tries to develop a management towards the growth, whereas the manager tries to develop a management towards the ROI of elaborated way instead profit or the income.

An additional aspect is the financial knowledge that has the shareholders and the manager of the company. It is habitual that the manager has high knowledge in this aspect, but is not habitual that the shareholders have it at a sufficient level, but is not habitual that the shareholders' knowledge be to a level enough.

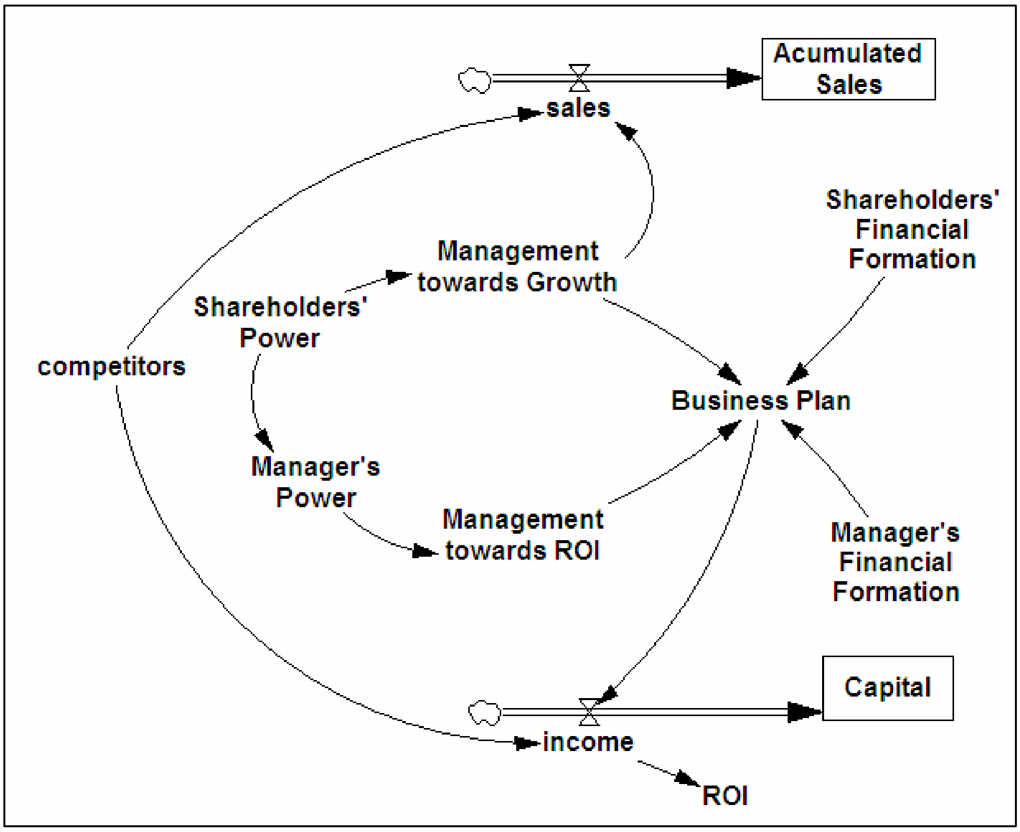
Thus, the model suggests the existence of these elements:

- Shareholders' power
- Manager's power
- Management towards the growth
- Management towards the ROI
- The shareholders' financial knowledge
- The manager's financial knowledge

The model considers that the company initiates its activity in the period 0, and central elements of the model are income and sales, in order to achieve a tracking of the impact on the ROI due to different policies that the company follows.

The corresponding accumulation of the Accumulated income is called Capital. The capital is the accumulated value of the income, understanding these as margin or benefit of the initial value of the existing representative capital at the beginning of the activity of the companies.

The set of the different powers, policies and knowledge is translated in the Business Plan, which we can value like 0 when it does not exist and like 1 when it is perfectly elaborated.



The evolution of the income can be defined directly influenced by the existence of a Business Plan and its quality, as well as of the situation of the conjuncture and the competition.

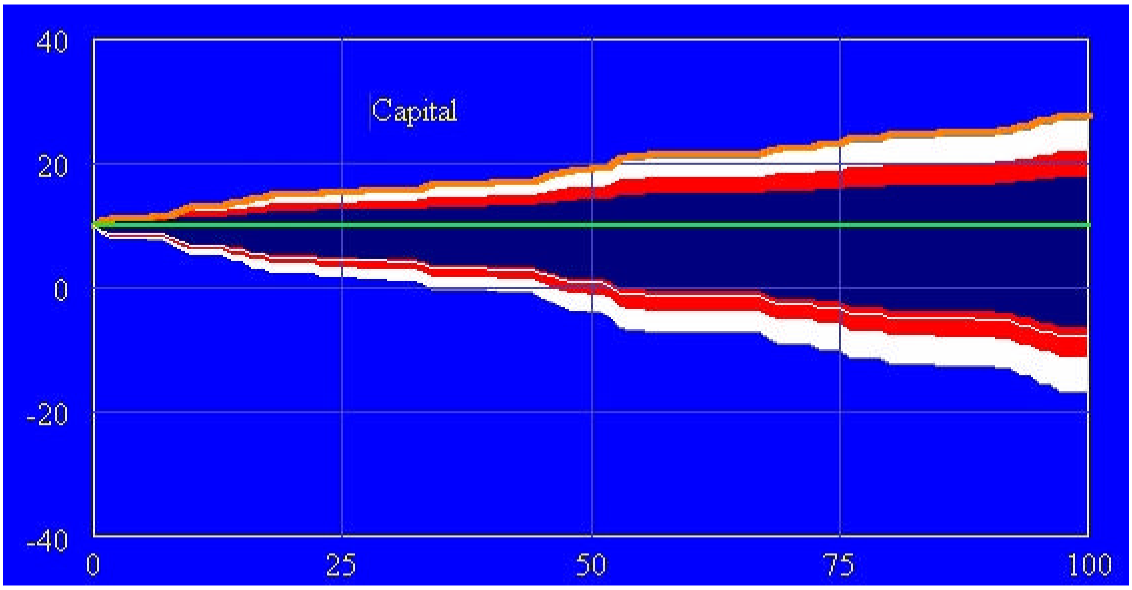
For the definition of these two last variables, we can utilize random variables that would help to show the different situations that affect the company.

Although, in the modeling of conjuncture we can take a value centered in 0, so that, their effects are sometimes beneficial and in other detrimental ones, in the case from the rival, without denying its random component, always will have an impact negative.

4.2. THE MODEL'S BEHAVIOR

We can observe in the following graph the trajectories that define the different scenarios of power among the shareholders and the manager for some determined financial knowledge, coherent with the taken hypothesis.

It is observed, that when exists a predominance of shareholders' power, which means policies that give priority to sales in relation to the income, with less financial knowledge of the shareholders than the manager, there is no one Business Plan well elaborated and this leads to a progressive erosion of the capital, more or less fast, according to circumstantial factors.



Evolution of the capital of the company

By the contrary, a much more moderated power of the shareholders open the possibility that the company's managers develop and implement a Business Plan that make a transformation in the company evolution of the income and capital.

5. CONCLUSIONS

The results of the model shows how an important power in hands of the shareholders makes difficult the Business Plan's concretion and the future viability based in the ROI's evolution.

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