AGENCY COSTS OF FREE CASH FLOW — THE SOUTH AFRICAN EXPERIENCE

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DECLARATION

I the undersigned hereby declare that the work contained in this dissertation is my own original work and has not previously in its entirety or in part been submitted at any university for a degree.

Signature:..... Date:.....

ABSTRACT

The use of free cash flow has been a source of conflict between shareholders and managers. This conflict derives from the agency relationship between shareholders and managers in that decisions taken by managers (as agents) affect the shareholders (as principals). The decisions of managers may not always be in the interest of shareholders. The interests of shareholders will be served if actions of managers lead to the maximisation of the total value of the company. The free cash flow theory suggests that managers have the tendency to misuse surplus cash resources. Any use of free cash flow that is not value maximising could result in losses to shareholders. These are termed the agency costs of free cash flow. It is believed that managers will think and act as shareholders if they own significant proportions of the equity capital of companies.

This dissertation examines the effects of the agency relationship on the utilisation of free cash flow. To investigate these issues, some companies listed on the industrial sector of the Johannesburg Stock Exchange were selected and divided into two basic groups. These groups are owner controlled companies and manager controlled companies. It was feared that the growth levels of the companies may blur the results and so they were further categorised into low growth companies and high growth companies. Whereas the first stage of the analysis dealt with companies categorised by either control structure or growth, the second stage considered companies categorised jointly by control structure and growth. Ratios indicative of the use of free cash flow were computed for each group and compared by means of box and whisker plots and the t-test. On the whole, the primary analyses showed that control structures do not

bring about any significant difference in the use of free cash flow. However, the secondary analyses revealed significant differences in the percentage of free cash flow paid as dividends and value added by low growth companies and high growth companies. The finding that high growth companies pay higher dividends than low growth companies was inconsistent with normal expectation. Equally puzzling was the finding that low growth companies added a greater value to the investment of shareholders than high growth companies. These findings were not adequately supported by other measures employed in the study and could not be interpreted in the agency framework. They could be the product of the effectiveness of the P/E ratio as a measure of growth.

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

It is generally accepted that the prime objective of business is the maximisation of shareholders' wealth (e.g. Van Horne 1995, 3 & Copeland & Weston 1988, 18). Although it is simply stated, there are a wide range of views on how to achieve this objective. It can be defined in terms of the maximisation of the firm's total market value or the price per share of its common stock or the value of its owners' equity (Levy & Sarnat 1977, 526). This diversity of opinion is compounded by different categories of claimants on the firm. These claimants are debt holders, employees, suppliers, customers and the society at large. Each of them strives to derive the greatest possible return from the relationship with the firm. Shareholders want companies to be profitable, debt holders require companies to be governed in ways which guarantee them interest payments and loan repayments, and employees desire good remuneration. Obviously, conflicts of interest are bound to occur periodically among these groups if management attempts to satisfy any one of them.

Shareholders' wealth maximisation objective can be achieved by maximising the total market value of the firm. Ideally, activities within the firm should be directed towards maximising firm value. A note of caution in this regard is that certain actions which lead to the maximisation of the total market value of the company may not necessarily lead to an increase in shareholders' wealth. For instance by introducing additional

capital acquired through debt, the value of the company may rise without a corresponding increase in shareholders' wealth. This is because the total value of the company is an aggregation of both debt and equity capital. What is important is maximising the difference between market value and total capital contributed by investors (Stewart III 1994,72). Managers of companies are therefore expected to seek investment opportunities and allocate funds to the opportunities so discovered.

The theory of finance has over the years supplied managers with a series of decision rules to assist them in carrying out their responsibilities. Some of the major building blocks of finance theory are the efficient market theory, portfolio theory, capital asset pricing theory, option pricing theory, arbitrage pricing theory and the agency theory (Jensen & Smith 1984). Although some of these theories cannot readily be applied in practice, they have nevertheless contributed immensely to the understanding of business transactions. As a result, better and informed decisions can be made by managers with the confidence of empirical backing of finance theory.

A brief overview of the development of corporate finance will help in understanding the current state. Fundamental changes in finance began to occur in the 1950s when analytical methods and techniques originating from economics began to be applied to problems in finance (Smith, 1990). Emphasis was placed on efficient allocation of resources to various projects in that period. Following that, Brennan (1995) notes a significant transformation in corporate finance from the consideration of valuation implications of alternative ways of allocating cash flows to the exploration of the effects of the structure of claims on cash flows. This move was a departure from the

economic model to the recognition of behavioural considerations in the decision-making process in financial management.

The structure of claims derives from the corporate form. The corporate form is characterised by the participation of the public in the affairs of companies by virtue of share ownership. This arrangement has brought a contract of agency between managers and outside shareholders. 'Outside shareholders' as used here refers to shareholders who do not take part in the day to day management of companies. The provisions of the contract of agency are well laid out in both common law and companies' acts of various countries. At common law, the directors of a company are expected to act for the benefit of the company and also to exercise reasonable care and skill in performing their duties. What is 'reasonable' depends on the circumstances surrounding a particular transaction and is not conclusively defined by the law. In any case it can be regarded as actions founded on rationalism as opposed to opportunism.

The parties to this contract of agency are the shareholders or the *principals* who engage the services of managers as *agents* to perform tasks on their behalf. Normally, such relationships involve the delegation of some decision-making authority. The puzzle which arises is whether the actions of managers would be in consonance with the expectations of shareholders. If rational utility maximising behaviour is assumed on the part of both parties then there is the possibility that the agent may act in his own interest rather than that of the principal (Jensen & Meckling 1976,85). This assertion draws support from financial-economic theory which endorses the view that a reasonable motivation for human behaviour is personal wealth maximisation (Dobson 1993, 57). The divergence of the agent from the expectations of the principal gives

rise to agency costs. Agency costs are therefore the sum of the monitoring expenditures incurred by the principal, bonding expenditures borne by the agent and the residual loss from managerial actions that are not value maximising (Jensen & Meckling 1976,85).

1.2 PROBLEM DEFINITION AND PROBLEM STATEMENT

Shareholders realise the gains of their investments in two main ways. They are dividends which are periodically declared by management and capital gains made on disposal of shares. Free cash flow is cash flow left over after the firm has exhausted its positive net present value projects (Jensen 1986,323). All else being equal, shareholders expect free cash flow to be distributed to them as dividends. Managers on the other hand may want to retain cash for other reasons. For example to finance the growth opportunities of companies. It is far from clear whether such policies are in the interests of shareholders. Jensen (1989, 66) notes that this conflict between shareholders and managers over the pay out of free cash flow is the central weakness in the public corporate form.

Following from the above discussion, the issue at stake is whether free cash flow is utilised in the interest of shareholders and whether ownership structures and levels of growth affect its disbursement. It would be in the interest of shareholders if free cash flow is invested in value maximising projects which lead to higher earnings and possibly increased dividends. This study examines the relationship between ownership structure, growth and free cash flow in an agency framework.

1.3 OBJECTIVES

The following are the objectives of the study:

1. To identify the uses of free cash flow, and
2. To evaluate the usage of free cash flows.

1.4 ORGANISATION OF CHAPTERS

The study is laid out in five chapters. The first chapter sets the dimensions of the study. The second chapter reviews important works germane to the study. The issues are addressed in a topical form. The third chapter highlights the measures to be used in the study and the structure of analysis. The fourth chapter discusses the results of the population categorised by control and growth. The fifth chapter discusses the findings arising from the pairings of low growth companies and high growth companies. The sixth chapter analyses the pairings of owner controlled companies on the one hand and manager controlled companies on the other hand. The final chapter provides concluding remarks.

CHAPTER TWO

LITERATURE REVIEW

2.1 AGENCY THEORY

Basically, the agency theory takes its roots from the relationship between shareholders and managers. In legal terminology it is referred to as a contract of agency. The parties to this contract are known as the principal and the agent. Applying this definition to the company setting, the principals are the shareholders and their agents are the managers.

The agency theory came into being about twenty years ago through a ground breaking article by Jensen & Meckling (1976). Before then important contributions were made by Smith (1776), Berle & Means (1932), Coase (1937) and Alchian & Demsetz (1972) to describe the relationship between shareholders and managers. An overview of their contributions follows. Smith (1776) likens the role of managers to stewards and states that they cannot be expected to watch over their master's money with the same care as their own. Berle & Means (1932) report that the separation of ownership and control leaves shareholders effectively powerless. This is because shareholders are widely dispersed and cannot take any co-ordinated action against managers. Coase (1937) reiterates the master servant relationship but lays emphasis on the right to control the servant by the master or his appointed agent. Alchian & Demsetz (1972) define the firm as being made up of contracts between a central agent

(owner) and several input owners. They add that control is exercised by continuous renegotiation of the aforementioned contracts.

Normally, authority originates from shareholders and flows to managers. In effect, managers cannot act unless mandated by shareholders. But managers are not like agents who execute specific tasks under the direction of their principals. They have broad responsibilities to act in the best interest of shareholders. It is expected that management acts within the overall authority limits granted it by shareholders. These boundaries are defined by transactions which fall within the objects of companies. Any action that transcends this limit can result in shareholders bringing legal action against the directors for breach of contract.

Shareholders and managers can potentially have many conflicts. These conflicts, for example, can arise with salary, investments, dividends and self dealing transactions. It is hard to say whether managers (as agents) would always place the interests of shareholders (their principals) above their own interests in decision-making. The interests of managers could be both pecuniary and non-pecuniary. Some examples are the pursuit of growth at the expense of profitability, pursuit of power and empire-building investments with corporate resources (Jensen, 1989).

In another dimension, managers can have private information that shareholders cannot gain without costs and so information asymmetry exists (Myers, Stewart & Majluf, 1984). For example, it is difficult for shareholders to determine all the investment opportunities from which the manager chooses. The only option left for shareholders

is to weigh the outcomes they observe against their guesses about what would have happened if managers had followed other strategies (Bhide 1994,133).

The modern theory of the firm regards the company as a form of legal fiction which serves as a nexus for contracting relationships. The typical feature which derives from this contract is the existence of divisible residual claims on the assets and cash flows of companies (Jensen & Meckling 1976,87). Shareholders have a right to cash flows only when cash dividends are declared by directors. By implication, shareholders do not have a decisive right to the company's free cash flow. Consequently, shareholders are faced with potential variability of returns. The other participants in the corporate contract mostly receive a fixed return that is essentially determined by external market rates. However, this situation does not preclude them from seeking some sort of protection. Debt holders normally incorporate covenants and other special clauses in debt agreements to limit the cost of managerial discretion (Smith & Warner, 1979). This is because certain actions which favour shareholders affect debt holders adversely. For example, the payment of a large dividend decreases the assets available as security for debt holders to fall on in time of bankruptcy.

Ownership structure may be affected by the size of companies. Size in turn may be a limiting factor on the degree of concentration of ownership. Ownership in companies with high market values is diffused among a wide spectrum of people (Demsetz & Lehn, 1985). All things being equal, individual shareholders would not have large proportionate claims on dividends. This situation gives rise to what is termed the 'free rider problem'. This is a fundamental problem associated with the delegation of power from many to a few. In this case, from shareholders to managers. In this setting, a

single shareholder does not have a large enough incentive to monitor the activities of managers. In contrast to the above, Strickland, Wiles & Zenner (1996) report that shareholder associations provided a forum for small shareholders to influence the corporate governance of large US companies.

Agency problems arise when managers who initiate decisions are not the major beneficiaries of those decisions [Fama & Jensen (1983a, 304)]. This view is buttressed by the inverse relationship between the cost of deviation from value maximisation and shareholding of managers [Jensen & Meckling (1976), Demsetz & Lehn (1985)]. Within this framework, managers have the tendency to engage in excessive perquisite consumption and other opportunistic behaviour since they receive the full benefit of such activities but bear less than the full share of costs. But as the equity stake of managers rise, they will consume less of corporate resources due to an increase in the fractional cost of their divergent behaviour incident upon them. An alternate view is presented by Slovin & Sushka (1993,1320) who find little support for the view that increased concentration of holdings by managers is a mechanism to align the interests of inside shareholders with outside shareholders. They also submit that large inside blockholders who dominate decision-making are not effective monitoring agents for outside shareholders.

2.2 DETERMINANTS OF AGENCY COSTS

Some factors which influence agency costs are the tastes of managers, the ease with which they can exercise their own preferences as opposed to value maximisation in decision making and the costs of monitoring and bonding activities (Jensen & Meckling, 1976). The costs of monitoring and bonding activities depend on the environment in which the company is operating. Firms which operate in environments characterised by stable prices, stable technology and stable market shares can be monitored at relatively low costs (Demsetz & Lehn 1985,1159). Managers are constrained by external forces and so have a narrow range of options. On the contrary, a highly volatile environment enhances managerial discretion and presents a formidable barrier to effective monitoring. Managers have a wide array of potential courses of action which might seem acceptable to shareholders. Therefore it is very difficult to differentiate between decisions that contribute positively to value creation and those that lead to value destruction. This situation underscores the amount of flexibility to be tolerated in monitoring strategies.

2.3 CONTROL OF AGENCY COSTS

Agency costs can be controlled by monitoring and bonding mechanisms. Monitoring mechanisms involve gathering information on the agent's efforts, on random external factors that may affect the success of the agent's effort and on the outcomes of the agent's activities. Bonding mechanisms represent a commitment by the agent to follow a predetermined course of action. These control procedures unavoidably involve cost in either monetary or non-monetary terms.

Monitoring costs are incurred by shareholders in the process of tracking and evaluating the actions of managers. Some components of this cost item are internal control systems, external auditor's fees and incentive compensation schemes for managers. Bonding costs on the other hand are those borne by managers to guarantee that their behaviour and actions are in the best interest of shareholders. An example of bonding mechanism is debt finance. Debt binds managers to make periodic payments of interest and principal to the providers of funds. Actually, it reduces the discretion of managers over free cash flow. It may also take the form of a pledge to abide by the code of ethics of the profession. In South Africa, the King Report makes recommendations on the responsibilities of directors, the role of auditors and the relationship between stakeholders and the company. It also develops a code of conduct and reports on the question of adoption and compliance by all interested parties (King Report 1994). Compliance with the provisions of the King Report can be regarded as a bonding mechanism.

Jensen (1993,850) broadly classifies the mechanisms used to control agency costs into the following groups:

- capital markets,
- legal / political / regulatory system,
- product and factor markets, and
- internal control system headed by the board of directors.

These mechanisms are discussed below in the South African context.

2.3.1 CAPITAL MARKETS

The capital market is the source of long-term finance to companies. The players on this market monitor managerial decisions closely and by the interplay of demand and supply, the prices of shares re fixed. The accuracy of this valuation however depends on the efficiency of the market in pricing shares and other securities. The JSE is said to be operationally efficient although the degree to which it is efficient is still a matter of dispute (Bhana 1994,93-94). It is worthwhile to note that a relatively large number of shares are not traded regularly on the JSE (Bradfield 1989,23). This problem of thin trading is likely to distort the pricing of shares. Put differently, prices of shares lag considerably behind new information, thus reflecting information available at the last trading.

Although companies do not derive direct monetary benefits from the trading of own shares on the stock exchange, the value of shares reflects the reaction of the investment community to the state of affairs of companies. The discipline of the capital market comes in various ways. The most obvious way is when the company requires additional funding from the market. In such a situation the providers of capital, investment bankers, security analysts and the market in general have the opportunity to scrutinise the past performance of managers. Using that as a basis, they determine the price at which to offer additional finance. Easterbrook (1984) suggests that a high dividend payout is a means of reducing agency costs by assuring investors that the firm will subject itself to the discipline of the market in order to finance new projects.

Another form of control exercised by the capital market comes through takeovers. Jensen & Ruback (1983) refer to it as the market for corporate control in which management teams compete for the rights to manage corporate resources. Managers who do not optimise the resources at their disposal are replaced by others who have better use for them. Shareholders take sides with the team which is able to deliver value maximising projects. Often, companies whose performance do not measure up to their potential are the targets of takeover activity. The natural response one can imagine is the motivation by managers to lead their companies towards optimal performance.

It ought to be noted that managers can erect barriers to takeovers in order to insulate themselves from the discipline of the outside market for control. Some of these tactics include poison pills, green mail and the so called 'golden parachutes' (Malatesta, Paul & Walking, 1988). Barr, Gerson & Kantor (1995, 26) observe that the hostile takeover is impossible in South Africa because the controllers of companies have succeeded in retaining a majority of the votes despite having less than simple majority of ownership claims.

In the absence of hostile takeovers, friendly mergers are the near substitutes in South Africa. Bhana (1984) posits that most mergers consummated are in the direction of conglomeration. The reason underlying conglomeration is to gain monopolistic or oligopolistic control over industries. Incidentally, Affleck-Graves, Burt & Cleasby (1989) share the opinion that conglomerates under-performed non-conglomerates on the JSE. The disciplining role of mergers is therefore blurred if not lost in this regard.

2.3.2 REGULATORY SYSTEM

The laws of the land in which the company operates can be used to check the activities of management. Some of these laws govern the conduct of management and disclosure policies. For instance the duties of directors are spelt out in the Companies' Act (Section 208-251) and common law. The form and contents of financial statements of companies are largely determined by the Companies Act. For instance Schedule 4 of the Act stipulates the required minimum information to be disclosed in financial statements. In addition, it provides that the following be presented at the annual general meeting (AGM): balance sheet, income statement, directors report and a cashflow statement. Other bodies such as the Securities Regulation Panel and the Competition Board play an important role in supervising corporate mergers and acquisitions.

Apart from the legal framework, other parties such as security analysts and investment advisors serve as a pressure group on management. The independent analyses conducted by these parties for their clients, normally shareholders and prospective investors affect share prices. Sometimes their reports are made public and the stock market reacts to them. Hence by these means, they indirectly assess the performance of managers by monitoring corporate performance. Bhide (1990, 535) explains in the following statement that security analysts played an additional role in the USA:

> "(A)s securities firms developed strong analytical skills, their appetite for information grew and they began to set standards for disclosure that exceeded regulatory requirements."

2.3.3 PRODUCT AND FACTOR MARKETS

Businesses do not operate in a vacuum. They must interact with both factor and product markets. Companies obtain the inputs of production from the factor market and in turn sell goods and services on the product market. The essential control forces inherent in these markets are pricing and product quality. Prices are normally driven to a large extent by macro-economic events and so it is expected that there will be a common component to the cost of production of companies. Therefore companies in the same industry are likely to display similarity in overheads. Fama & Jensen (1983a,301) succinctly put it that firms that are able to survive in the competitive environment are those that deliver the product demanded by customers at the lowest price whilst covering costs.

Hart (1983), in a study of the product market considers two types of firms namely entrepreneurial firms (assumed to be run in the interest of their owners) and managerial firms (assumed to be run by managers who have their own goals). The study states that when faced with low costs, entrepreneurial firms expand and thus compel managerial firms to follow suit. This is due to the rise in aggregate supply of products and a corresponding fall in product prices. Competition in effect will reduce managerial slack if the firms' environments are correlated. But the product and factor market disciplines often take effect gradually (Jensen 1993, 850).

2.3.4 INTERNAL CONTROL SYSTEM

The internal control system is concerned with the system of controls established to carry on the business of the enterprise in an orderly and efficient manner. These controls permeate every facet of corporate activity. A number of approaches are used to ensure the working of the internal control system and these are; appointment of outside directors to the board, formation of audit committees and introduction of competitive compensation schemes.

The board of directors supervise the working of the control systems. Theoretically, outside members on the board of directors are regarded as neutral parties between shareholders and managers. Their supposed neutrality enables them to monitor managers effectively without compromising the interests of shareholders. Under the dispensation which allowed bankers to serve on corporate boards in the USA, Ramirez (1995) contends that the form of monitoring JP Morgan provided for its client corporations curtailed the principal-agent problem and diminished informational asymmetries between investors and managers.

Audit committees play an important role in cross-checking the expenditure of companies. They scrutinise the usage of cash and other corporate resources and are able to detect unnecessary expenses. Most importantly, the operations of audit committees can determine the uses of free cash flow and the productivity of such expenditures.

The principal-agent literature suggests that linking pay to the outcomes of the agent's performance induces the agent to behave optimally. That said, control can be achieved through compensation schemes when they are tied to observed productivity. Some examples of these schemes are bonus plans, profit sharing plans and long-term performance plans. Others are employee stock ownership schemes (ESOP) such as stock options plans, stock appreciation rights plans and restricted stock arrangements.

To avoid conflicts of interest between shareholders and creditors, it is needful that management be placed on a scheme that rewards it according to the total market value of the company rather than just the value of equity [Hart & Moore (1995,568)]. Presumably, whatever measures of performance that are used to implement these schemes must clearly reflect the effect of managerial actions on corporate investment and financing policies. This assertion seems plausible but there is yet another possibility of certain random factors distorting this link. Smith & Watts (1992,280) recognise growth as one of these factors and thereby suggest that firms with good growth prospects use stock options because it is difficult to monitor management in this state of the world.

2.4 FREE CASH FLOW THEORY

As stated earlier, free cash flow is discretionary cash flow available to managers in excess of that required to fund all positive net present value investment projects. The free cash flow theory suggests that managers have the tendency to misuse surplus cash resources. Jensen (1986) argues that when cash flow is high managers invest in negative net present value projects rather than pay out cash. Companies may have excess cash because management is risk averse, or reluctant to pay out funds to shareholders or want to have more flexibility to pursue its own objectives. If managers use unencumbered funds to increase their own utility rather than distributing it to shareholders, it would inevitably result in agency costs. These are termed agency costs of free cash flow.

If the interest of managers and shareholders are perfectly aligned, managers would distribute all free cash flow to the shareholders. However, managers have incentives to reduce the uncertainty inherent in their term of employment (Amihud & Lev 1981). Managers can increase the security of their positions by expanding and diversifying the real assets of the company since compensation is positively related to firm size (Barker, Jensen & Murphy 1988, 609). Harford (1997) finds that cash rich firms are more likely to make acquisitions and that these acquisitions are more likely decrease shareholder wealth.

There are several possible resolutions to the agency conflict associated with free cash flow. Agency costs of free cash flow can be curtailed by large dividend payments. These payments reduce the resources under managers' control and make it more likely that they will incur the monitoring of the capital market when the firm requires new capital (Easterbrook 1984). Jensen (1986, 324) argues that debt can be an effective substitute for dividends because it obliges managers to pay out future cash flows in a way that cannot be accomplished by dividend increases. Also, organisational form can reduce agency costs of free cash flow. Lehn & Poulsen (1989) present evidence suggesting that going private transactions reduce agency costs.

2.5 RELATED RESEARCH IN SOUTH AFRICA

Shung, Stadler & Affleck-Graves (1987) examine the performance of family controlled companies on the JSE from financial management and investment performance perspectives. In analysing investment performance, they computed mean returns of the companies in question and compared them to sector mean returns. The aim of their study was to determine whether the unique agent-principal relationship in family controlled companies leads to differential stock market performance. They concluded that family controlled companies underperformed in their respective sectors. But from a finance point of view it was evident that family owner controlled companies adopted a conservative debt policy and performed below the industry average in terms of profitability. The striking feature of this study is that it considered only one control structure in isolation.

Uliana (1991), on the other hand, studied the effects of three control structures on financial policies of companies. These are owner controlled, foreign controlled and conglomerate controlled companies. Uliana asserts that foreign controlled companies adopt similar financial strategies as conglomerate controlled companies while owner controlled companies differ significantly in this respect. Although these results provide some insights of the agency relationship in the finance domain, an extension of the scope to the investment domain may provide a holistic understanding.

Barr, Gerson & Kantor (1995) analyse the performance of some major mining houses by comparing their average stock returns to other market indices over a period of twenty years (1971-1992). These mining houses are essentially owner controlled companies since most of them are controlled by founding families through tiers of holding companies (Barr et al 1995, 19) . On the strength of a relatively high mining house index, they note that these houses generated positive returns to shareholders and more importantly created value to shareholders over and above their listed holdings. Hence the authors regarded the pyramid structures prevalent in these companies as an efficient resolution of the principal-agent problem.

Although the methodologies of the above studies differ, they dealt broadly with investment policy. But this study will specifically probe investment policy in relation to free cash flow. It also seeks to address the question of growth which has not been explored by earlier studies. That is how growth opportunities affect agency costs of free cash flow.

2.6 JUSTIFICATION

The motivation for this study is drawn from the importance attached to the behaviour of individuals in the management of corporate resources. The results of the study may be useful in corporate governance. It is envisaged that the study will explain the link between control structures on the one hand and the debt, investment and dividend policies of companies on the other hand. The issue here is how free cash flow is utilised by managers to satisfy the interests of shareholders in relation to the above policies. The results may also suggest both value creating and value destroying activities in companies.

CHAPTER THREE

METHODOLOGY

3.1 DEVELOPMENT OF THE HYPOTHESES

Free cash flow can be used in various ways. It can be used to pay dividends, repay loans or be retained for the purpose of reinvestment in future projects. Ownership structure may affect the distribution of free cash flow among these competing needs. Ownership structure is defined by the distribution of shareholdings. If ownership is widely distributed, it is likely that no individual will have an interest large enough to influence management. But when ownership is highly concentrated, shareholders can exert more influence over management.

The agency literature states that managerial stock ownership helps in aligning managerial interests with those of external stockholders. In view of this, it is proposed that there is an inverse relationship between agency costs of free cash flow and managerial ownership. To illustrate, the higher the shareholding of managers, the lower the potential of agency costs; and the lower the shareholding, of managers, the higher the potential of agency costs.

It is further proposed that companies with high investment opportunities would have a lower payout than those with low investment opportunities. Whereas low growth prospects suggest that companies have limited opportunities to re-invest free cash flow profitably, high growth prospects dictate the opposite. Payment of cash dividends

effectively reduces free cash flow under the control of managers. It is interesting to note that these same managers make decisions on the size of dividends.

The use of free cash flows to finance future projects may differ across ownership structures. Owner controlled companies are likely to depend more on this source of finance than professionally managed companies. This is because the other ways of raising capital namely the issuing of additional shares and the borrowing of funds endanger the control of owners. If more shares are issued, it decreases the stake of majority shareholders if they are unable to exercise their rights. If debt finance is acquired, not only does it increase the risk profile of companies but it also allows for the tax shield benefits of debt.

From the foregoing comments, the null hypothesis put forward is that:

H_0: There are no differences in the use of free cash flows by owner controlled companies and professionally managed companies.

The alternate hypothesis is:

H_1: There are differences in the use of free cash flows by owner controlled and professionally managed companies.

To test the central hypothesis, it is necessary to establish sub-hypotheses. These complementary hypotheses will each address the three major areas of concern to this study: debt policy, investment of free cash flow and dividend policy. The first sub-hypothesis put forward is:

H_0: Owner controlled companies and manager controlled companies assume same proportions of debt.

H_1: Owner controlled companies and manager controlled companies assume different proportions of debt.

The second sub-hypothesis is as follows:

H_0: Owner controlled companies and manager controlled companies invest same proportions of free cash flow.

H_1: Owner controlled companies and manager controlled companies invest different proportions of free cash flow.

The third and final sub-hypothesis is:

H_0: Owner controlled companies and manager controlled companies have similar dividend payout policies.

H_1: Owner controlled companies and manager controlled companies exhibit different dividend payout policies.

3.2 SAMPLE SELECTION

The study was conducted over a period of three years. That is from 1993-1995. Earlier studies in South Africa are pre-1990 and so it was decided to conduct the study in the 1990s. Initially, a five year period was considered but it yielded a small sample (based on the criteria below). Hence the period was shortened. The sample was drawn from the industrial sector of the JSE. Holding companies were excluded to avoid the

duplication of results. But in some cases the demarcation between holding and operating companies were blurred by the cross holdings of controlling shareholders. Some discretion was exercised in this respect. Companies included under this condition are; Ventron, Mobile, Fraser Alexander and Storeco.

The companies were categorised into two main groups, namely owner controlled companies and manager controlled companies. Owner controlled companies are companies whose majority voting rights lied in the hands of an individual, family or the board of directors. Manager controlled companies are companies whose majority voting rights did not rest with an individual or a group of persons, say families. It should be noted that majority of South African industrial companies are controlled by individuals, groups of associated businesses and large businesses (Savage 1985, 22). Barr et al (1995, 18) describe the control process thus:

> "(B)y means of pyramid holding companies — and also by way of cross shareholdings and voting trusts — founders or their families retain control over vast assets with ownership claims on them that can be less than 10%."

Previous studies in South Africa used different proportions of shareholding to classify companies. For example, Shung et al (1987, 7) defined family controlled companies as those in which at least 50% of issued shares are owned by individual families while Uliana (1991) used the ownership of at least 20% of equity capital to classify companies into three groups. The latter study identified significant differences in operational management and financial policies of these groups. These differences were evident even after controlling for industry and size effects. This indicates the ability to influence corporate decisions with a 20% shareholding.

Following Uliana (1991), the mark for identifying owner controlled companies was the holding of a minimum of twenty per cent (20%) equity stake either by the owner/family or board of directors. All other companies which did not meet this criterion were deemed to be professionally managed. Ownership data was obtained from McGregor's "Who Owns Whom" (1993 & 1996).

Owing to the varying degrees of growth potential of companies, a further classification of companies was necessary. The price to earnings (P/E) ratio was used as a benchmark for distinguishing between high growth companies and low growth companies [Firer (1994), Capaul, Rowley & Sharpe (1994, 28-29)]. Also the P/E ratio of the industrial sector of the JSE is reported among other things to be significantly correlated with growth proxies [Ward & Stathoulis,1994)]. All companies in the industrial sector (Appendix 1) were ranked according to the magnitude of their P/E ratios and the following practicable limits were decided upon. Companies with P/E ratios consistently below 10 for the period were considered as low growth companies and those with consecutive P/E ratios above 15 were deemed as high growth companies. The resultant sub-samples were; low growth owner controlled companies, low growth manager controlled companies, high growth owner controlled companies and high growth manager controlled companies. The average P/E of low growth and high growth companies for the sample period were 6.41 and 23.25 respectively.

3.3 SAMPLE DESCRIPTION

A total of one hundred and nine (109) companies were identified for the purpose of this study. The distribution of companies among owner controlled (low growth and high growth) and manager controlled (low growth and high growth) categories is shown in Table 3.1 (see list in Appendix 2).

Table 3.1
Population of companies in categories

Type	Low Growth	High Growth	Sample
Owner controlled	35	16	51
Manager controlled	28	30	58
TOTAL	63	46	109

From Table 3.1, the low growth group has the highest number of companies. Owner controlled companies occupied the highest and lowest positions in the low growth and high growth categories respectively. On the other hand manager controlled companies yielded almost the same number of companies across the groups.

3.4 DATA COLLECTION

Data on free cash flow was drawn from the annual statements of the companies. The Bureau of Financial Analysis Network (BFA-Net) served as the main database. The standardised format of financial statements presented in this database was used so as to eliminate differences caused by presentation and disclosure. Other sources of data are the *JSE Monthly Bulletin* and the annual publications of McGregors "Who Owns Whom."

Due to the difficulty in identifying cash flows in excess of that required to fund positive net present value projects, an operational definition of free cash flow is adopted. Free cash flow (FCF) is measured as post-tax cash flow that is available for distribution to shareholders. The line item 'cash available' in the cash flow statement (Appendix 3) is treated as free cash flow. This item comprises operating profit adjusted for non-cash items, movements in working capital as well as interest and tax. Free Cash Flow (FCF), is symbolised as follows:

FCF = CO - INT - TAX

where CO is cash from operations (#711),

INT is interest paid (#712), and

TAX is tax paid(#713).

3.5 MEASURES

The uses of free cash flow will be identified by calculating the proportion of cash balance used for investment purposes and the proportion utilised in paying dividends. The extent to which cash flows from operations cover dividend payments in the respective years will be scrutinised. The aim of this exercise is to determine the source of funds for payment of dividends. These variables are designated as Free Cash Flow Invested (FCFI) and Free Cash Flow used to pay Dividends (FCFD).

FCFI is computed as follows:

$$FCFI = \frac{CI}{FCF} \times 100$$

where CI is cash invested (#718).

FCFD is calculated as follows:

$$FCFD = \frac{CD}{FCF} \times 100$$

where CD is the sum of ordinary share dividends and preference share dividends (#715 & #716).

Preference dividends are included in the numerator to conform to the spirit of the agency theory. The rights of preference shareholders in the residual return of a company are akin to those of ordinary shareholders. However it is not expected to influence the results significantly. Twenty-three (23) companies issued preference shares but a company retired its shares within the sample period.

While it is of interest to analyse how FCF is used via these ratios, there is an implicit assumption in the formulae. That is all FCF is either paid out as dividends or invested. This is due to the difficulty in determining the sequence of events. In cases where cash invested or cash paid as dividends is greater than total FCF, it is not known whether cash was invested before dividends were paid or otherwise. For these reasons FCF is expressed as a proportion of both cash invested and cash dividends.

The count for FCF ratios are mostly lower than the population of the sample because of negative cash flows recorded by certain companies. If a firm has negative cash flow it is treated as a missing observation because of the inherent difficulty in interpreting the FCF ratios. Thirty-six (36) companies had negative cash flows.

Dividend payout percentage will be computed to shed light on the dividend policy of the companies. It is computed as :

$$\text{PAYOUT} = \left[\frac{\text{Dividends Paid}}{\text{Profit Available to Ordinary Shareholders}} \right] \text{X } 100$$

In addition, debt ratios such as total debt to total assets and long-term debt to total assets will be computed. Long-term debt is defined as all loan funds obtained on a long-term basis and therefore not repayable within the next financial year. It does not include preference shares and deferred taxes. These ratios will indicate the proportion of assets that are financed by non-shareholder sources.

The success of managerial discretion over investment and financing policies can be determined by the extent to which economic value is created or destroyed. This is obtained through the market value added (MVA) measure. As indicated earlier, wealth creation increases the difference between the market value and total capital contributed by investors. Since MVA is a cumulative measure, two cut off points have to be established. These are the last trading days in 1992 and 1995. The extent to which management has created economic value for shareholders will be evaluated by the change in MVA over the period. MVA is calculated thus:

$$MVA = \left[\frac{(MV_{1995} - BKVAL_{1995}) - (MV_{1992} - BKVAL_{1992})}{(MV_{1992} - BKVAL_{1992})} \right] X\ 100$$

where MV is the market value of ordinary shares and

BKVAL is book value of ordinary shares

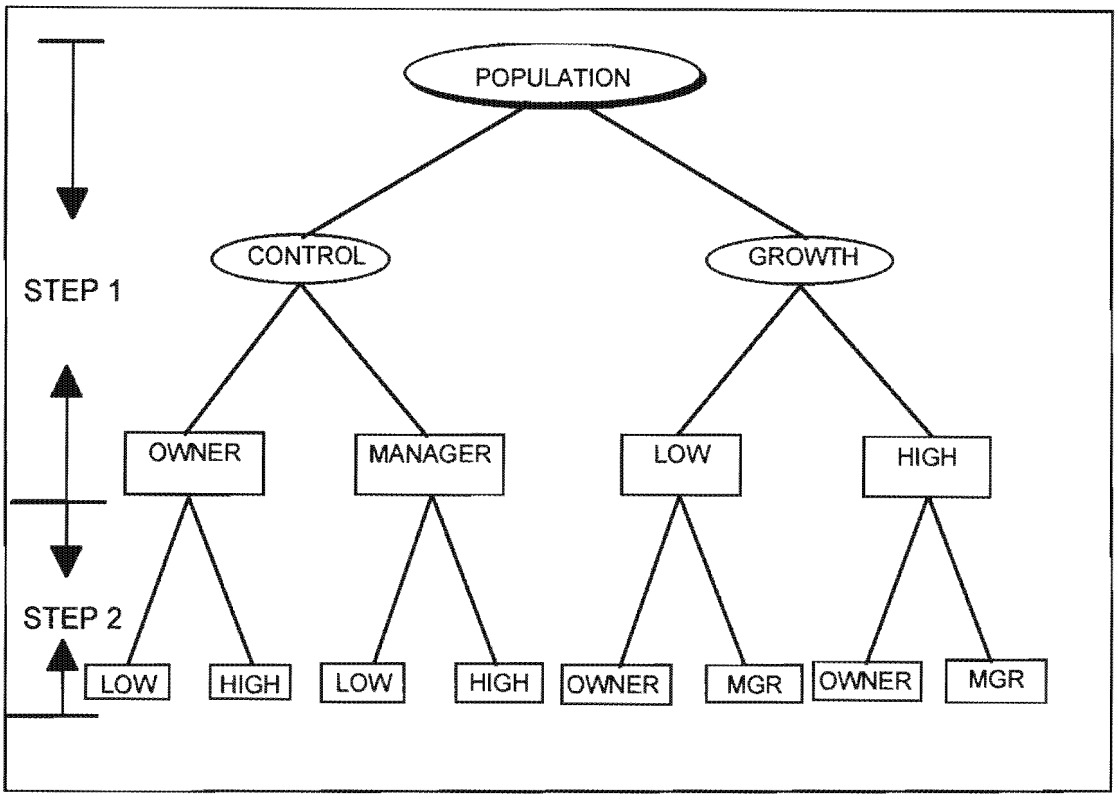
Preference shares are excluded from both MV and BKVAL. Although the MVA does not take account of the efficiency with which internally generated cash flows are utilised by managers, it can serve as a composite indicator of the performance of managers.

3.6 STRUCTURE OF ANALYSIS

The three major areas to be examined are debt policy, dividend policy and investment policy. Data will be analysed in pairs under each policy following a two-step approach. The approach is illustrated in Figure 3.1.

Figure 3.1

Data analysis procedure



As can be seen from Figure 3.1, the first step is comparison of companies categorised by type of control and by growth. That is owner controlled companies versus manager controlled companies and low growth companies versus high growth companies. The aim of this part was to present a broad view of the characteristics of the companies before finer divisions were made. The second step entailed comparison of companies categorised jointly by type of control and level of growth. The pairings under this step are low growth owner controlled companies versus high growth owner controlled companies; and, low growth manager controlled companies versus high growth manager controlled companies. The rest are low growth owner controlled companies versus low growth manager controlled companies; and, high growth owner controlled companies versus high growth manager controlled companies. Each of the policies is

analysed in turns under the above headings and a summary provided. A more detailed analysis is conducted in the second step.

The analysis begins with the comparison of the means and medians by the aid of tables and box and whisker plots. Two kinds of box and whisker plots are used. One is the mean plot with a box bounded by one standard error and whiskers representing a 95% confidence interval. The other is the median plot with a box bounded by the lower and upper quartiles and whiskers representing minimum and maximum points. Median plots are chosen because they are not highly sensitive to outliers. In both plots, the mean and median are identified by a small triangle in the box.

Some descriptive statistics are reported in tables. These are the mean, median, standard error, lower quartile, upper quartile and quartile range. The rest are minimum, maximum, skewness coefficient and kurtosis coefficient. In addition, the results of the t-test will be provided. Data is processed by Statistica 6.0 and Microsoft Excel 5.0.

The descriptive statistics are used to identify the basic nature of data. One aspect is to describe the centre of the data mass and the other is to describe the dispersion of the distribution. As an indication of the central tendency of the distribution the arithmetic mean and the median are calculated. The extent to which individual items vary around these central points is assessed. For the mean, the standard error is calculated. This statistic indicates whether the items are concentrated around the mean or widely dispersed throughout the distribution. For the median, the inter-quartile range will be employed as the measure of variation. This range accounts for the spread of the

middle 50% of the cases in the distribution, in that sense, the most significant part of the data.

To gain an insight into the symmetry of the distribution, the skewness, the kurtosis and the lower and upper quartiles are calculated. Skewness measures the amount of asymmetry in the distribution. The sign of the skewness coefficient indicates whether the majority of the items are less than or greater than the mean. When the distribution is positively skewed then it means that majority of the observations are less than the mean. For a negatively skewed distribution, majority of the items are greater than the mean. As a rough guide, skewness coefficients in the region of ±0.50 are considered as normal (Foster 1986, 106). Any value greater than this would indicate that the distribution is not normal. Since most of the ratios employed in this study are bounded by zero, it is envisaged that the distributions will be positively skewed. The kurtosis coefficient indicates whether the cases are homogenous or heterogeneous. Values in the region of ±1 are deemed to conform to a normal distribution (Foster 1986, 107). Basically this study is concerned with differences between pairs of means as illustrated in the Figure 4.1. The t-test, the test which measures the statistical significance of deviations from two means seems the most appropriate. However, there are certain conditions that must be satisfied to make it useful (Siegel & Castellan Jr. 1988, 20). These are :

— the observations must be independent,

— the observations must be drawn from normally distributed populations,

— the population must have the same variance, and

— the variables must have been measured in at least an interval scale.

The requirements concerning independence and measurement scale are met outright by the study. The independence of the observations is affirmed by the sample selection procedure as described in Section 3.2. The variables are measured in a ratio scale which has all the characteristics of an interval scale (Siegel & Castellan Jr. 1988, 30-32).

The normality of the population distribution could not be presumed. This is because any ratio which is bounded is unlikely to be normally distributed (Rees 1995, 107). For example the total debt to total assets ratio has a technical lower limit of zero a technical upper limit of one. The dividend payout ratio, FCFD and FCFI have an effective lower limit of zero and an indefinite upper limit. However, a normal distribution will include negative values.

In view of the matters raised above, it was necessary to transform the raw data to achieve a higher level of normality. Some researchers suggest that transformations such as taking the log or square root of ratios can be effective in symmetrising skewed distributions (Frecka & Hopwood 1983, Ezzamel, Molinero & Beeher, 1987). That is spreading out small values and compressing large ones. But other researchers view them as questionable manipulation of data which changes the interrelationships among variables and the relative positions of observations of a group [Eisenbeis (1977), Barnes (1982,57)].

Logarithmic transformation was chosen for this study. This method of transformation however has the disadvantage of not being applicable to negative and zero values. Since the dividend payout included zero values, this transformation was not applicable. The ratios were transformed in two ways. First, for ratios bounded between zero and infinity, the log of the ratio was taken. This was applicable to the FCFD and FCFI. Second, ratios bounded between zero and one were transformed by log[ratio/1-ratio] (Hawkins & Weber 1980, 414). These are total debt to total assets and long-term debt to total assets. MVA was not transformed because in the strict sense it does not satisfy the proportionality assumption underlying ratios.

The Shapiro-Wilk test was applied to the groups to determine whether the data follow a normal distribution. This test was chosen because it is an effective test for normality for small samples such as we have in this study (Shapiro & Wilk, 1968). The test was applied to the transformed values for debt ratios and FCF ratios and raw values for dividend payout and MVA. The results of the test are produced in Table 3.2.

Table 3.2

Results of Shapiro-Wilk Test

Ratios	Low Owner	High Owner	Low Manager	High Manager
Total Debt/Total Assets	0.9841	0.9554	0.9729	0.9294
LT Debt/Total Assets	0.9852	0.8960	0.9700	0.9862
Dividend Payout	0.8905	0.9501	0.9534	0.9821
FCFI	0.9519	0.9678	0.9658	0.9538
FCFD	0.9586	0.9461	0.9405	0.9828
MVA	0.6148*	0.3983*	0.8542*	0.7142*

*Normality rejected at 5% significance level

The results of the Shapiro-Wilk test indicate departures from normality for the MVA measure. All the MVA entries are significant at the 5% level. This affected the choice of statistical method to be applied in testing hypothesis. In the case of the MVA, the Mann-Whitney U test is used instead of the t-test. This test replaces the raw data by ranks and also has the effect of moderating the influence of outliers.

3.7 ASSUMPTIONS AND LIMITATIONS

The study is restricted to cash dividends declared and paid by the companies in question. Scrip dividends, which are offers of additional shares to shareholders in lieu of cash dividends are excluded from the analysis. This is because the emphasis of the study is on cash flows hence the limitation to cash items.

The study is limited by the effectiveness of the P/E ratio to adequately distinguish between low growth companies and high growth companies. By definition the numerator is the market price and the denominator is the accounting earnings of the companies. These items may be influenced by factors which are not common to both. For instance, an increase or decrease in inflation can be expected to have the same corresponding effects on the P/E ratio. However, this change is greater for firms employing short-lived assets than for firms employing long-lived assets (De Villiers, 1995). For that matter, any conclusions arrived at in this study should be viewed with this caveat in mind.

Another limitation of the study is the inability to capture the discretionary investment opportunities of companies and the cash spent on them. A way to get around this problem (as suggested in Section 3.5) was to take the global amount spent on investments for the analysis.

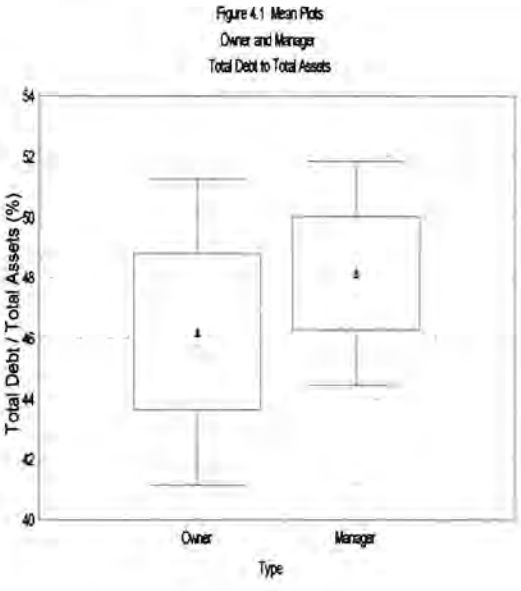
CHAPTER FOUR

EFFECT OF CONTROL STRUCTURES AND GROWTH ON FINANCIAL POLICIES

4.1 CONTROL STRUCTURES AND DEBT POLICY

The role of debt in curbing agency costs of FCF cannot be overemphasised. To recapitulate, debt pre-commits managers to pay out FCF in the form of interest payments and loan repayments. In view of this, companies that have a significant proportion of debt should incur lower agency costs of FCF than companies without this source of finance. The hypothesis to be examined in this vein is that the debt policy of owner controlled companies do not differ from that of manager controlled companies.

The measures to be used in this analysis are the total debt to total assets ratio and the long-term debt to total assets ratio. The comparison of the means are depicted in box and whisker plots in Figure 4.1 and Figure 4.2. Table 4.1 reports some descriptive statistics and results of the t-test on the debt policies of owner controlled and manager controlled companies.



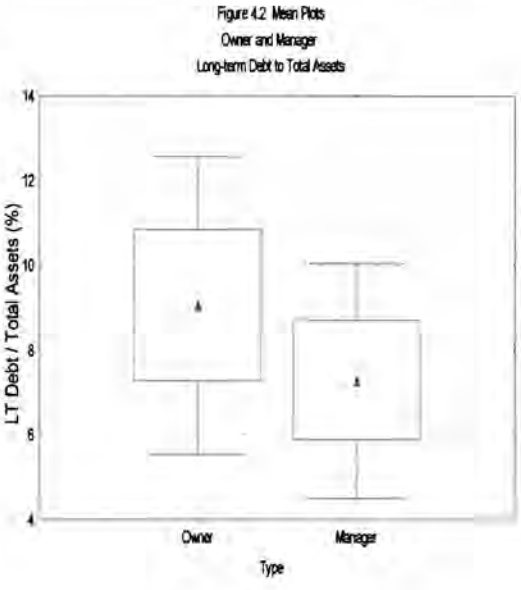


Table 4.1

Debt Policies of Owner Controlled and Manager Controlled Companies

	Count	Mean	Std Error	95% Confidence Interval		t-stat	p value
Total Debt/Total Assets:							
Owner	51	46.20	2.58	41.02	51.39		
Manager	58	48.14	1.86	44.36	51.91	-0.75	0.45
LT Debt/Total Assets:							
Owner	51	9.05	1.79	5.44	12.65		
Manager	58	7.28	1.42	4.44	10.11	0.89	0.38

The box and whisker plots present contrasting positions for the two ratios of owner and manager controlled companies. Figure 4.1 reveals that manager controlled companies assume a higher proportion of debt than owner controlled companies. Figure 4.2 however shows that manager controlled companies assume a lower proportion of long-term debt than owner controlled companies. There is an overlap in both ratios for the groups so some similarity exists.

As can be seen from Table 4.1, the t-statistic for the difference in the means of total debt to total assets and long-term debt to total assets are -0.75 and 0.89 respectively. This indicates a significance level of 0.45 for total debt to total assets and 0.38 for long-term debt to total assets. In view of the above results, the null hypothesis that the debt policies of owner controlled and manager controlled companies are similar is accepted.

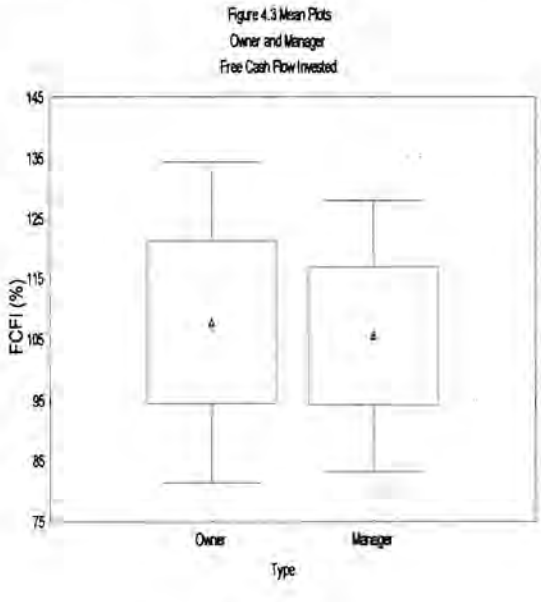
The relatively low means recorded for long-term debt to total assets of both groups reveal that long-term debt is not an important source of finance. Less than a tenth of assets are financed with long-term debt (Table 4.1). Hence, the impact of long-term debt on agency costs of FCF is minimal. The results contradict the findings of Uliana (1991) that owner controlled companies carry more debt than other types of companies. This could be due to the relatively high prime overdraft rate during the period. The weighted average of the prevailing prime overdraft rates, as published by the *South African Reserve Bank Quarterly Bulletin*, ranged from a low of 17.36% to a high of 20.33% during the period. To a limited extent, the findings are supportive of that of Shung et al (1987) that owner controlled companies adopt a conservative debt policy.

4.2 CONTROL STRUCTURES AND INVESTMENT POLICY

This section aims at identifying differences in the proportion of FCF invested and the economic value added by owner and manager controlled companies to the investment of shareholders. Analysis will be conducted via two measures, FCFI and MVA. The hypothesis to be tested is whether or not owner and manager controlled companies invest same proportions of FCF.

4.2.1 Free Cash Flow Invested

The box and whisker plots are shown in Figures 4.3 and 4.4 and the Table 4.2 provides a summary of the descriptive statistics and the results of the t-test.



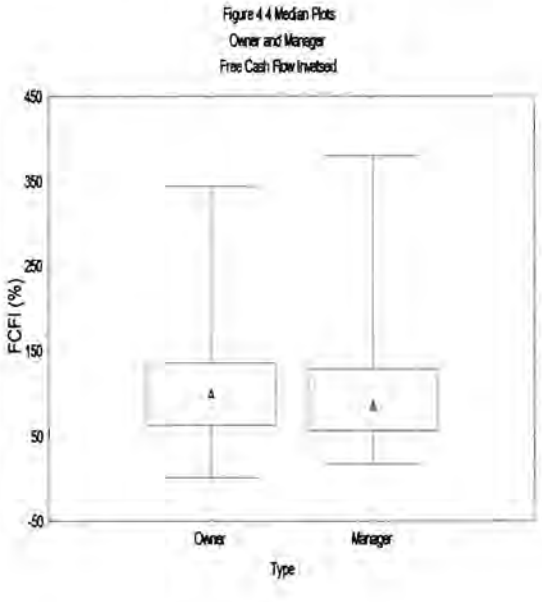


Table 4.2
Descriptive Statistics for Owner and Manager Controlled Companies
Free Cash Flow Invested

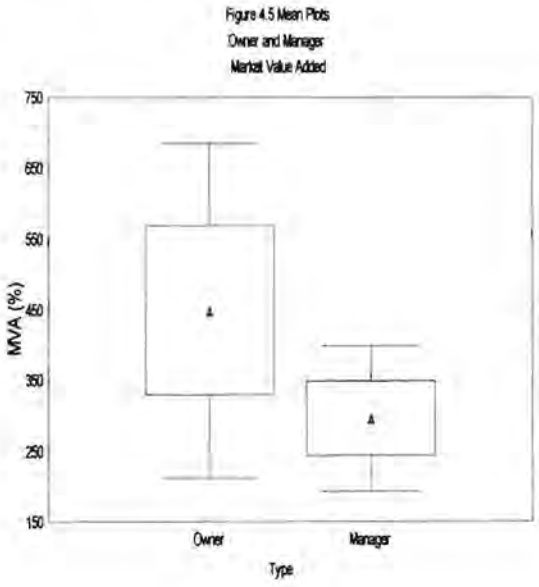
Statistics	Owner	Manager
Count	30	43
Mean	107.80	105.52
Median	100.82	85.98
Standard Error	13.50	11.41
Quartile Range	72.21	72.21
Lower Quartile	62.66	55.70
Upper Quartile	134.87	127.91
T-TEST		
t-stat	-0.63	
p-value	0.53	

The descriptive statistics for owner and manager controlled companies are remarkably similar. For instance the mean of owner controlled companies is 107.80% and the mean of manager controlled companies is 105.52%. It is noteworthy that both groups have the same quartile range of 72.21%. The similarity between the proportion of FCF invested for both groups is confirmed by the box and whisker plots (Figures 4.3 & 4.4) which overlap in a large part.

The difference in means between the two groups, observed in Table 4.2, is small and not significant (p=0.53). In other words, control structures do not affect the proportion of FCF invested. Both groups of companies seem to invest similar proportions of FCF. But the extent to which they achieve the objective of maximising shareholder wealth remains to be seen in the next section.

4.2.2 Market Value Added

Box and whisker plots are shown in Figures 4.5 and 4.6 and descriptive statistics in Table 4.3.



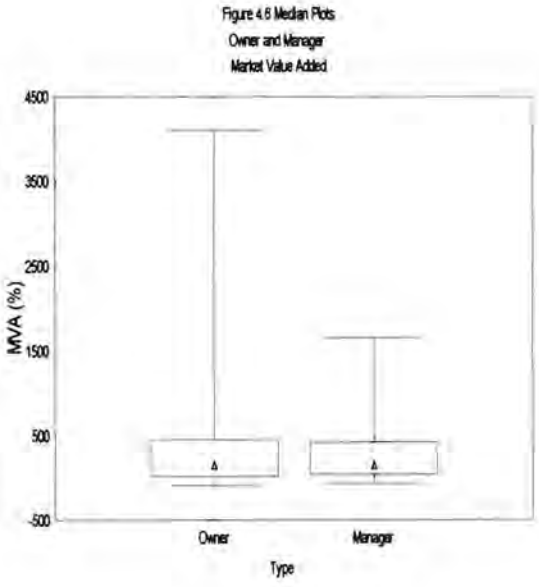


Table 4.3
Descriptive Statistics for Owner and Manager Controlled Companies
Market Value Added

Statistics	Owner	Manager
Count	51	58
Mean	448.17	295.33
Median	149.66	150.57
Standard Error	120.42	52.37
Quartile Range	434.08	388.84
Lower Quartile	11.39	32.66
Upper Quartile	445.47	421.59
Minimum	-88.22	-69.79
Maximum	4098.39	1657.14
Mann-Whitney U Test u-stat 1465.00 p-value 0.930		

Figure 4.5 shows that the change in MVA for owner controlled companies is greater than that of manager controlled companies. But Figure 4.6 reveals that three quarters of companies in each group have similar MVA measures. The long whisker of the plot of owner controlled companies is an indication of the presence of high ratios that dominate the sample. This is reflected in the relatively high standard error of 120.42 for owner controlled companies as against 52.37 for manager controlled companies.

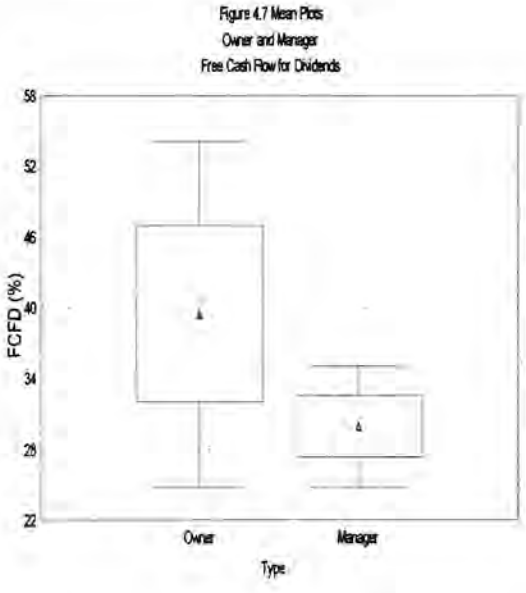
The results of the Mann-Whitney U test do not show any significant difference in the change in MVA. The U stat of 1465 and the associated probability value of 0.93 indicates that there is no major difference in the value added by both groups. However it is worth noting that most companies recorded positive contributions to the investment of shareholders. This can be observed from the lower quartiles of 11.39% and 32.66% for owner controlled and manager controlled companies respectively.

4.3 CONTROL STRUCTURES AND DIVIDEND POLICY

The hypothesis to be tested is whether or not both categories have similar dividend payout. This aspect of the argument proposes that by paying consistently high dividends, managers are forced to raise additional capital in the market. The evaluation processes associated with this event induces managers to utilise FCF optimally. Thus the dividend policy of owner controlled companies and manager controlled companies are examined via FCFD and dividend payout.

4.3.1 Free Cash Flow for Dividends

The box and whisker plots are reported in Figures 4.7 and 4.8 and the descriptive statistics are listed in Table 4.4.



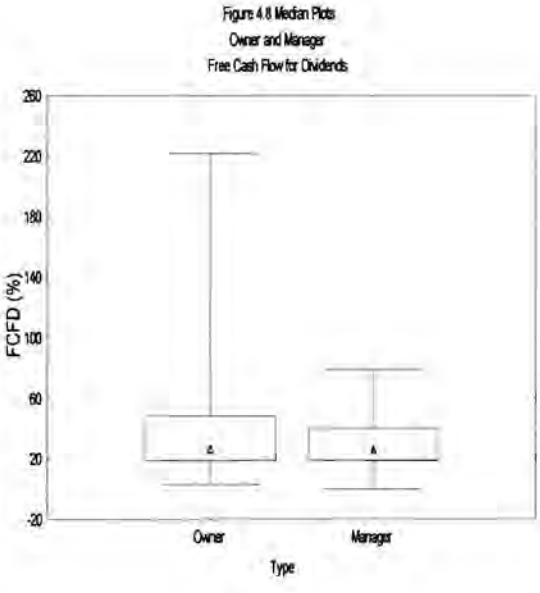


Table 4.4

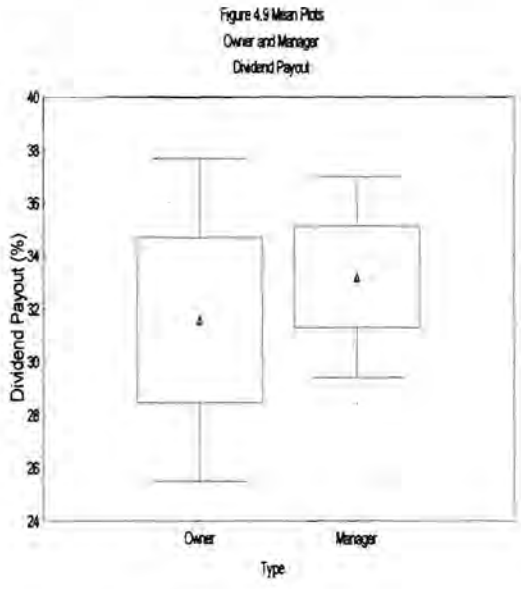
Descriptive Statistics for Owner and Manager Controlled Companies
Free Cash Flow for Dividends

Statistics	Owner	Manager
Count	30	43
Mean	39.43	29.93
Median	26.46	26.26
Standard Error	7.49	2.62
Quartile Range	30.10	21.59
Lower Quartile	18.09	18.41
Upper Quartile	48.19	40.00
T-TEST		
t-stat	-0.24	
p-value	0.81	

Owner controlled companies pay out a greater proportion of FCF than manager controlled companies. The mean FCFD of owner controlled companies is 39.43% as against 29.93% of manager controlled companies. There is however the possibility that the results are dominated by extreme observations. This is certainly the case in the present instance because the standard error of owner controlled companies, that is 7.49, is far higher than 2.62 recorded by manager controlled companies. The medians are almost the same and the plots show that there is little variation in the FCF payout percentages of the groups. The lower and upper quartiles of owner and manager controlled companies indicate that the middle 50% of companies follow similar policies. The lower and upper quartiles of owner controlled companies are 18.09% and 48.19% respectively. On the other hand, manager controlled companies have a lower quartile of 18.41% and an upper quartile of 40%. The p-value of 0.81 indicates there is no significant difference in the proportion of FCF paid out to shareholders.

4.3.2 Dividend Payout

Figures 4.9 and 4.10 display the box and whisker plots of the two categories. Table 4.5 lists the descriptive statistics of owner controlled companies alongside those of manager controlled companies.



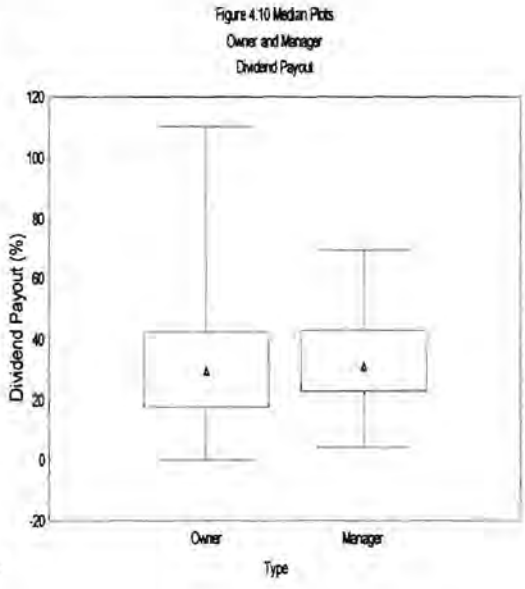


Table 4.5
Descriptive Statistics for Owner and Manager Controlled Companies
Dividend Payout

Statistics	Owner	Manager
Count	50	56
Mean	31.57	33.20
Median	29.45	30.96
Standard Error	3.11	1.93
Lower Quartile	17.48	22.45
Upper Quartile	42.11	42.92
Quartile Range	24.63	20.48
T-TEST t-stat -0.45 p-value 0.65		

The box and whisker plots reveal that manager controlled companies pay almost the same portion of earnings as dividends like owner controlled companies. From Table 4.5, the means of owner controlled and manager controlled companies are 31.57% and 33.20% respectively. Also, the overlap in the spread of the boxes (Figures 4.9 & 4.10) shows that both groups have similar payout percentages.

The difference in means between the two groups is not significant (p=0.64). This contradicts the assertion of Uliana (1989) that owner controlled companies pay higher dividends than manager controlled companies. As noted earlier under debt policy, the difference in finding could be due to the sample selection procedure.

4.4 SUMMARY

Both groups do not report any significant difference in debt, investment and dividend policies. The null hypotheses are therefore accepted in all the above instances. The implications of these findings are that:

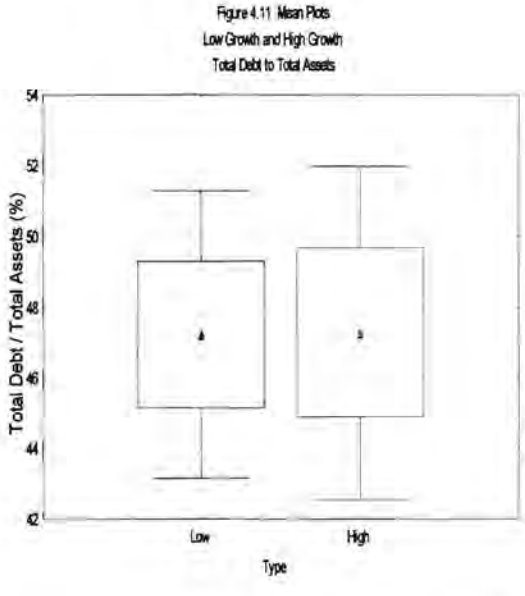
— the impact of debt in bonding managers to use FCF is negligible,

— control structures do not influence the investment of FCF, and

— control structures have little influence on the payout of FCF.

4.5 GROWTH AND DEBT POLICY

The comparison of low growth to high growth companies should provide a ground for identifying differences arising from the growth factor as explained in Section 3.1. The hypothesis to be examined is that low growth and high growth companies carry same proportions of debt. The data for total debt to total assets are depicted in Figure 4.11 and long-term debt to total assets in Figure 4.12. Some descriptive statistics and the results of the t-test are produced in Table 4.6.



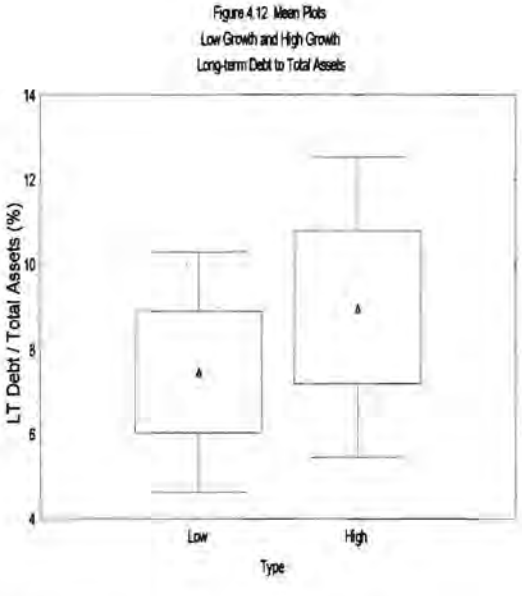


Table 4.6

Debt Policies of Low Growth and High Growth Companies

	Count	Mean	Std Error	95% Confidence Interval		t-stat	p value
Total Debt/Total Assets:							
Low Growth	63	47.21	2.08	43.06	51.37		
High Growth	46	47.26	2.40	42.42	52.10	0.15	0.88
LT Debt/Total Assets:							
Low Growth	63	7.46	1.44	4.59	10.34		
High Growth	46	8.98	1.81	5.34	12.62	-0.58	0.56

The overlapping of the boxes in Figure 4.11 indicates that low growth and high growth companies carry similar levels of debt. This is not surprising as the mean of 47.21% for low growth companies and 47.26% for high growth companies hardly show any difference. However, a slight difference is noticeable between both groups in terms of the proportion of assets financed by long-term debt (Figure 4.12). The role of long-term debt in reducing agency costs of FCF is negligible. The low means signify that only a small portion of assets is financed with long-term debt.

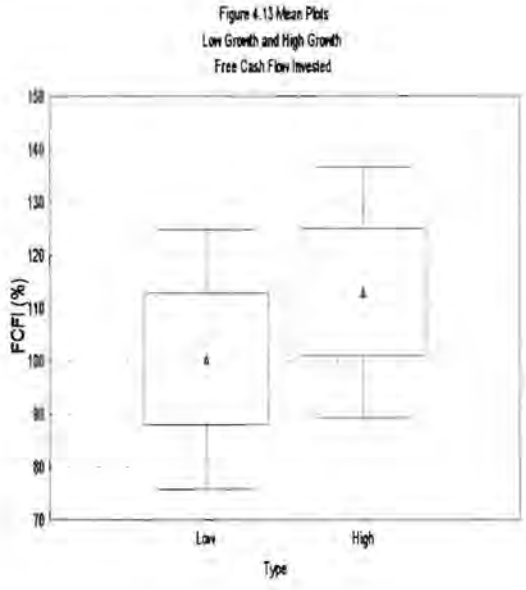
The t-test results confirm the visual impression that there is no significant difference in the levels of debt contracted by low growth and high growth companies. The null hypothesis is therefore accepted. The unanticipated support for the alternate hypothesis affords a useful opportunity to explore further the implications of these findings. First, it is possible that the growth factor is not an important determinant of debt policy. Factors such as control structures, risk considerations and availability of debt finance could affect the assumption of debt by these companies. Further analysis might be revealing. Second, other sources of finance such as the issuing of additional shares and retention of earnings could be substituted for debt. Third, the effectiveness of the P/E ratio as a proxy for growth could be questioned.

4.6 GROWTH AND INVESTMENT POLICY

It is expected that growth prospects will affect the investment of FCF and consequently the level of returns on investment. The investment policies of low growth and high growth companies as represented by FCFI and MVA are discussed in this section. The hypothesis in this regard is that low growth and high growth companies invest same proportions of FCF.

4.6.1 Free Cash Flow Invested

Figures 4.13 and 4.14 display the box and whisker plots of low growth and high growth companies. Table 4.7 reports the summary statistics.



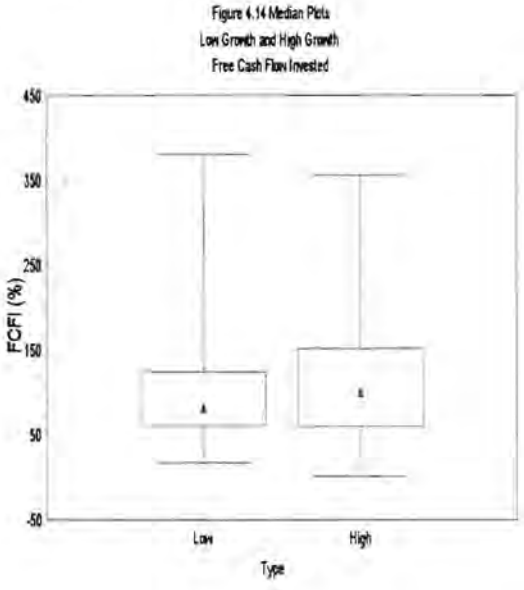


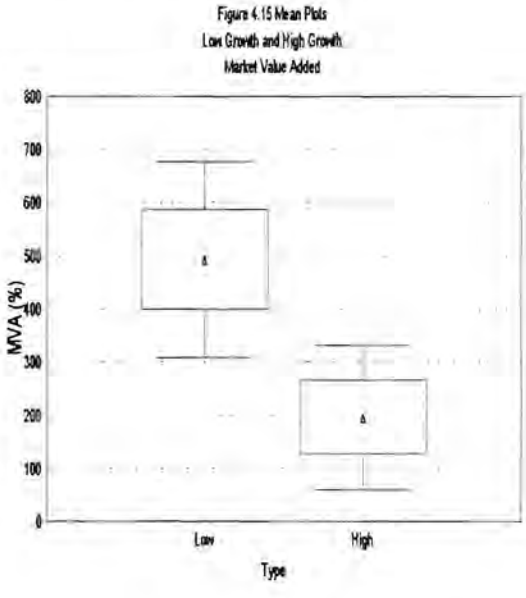
Table 4.7
Descriptive Statistics for Low and High Growth Companies
Free Cash Flow Invested

Statistics	Low	High
Count	37	36
Mean	100.18	112.91
Median	80.83	99.72
Standard Error	12.49	12.05
Quartile Range	63.73	92.09
Lower Quartile	59.38	58.61
Upper Quartile	123.11	150.70
T-TEST		
t-stat	-0.25	
p-value	0.80	

Both the mean and median plots depict high growth companies as investing a higher proportion of FCF than low growth companies. Low growth companies invest on the average 100.18% of FCF while high growth companies invest 112.91% of FCF. For the median, low growth companies even display a much smaller value of 80.83% as compared to 99.72% for high growth companies. But the spread of the companies are quite close as indicated by the standard errors, 12.49 for the low growth group and 12.05 for the high growth group. It is important to note that in both cases, more than half of FCF is invested by majority of the companies. This is evidenced by the lower quartiles of 59.38% and 58.61% for low growth and high growth companies respectively. The results of the t-test do not reveal any significant difference in FCFI of both groups.

4.6.2 Market Value Added

The box and whisker plots comparing low growth companies to high growth companies are depicted in Figure 4.15 and 4.16. A table of descriptive statistics follows in Table 4.8.



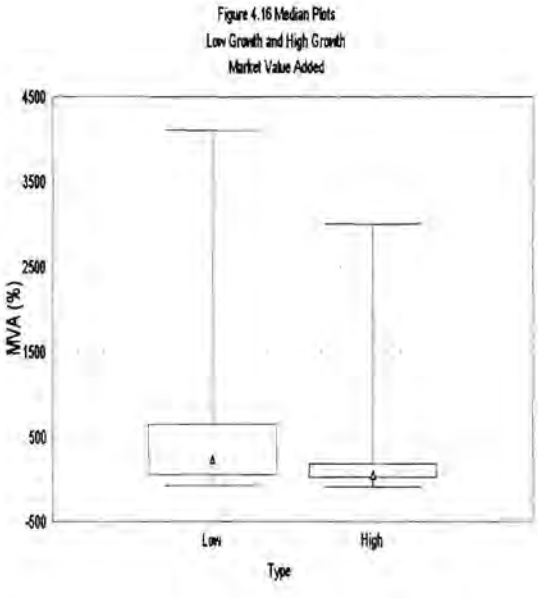


Table 4.8

Descriptive Statistics for Low and High Growth Companies
Market Value Added

Statistics	Low	High
Count	63	46
Mean	492.08	195.32
Median	234.78	49.48
Standard Error	93.73	69.59
Quartile Range	596.61	165.69
Lower Quartile	46.58	12.94
Upper Quartile	643.19	178.63
Minimum	-72.84	-88.23
Maximum	4098.39	3005.97
Mann-Whitney U Test u-stat 936.00 p-value 0.00		

The box and whisker plots of low growth companies are noticeably different from those of high growth companies (Figure 4.15 & 4.16). Low growth companies achieve a higher increase in MVA than high growth companies. As can be seen from the mean plots there is virtually no overlap between both groups of companies. The mean MVA of low growth companies is 492.09% and is far greater than 195.32% of high growth companies. The same trend is shown in the median plots. The median of low growth companies is 234.78% and that of high growth companies is 49.48%. The quartile ranges show that low growth companies are widely dispersed than high growth companies. These are 596.61% and 165.69% for low growth and high growth companies respectively.

The Mann-Whitney U test results reaffirm the observations made in the foregoing paragraphs. The U stat of 936.00 reveals a statistically significant difference in MVA at an extremely high level of probability ($p = 0$). This significant result puts low growth companies ahead of high growth companies in terms of meeting the expectations of shareholders.

4.7 GROWTH AND DIVIDEND POLICY

The relationship between growth and dividend policy is investigated in this section. Dividend theory suggests that companies which require funding for superior investment opportunities should not pay dividends. The reason is to conserve cash for investment purposes. For instance a high growth company is not expected to distribute FCF as much as a low growth company. The null hypothesis put forward here is that the dividend policies of such companies are similar.

4.7.1 Free Cash Flow for Dividends

The percentage of FCF paid as dividends by low growth and high growth companies are compared in box and whisker plots in Figures 4.17 and 4.18 and the descriptive statistics are listed in Table 4.9.

Figure 4.17 Mean Plots
Low Growth and High Growth
Free Cash Flow for Dividends

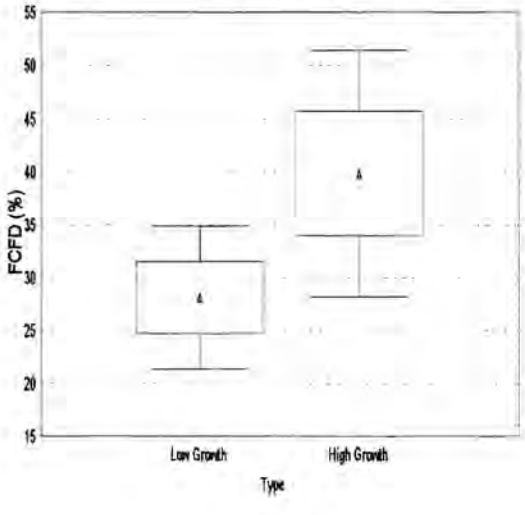


Figure 4.18 Median Plots
Low Growth and High Growth
Free Cash Flow for Dividends

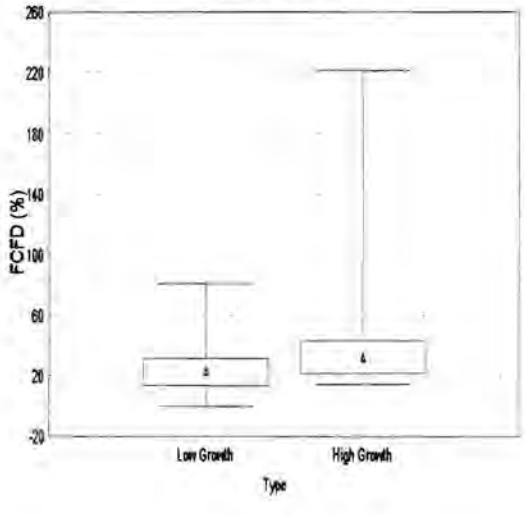


Table 4.9
Descriptive Statistics for Low and High Growth Companies
Free Cash Flow for Dividends

Statistics	Low	High
Count	37	36
Mean	28.06	39.78
Median	23.44	32.46
Standard Error	3.45	5.94
Quartile Range	18.51	21.75
Lower Quartile	12.91	21.26
Upper Quartile	31.42	43.01
T-TEST		
t-stat	-2.41	
p-value	0.02	

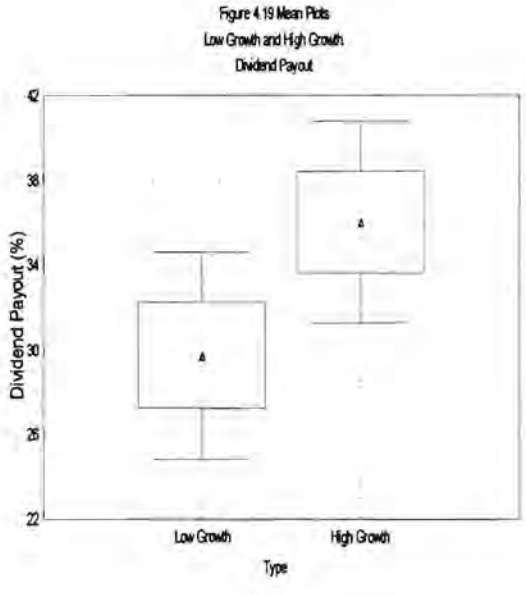
It is immediately evident in Figures 4.17 and 4.18 that high growth companies pay a remarkably higher percentage of FCF as dividends than low growth companies. Low growth companies have a relatively low mean of 28.06% compared with 39.78% for high growth companies. Also low growth companies have a lower median of 23.44% as against 32.44% for high growth companies. A closer inspection of the spread of both groups provides some interesting details. In both groups, the upper quartile is less than 50% which suggests that majority of companies pay only a small proportion of FCF as dividends.

The results of the t-test are shown in Table 4.9, and the null hypothesis is rejected at 0.02 significance level. The finding that high growth companies pay a higher proportion of FCF than low growth companies is puzzling. This is not consistent with the expectations mentioned in Section 3.1. In spite of the fact that the analysis has not led to a suitable explanation of these findings, it is refreshing that the analogy between

FCFD and dividend payout is easy to make. A look at dividend payout in tandem with FCFD should provide a clearer picture on this issue.

4.7.2 Dividend Payout

Box and whisker plots comparing low growth to high growth companies are presented in Figures 4.19 and 4.20 while Table 4.10 provides a list of descriptive statistics.



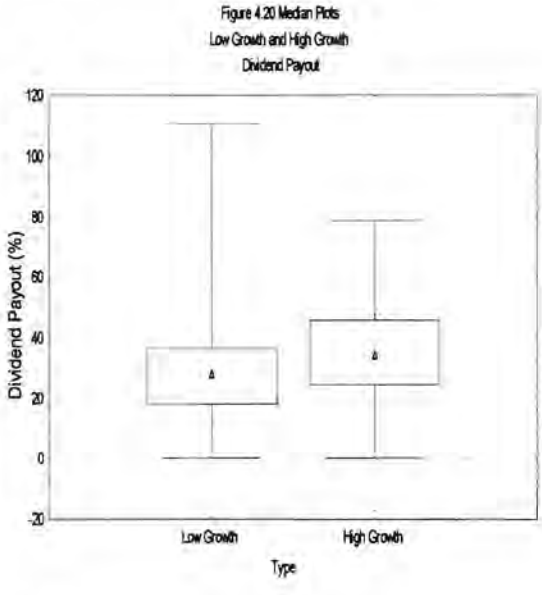


Table 4.10
Descriptive Statistics for Low and High Growth Companies
Dividend Payout

Statistics	Low	High
Count	60	46
Mean	29.69	35.10
Median	27.94	34.41
Standard Error	2.49	2.43
Lower Quartile	17.59	24.20
Upper Quartile	36.18	45.47
Quartile Range	18.59	21.27
T-TEST		
t-stat	-1.78	
p-value	0.08	

The box and whisker plots generally indicate that the dividend payout of high growth companies is higher than the payout of low growth companies (Figures 4.19 & 4.20). The descriptive statistics presented in Table 4.10 show a some variability between the dividend payout of the two groups. For instance the mean payout of low growth companies is 29.69% and that for high growth companies is 35.40%. The median payout for low growth companies, that is 27.94% is again smaller than 34.41% for high growth companies. Another aspect worth commenting on is the quartile range. Both the lower and upper quartile of high growth companies are greater than that of low growth companies. This brings a clear difference between the dividend payout of both groups. The results of the t-test do not reveal any significant difference between the dividend payout of both groups. The p-value of 0.08 is actually at the threshold of reporting a significant difference.

The observations on dividend payout could be helpful in explaining the findings on FCFD. High growth companies actually pay a slightly greater portion of earnings to shareholders than low growth companies. But this contradicts the argument of Rozef (1982) that companies with greater growth opportunities choose lower payout ratios to reduce the need for costly external financing. The higher payout observed in high growth companies cannot be attributed to external borrowing. As reported in Section 4.5, high growth companies adopt similar proportions of debt as low growth companies. Hence the results are not explained by this characteristic.

4.8 SUMMARY

High growth companies adopt same proportions of debt as low growth companies. Both groups invest similar proportions of FCF but low growth companies add significantly higher values to the investment of shareholders than high growth companies. This finding is somehow consistent with the trend of value stocks outperforming growth stocks on the big stock exchanges in the world. However, it also raises questions about the effectiveness of the P/E ratio as a measure of growth. The dividend policies of low growth and high growth companies are very different. Surprisingly high growth companies pay out higher dividends than low growth companies and this could be a signalling move.

CHAPTER FIVE

EFFECT OF CONTROL STRUCTURES ON THE FINANCIAL POLICIES OF LOW GROWTH COMPANIES AND HIGH GROWTH COMPANIES

5.1 DEBT POLICY OF LOW GROWTH COMPANIES

The hypothesis to be examined in this vein is that the debt policies of low growth owner controlled companies and low growth manager controlled companies do not differ. As indicated in Section 3.1, the comparison of low growth companies should provide a common ground for identification of differences arising from control structures.

5.1.1 Total Debt to Total Assets

The box and whisker plots for low growth owner controlled companies and low growth manager controlled companies are depicted in Figures 5.1 and 5.2.

Figure 5.1 Mean Plots
Low Growth Companies
Total Debt to Total Assets

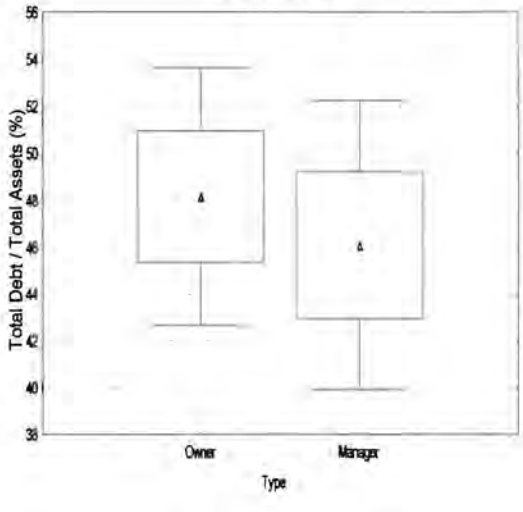
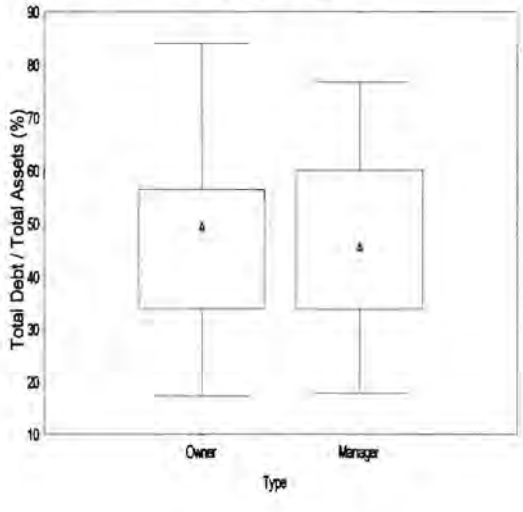


Figure 5.2 Median Plots
Low Growth Companies
Total Debt to Total Assets



The mean plots show that owner controlled companies assume a higher proportion of debt than manager controlled companies (Figure 5.1). Figure 5.2 reveals that owner controlled companies have a lower inter-quartile range. It can be seen that owner controlled companies are widely dispersed in the bottom half than in the upper half of the distribution (Figure 5.2). Table 5.1 reports some relevant descriptive statistics and results of the t-test.

Table 5.1
Descriptive Statistics for Low Growth Companies
Total Debt to Total Assets

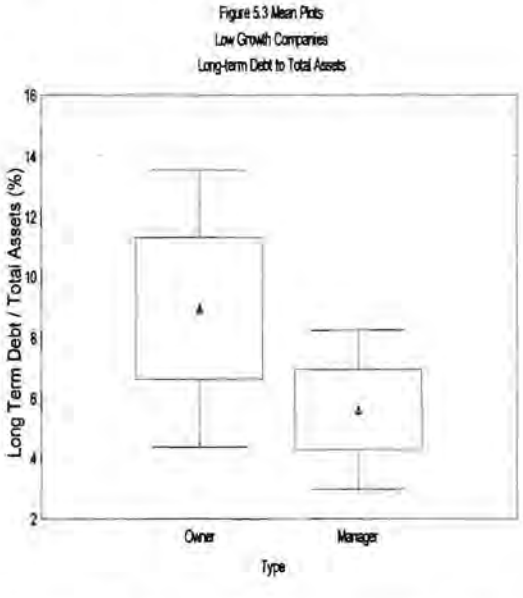
Statistics	Owner	Manager
Count	35	28
Mean	48.13	46.07
Median	49.67	45.65
Standard Error	2.80	0.31
Lower Quartile	33.64	33.60
Upper Quartile	56.48	60.01
Quartile Range	22.84	26.41
Skewness	0.23	0.15
Kurtosis	-0.41	-1.02
T-TEST		
t-stat	0.53	
p-value	0.60	

Table 5.1 shows that most of the statistics are similar for both groups. One exception is the coefficient of kurtosis. The kurtosis coefficient of -1.02 recorded for manager controlled companies suggests that most companies in this category are clustered around the mean of 46.07%. Owner controlled companies have a slightly greater skewness coefficient of 0.23 which indicates a greater concentration of companies above the mean of 48.13%. This is confirmed by the cluster of companies in the narrow range between the median of 49.67% and the upper quartile of 56.48%.

The t-test does not reveal any significant difference in the levels of debt adopted by these companies. In aggregate both groups seem to apply the same proportion of debt but the marginally wider spread of manager controlled companies suggests that they contract varying levels of debt.

5.1.2 Long-term Debt to Total Assets

The mean plots of low growth owner controlled companies and low growth manager controlled companies are depicted in Figure 5.3 and the median plots are shown in Figure 5.4.



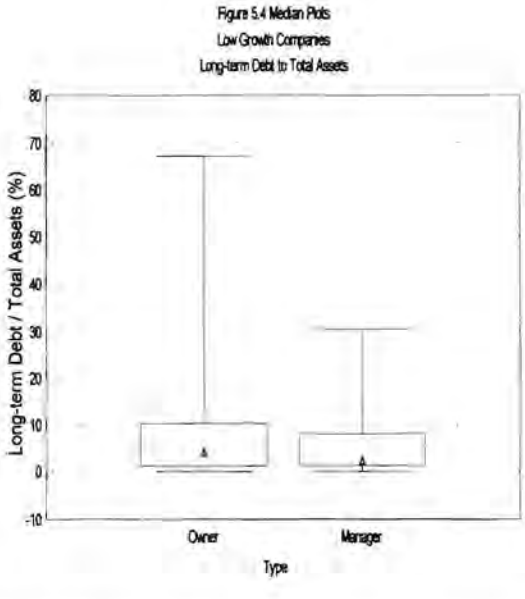


Figure 5.3 shows that low growth owner controlled companies take on more long-term debt than low growth manager controlled companies. The median of the owner controlled group is slightly larger than the median of the manager controlled group, but the two distributions overlap substantially. Actually majority of the companies have very low ratios. By inspection, 75% of the companies in each group have ratios below 10% (Figure 5.4). But above the upper quartile, owner controlled companies display a greater variability than manager controlled companies. This perhaps hints at

the presence of extreme observations. This is evidenced by the wider range between the upper quartile and maximum point in the median plot of owner controlled companies. The data points of both groups are reported in Table 5.2.

Table 5.2
Descriptive statistics for Low Growth Companies
Long-term Debt to Total Assets

Statistics	Owner	Manager
Count	35	28
Mean	8.95	5.60
Median	4.17	2.38
Standard Error	2.34	1.35
Lower Quartile	1.05	1.15
Upper Quartile	10.20	8.08
Quartile Range	9.15	6.94
Skewness	3.02	1.98
Kurtosis	10.19	4.34
T-TEST t-stat 1.81 p-value 0.08		

Owner controlled companies recorded a mean of 8.95% which is greater than the mean of 5.60% recorded by manager controlled companies (Table 5.2). Also, the median of owner controlled companies is greater than the median of manager controlled companies. These are 4.17% and 2.38% for owner controlled companies and manager controlled companies respectively. Interpreting the mean of owner controlled companies by the corresponding skewness coefficient of 3.02 implies that the majority of companies have ratios below the mean. In relation to the median, it is notable that both groups have close quartile ranges. The quartile range of 9.15% for owner controlled companies and 6.94% for manager controlled companies point to the homogeneity of cases in each group. In addition it shows that long-term debt does not constitute an important source of finance.

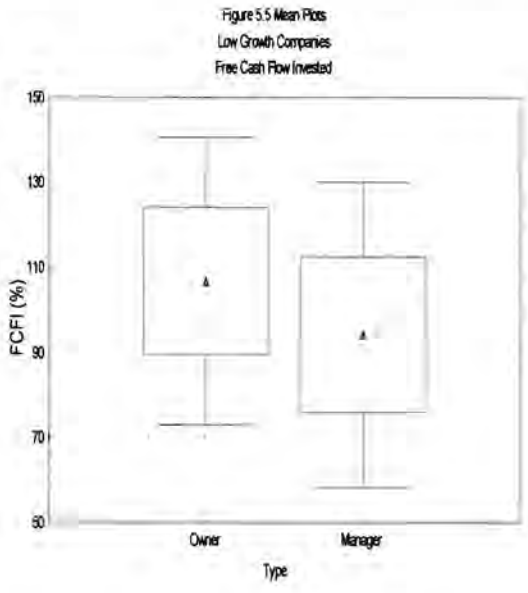
The t-statistic of 1.81 which gives a p-value of 0.08 does not reveal any significant difference in the long-term debt position of both groups. The null hypothesis is therefore accepted

5.2 INVESTMENT POLICY OF LOW GROWTH COMPANIES

This section deals with the investment policy of low growth owner controlled companies and low growth manager controlled companies. Low growth companies are assumed to have few investment opportunities so they are not expected to expend high proportions of FCF in this respect. This pairing places the categories on equal grounds so any difference identified could be attributed to control structures.

5.2.1 Free Cash Flow Invested

The box and whisker plots of low growth owner controlled companies and low growth manager controlled companies are shown in Figures 5.5 and 5.6, and Table 5.3 provides a list of descriptive statistics for both groups.



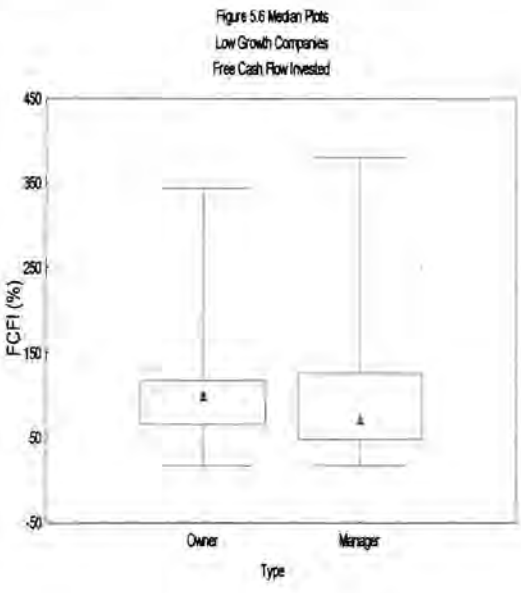


Table 5.3
Descriptive Statistics for Low Growth Companies
Free Cash Flow Invested

Statistics	Owner	Manager
Count	18	19
Mean	106.65	94.05
Median	98.93	71.10
Standard Error	17.25	18.35
Lower Quartile	64.47	47.09
Upper Quartile	117.51	125.98
Quartile Range	53.04	78.89
Skewness	2.14	2.72
Kurtosis	6.21	9.42
T-TEST t-stat 0.80 p-value 0.43		

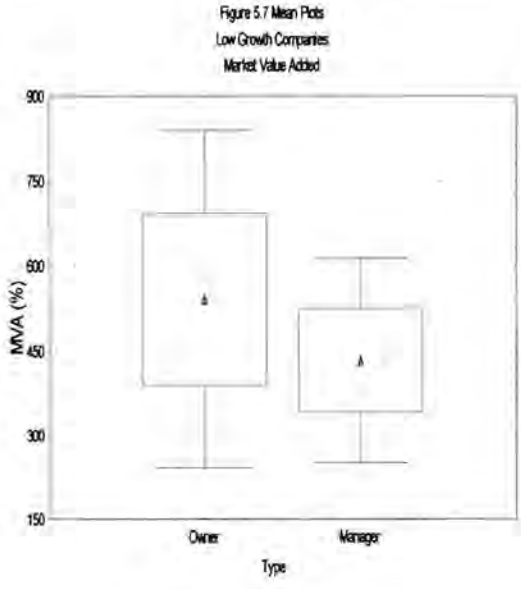
There is little difference between the mean and median for both groups. The means are 106.65% and 94.05% for low growth owner and low growth manager controlled companies respectively. But the medians are not so close. They are 98.93% for low growth owner controlled group and 71.10% for low growth manager controlled group. The median plots show that low growth owner controlled companies invest almost the

same proportions of FCF while low growth manager controlled companies invest varying percentages of FCF. This is illustrated by the quartile range of both groups. The quartile range of 53.04% for low growth owner controlled companies is smaller than 78.89% for low growth manager controlled companies.

As has been implied by the box and whisker plots, the t-test does not reveal any significant difference in the proportion of FCF invested. The similarity of both groups stresses the role of the growth factor in the utilisation of FCF. This is confirmed by the fact that most companies invest less than 100% of FCF. Thus suggesting that these companies do not borrow funds to finance dwindling investment opportunities.

5.2.2 Market Value Added

The comparison of both groups is shown in the box and whisker plots (Figures 5.7 & 5.8). Table 5.4 reports the descriptive statistics.



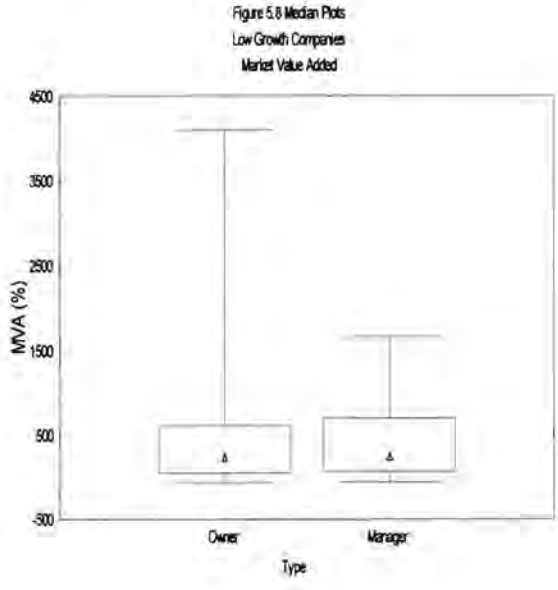


Table 5.4
Descriptive Statistics for Low Growth Companies
Market Value Added

Statistics	Owner	Manager
Count	35	28
Mean	540.33	431.77
Median	234.78	246.58
Standard Error	152.52	92.37
Quartile Range	567.32	627.41
Lower Quartile	36.68	64.57
Upper Quartile	604.00	691.98
Minimum	-72.84	-69.79
Maximum	4098.39	1657.14
Mann-Whitney U Test		
u-stat	486.00	
p-value	0.96	

The median plots hardly show any difference in MVA of both groups. Both groups have very close medians. That is 234.78% for owner controlled companies and 246.58% for manager controlled companies. The spread of manager controlled companies is a little above that of owner controlled companies. Low growth manager controlled companies have a higher quartile range, 627.41% as opposed to 567.32% of owner controlled companies. What it means is that manager controlled companies achieve higher and more varied changes in MVA than low growth owner controlled companies.

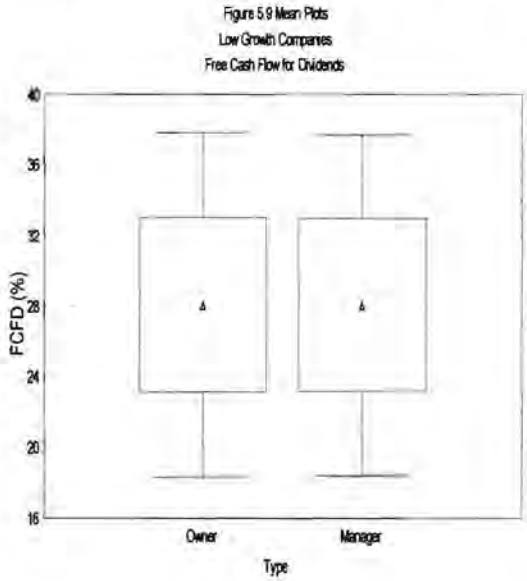
The Mann-Whitney U test confirms that there is no significant between the economic value added by the two groups. This provides further justification for segregating companies by growth potential as both groups seem to be equally rated by the market.

5.3 DIVIDEND POLICY OF LOW GROWTH COMPANIES

The dividend policy of low growth owner controlled companies and low growth manager controlled companies are compared in this section. In such companies the avenues for profitable investments are limited. If this situation persists then the objective of shareholder wealth maximisation dictates that surplus cash be returned to the owners of the company.

5.3.1 Free Cash Flow for Dividends

Low growth owner controlled companies and low growth manager controlled companies are compared in box and whisker plots in Figures 5.9 and 5.10. The descriptive statistics of both groups are listed in Table 5.5.



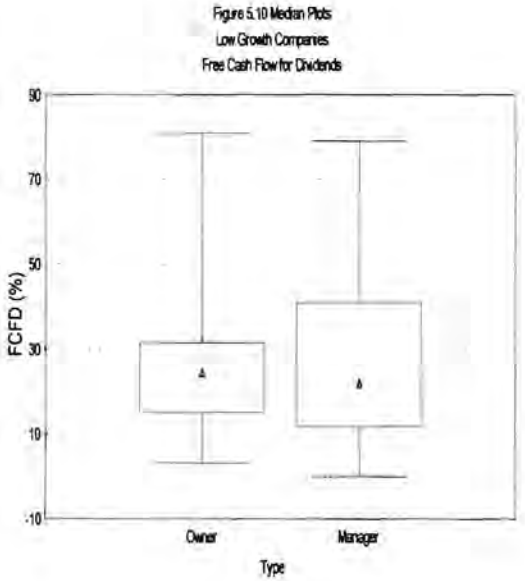


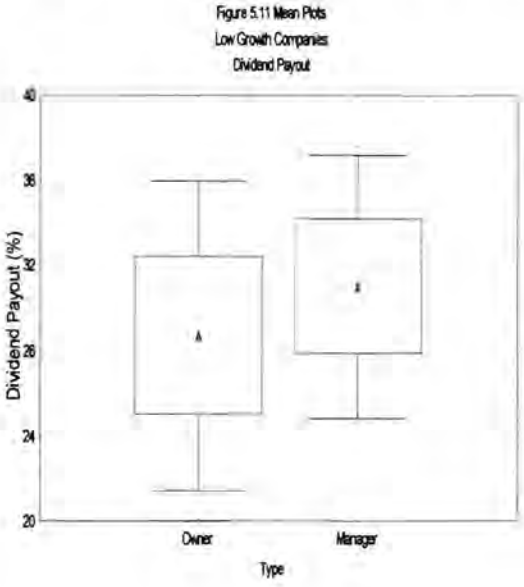
Table 5.5
Descriptive Statistics for Low Growth Companies
Free Cash Flow for Dividends

Statistics	Owner	Manager
Count	18	19
Mean	28.07	28.05
Median	22.44	22.04
Standard Error	4.97	4.93
Lower Quartile	14.93	11.55
Upper Quartile	31.42	40.99
Quartile Range	16.49	29.44
Skewness	1.42	1.12
Kurtosis	1.78	0.47
T-TEST		
t-stat	-0.46	
p-value	0.65	

It is remarkable that the mean FCFD of both groups are very close. Low growth owner controlled companies have a mean 28.07% and that of low growth manager controlled companies is 28.05%. In a similar fashion, the medians are very close. These are 24.44% and 22.04% for low growth owner and low growth manager controlled companies respectively. The above observations are confirmed by the visual impression of the box and whisker plots. Both plots display a great deal of overlapping. The only difference is that low growth owner controlled companies have a slightly lower quartile range than low growth manager controlled companies. That is 16.49% as against 29.44%. No significant difference is reported by the t-test. In general, these companies should experience high agency costs because they retain FCF in the face of low investment opportunities. The issue here is the tendency to invest in negative NPV projects.

5.3.2 Dividend Payout

The box and whisker plots are presented in Figures 5.11 and 5.12. Table 5.6 reports the descriptive statistics for both groups and the results of the t-test.



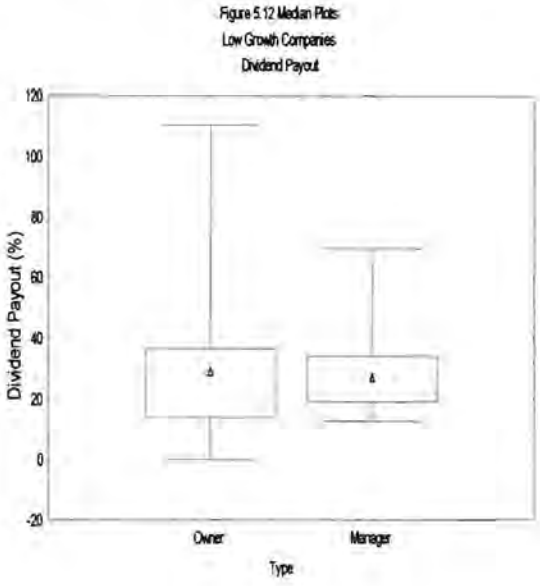


Table 5.6
Descriptive Statistics for Low Growth Companies
Dividend Payout

Statistics	Owner	Manager
Count	34	26
Mean	28.70	30.10
Median	28.93	26.99
Standard Error	3.71	3.16
Lower Quartile	13.64	18.59
Upper Quartile	36.42	33.99
Quartile Range	22.78	15.40
Skewness	1.55	1.20
Kurtosis	4.84	0.66
T-TEST		
t-stat	-0.45	
p-value	0.65	

It can be seen from the box and whisker plots that both groups of companies have quite similar dividend payout percentages. The boxes of both plots overlap, thus indicating similarity in the middle 50% of the constituents of the groups (Figures 5.11 & 5.12). The mean payout of 28.70% for low growth owner controlled companies is only a little lower than 30.10% for high growth manager controlled companies. Figure 5.12 reveals that most companies in both groups pay less than 40% of earnings as dividends. The noticeable variation is that some owner controlled companies did not pay dividends at all. This suggests the presence of agency costs of FCF in such companies. The t-test does not report any significant difference between the payout of the groups. As far as control structures are concerned, no differences in dividend payout can be established.

5.4 SUMMARY

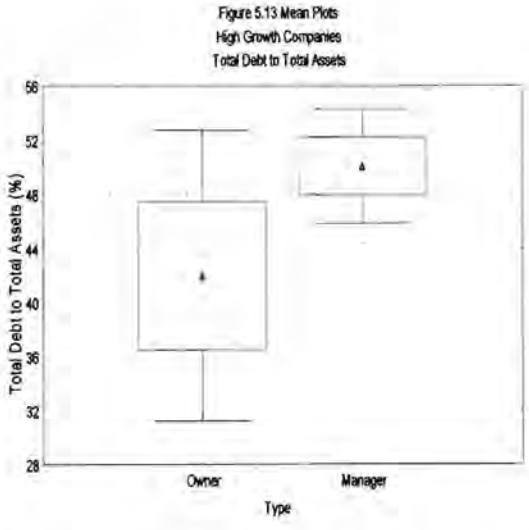
The null hypotheses is upheld in all the three policies analysed. On the surface, both groups adopt similar proportions of debt. It should be noted that owner controlled companies carry a slightly higher proportion of long-term debt than manager controlled companies. Both groups invest similar levels of FCF and also add similar values to the investment of shareholders. Generally, these companies do not make investments above the FCF generated. This demonstrates the importance of growth in the utilisation of FCF. It is puzzling that both groups of companies pay out only a small portion of FCF. Viewed in the light of the low growth potential, it is most likely that the utilisation of FCF would give rise to agency costs.

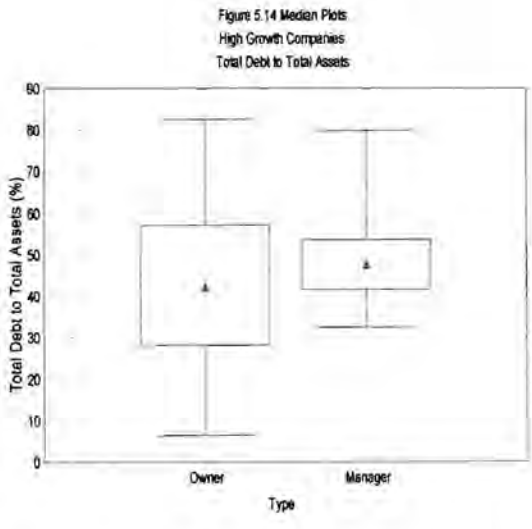
5.5 DEBT POLICY OF HIGH GROWTH COMPANIES

Funds for investment could be obtained from retained earnings. But they may be inadequate in financing new projects. For that matter it is expected that high growth companies would carry relatively large debt burdens to achieve their full potential. The hypothesis to be tested here is that the proportions of debt contracted by high growth owner controlled companies and high growth manager controlled companies are not different.

5.5.1 Total Debt to Total Assets

Figure 5.13 displays the mean plots of both types of high growth companies and Figure 5.14 shows the median plots.





It is evident from the box and whisker plots that high growth manager controlled companies are clearly distinguished from high growth owner controlled companies in terms of debt policy (Figures 5.13 & 5.14). Manager controlled companies finance a larger proportion of assets through debt than owner controlled companies. As is apparent in the mean plots, there is only a little overlap within the 95% confidence

interval. The ratios of manager controlled companies are concentrated in a narrow range as evidenced by the spread of the quartile range in the median plots. The descriptive statistics are listed in Table 5.7.

Table 5.7
Descriptive Statistics for High Growth Companies
Total Debt to Total Assets

Statistics	Owner	Manager
Count	16	30
Mean	41.98	50.07
Median	42.02	47.49
Standard Error	5.50	2.15
Lower Quartile	28.02	41.32
Upper Quartile	57.14	53.47
Quartile Range	29.12	12.15
Skewness	0.12	0.81
Kurtosis	-0.49	0.15
T-TEST		
t-stat	-1.83	
p-value	0.07	

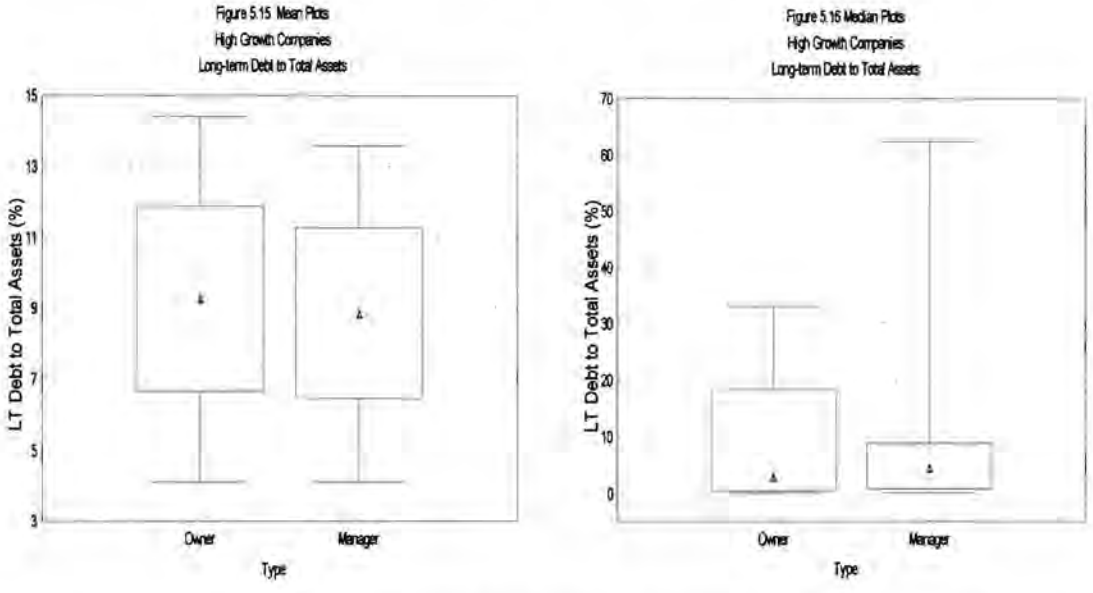
It can be seen from Table 5.7 that both the mean and median of manager controlled companies are higher than the corresponding values of owner controlled companies. Manager controlled companies record a mean of 50.07% while owner controlled companies have 41.98%. The medians are 47.49% and 42.02% for manager and owner controlled companies respectively. Manager controlled companies have a close quartile range, that is 12.15% as compared to 29.12% for owner controlled companies. This shows that manager controlled companies adopt higher levels of debt because the lower quartile, 41.32% is far above the 28.02% for owner controlled companies.

The marked observable difference noticed between the pair is confirmed by the t-test results which can actually be said to be significant at 7%. The results further deepen the contradiction to Uliana's finding that owner controlled companies carry more debt than manager controlled companies. Again, this could be due to the sample selection procedure, but in a different direction. That is exclusion of low growth companies.

In the light of the above findings, manager controlled companies may experience lower agency costs of FCF than owner controlled companies. This is because the relatively high proportion of assets financed by non-shareholder sources demands that FCF be spent judiciously. In other words there is a pre-commitment to use FCF for specific purposes, say payment of interest and principal of debt. Since manager controlled companies seem to be financing growth through debt, it is not likely that they will pay large dividends. On the other hand, there is only a little external influence (from debt holders) on owner managers to dispense of FCF.

5.5.2 Long-term Debt to Total Assets

The box and whisker plots for high growth owner controlled companies and high growth manager controlled companies are presented in Figures 5.15 and 5.16.



The common characteristics observed in the distribution is the dominance of low ratios (Figure 5.16). For example the proportion of assets financed with long-term debt in 75% of manager controlled companies is under 10%. Figure 5.16 also reveals that half of owner controlled companies have very low ratios as compared to the same proportion of manager controlled companies. This can be seen from the bottom half of the plot of owner controlled companies. The overlap of the mean and median plot suggests that both groups adopt similar proportions of long-term debt. Generally, long-term debt can be described as a less important source of finance in these companies. Table 5.8 presents the descriptive statistics for the groups.

Table 5.8
Descriptive Statistics for High Growth Companies
Long-term Debt to Total Assets

Statistics	Owner	Manager
Count	16	30
Mean	9.25	8.84
Median	2.91	4.53
Standard Error	2.63	2.42
Lower Quartile	0.30	0.70
Upper Quartile	18.25	8.86
Quartile Range	17.95	8.16
Skewness	0.87	2.70
Kurtosis	-0.28	8.64
T-TEST		
t-stat	-0.45	
p-value	0.66	

A noteworthy variation between high growth owner controlled companies and high growth manager controlled companies is the quartile range. Owner controlled companies have a wider inter-quartile range of 17.95% while manager controlled companies record 8.16%. Considering the lower quartile of 0.70% and upper quartile of 8.86% for owner controlled companies, it can be inferred that long-term debt is not a regular source of finance.

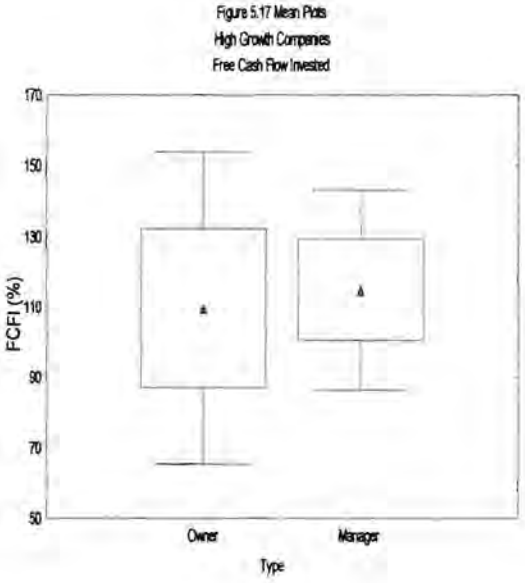
The results of the t-test confirm the observations made that there is no significant difference in the levels of long-term debt adopted by the two categories. Part of the explanation could be that managers do not want to subject themselves to the demands of external capital providers. In the agency literature managers seem to prefer independence to external monitoring.

5.6 INVESTMENT POLICY OF HIGH GROWTH COMPANIES

Following the same rationale as in Section 5.2, high growth owner and high growth manager controlled companies are examined in this section. It is envisaged that managers of these companies would want to conserve cash for re-investment. The hypothesis put forward in this direction is that the proportions of FCF invested by high growth owner controlled companies and high growth manager controlled companies are similar.

5.6.1 Free Cash Flow Invested

Figures 5.17 and 5.18 display the box and whisker plots of high growth owner controlled companies and high growth manager controlled companies respectively. Table 5.9 provides a list of descriptive statistics for both groups.



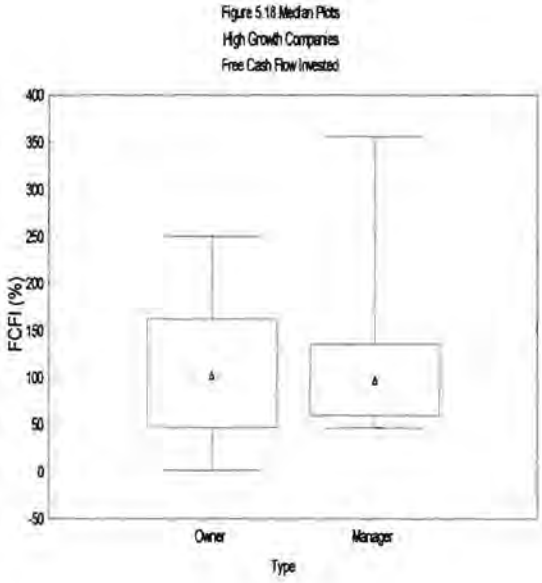


Table 5.9
Descriptive Statistics for High Growth Companies
Free Cash Flow Invested

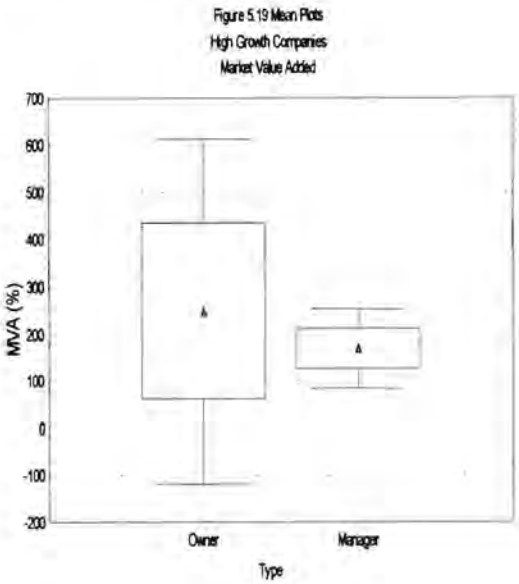
Statistics	Owner	Manager
Count	12	24
Mean	109.51	114.61
Median	102.56	97.53
Standard Error	22.58	14.47
Lower Quartile	46.48	58.61
Upper Quartile	161.50	134.74
Quartile Range	115.03	76.13
Skewness	0.31	1.91
Kurtosis	-0.63	4.79
T-TEST		
t-stat	-1.35	
p-value	0.19	

The box and whisker plots indicate that high growth manager controlled companies invest more of FCF than high growth owner controlled companies. The mean FCFI of the manager controlled group is 114.61% and that of the owner controlled group is 109.51%. The fact that manager controlled companies are not as widely dispersed as owner controlled companies shows that they invest similar proportions of FCF. This characteristic is reflected by the comparatively low quartile range of 76.13% recorded by the manager controlled group as against 115.03% of the owner controlled group. As seen in Section 5.5, manager controlled companies tend to finance growth through debt and it follows that they should make investments in excess of FCF generated internally. This is exactly the case as the ratios of manager controlled companies are generally higher than those of owner controlled companies. To illustrate, the lower quartile of manager controlled companies is 58.61% as against 46.48% of owner controlled companies.

The p-value of 0.19 reported by the t-test does not indicate any significant difference in the investment of FCF of these groups. Both groups of companies seem to be investing large proportions of FCF so it could be inferred that agency costs of FCF are low. Since almost one half of companies in each group invest more than FCF obtained, it is imperative that they depend on external sources of finance. The presence of debt therefore is likely to prevent managers from misusing FCF.

5.6.2 Market Value Added

The box and whisker plots are depicted in Figures 5.19 and 5.20. Table 5.10 lists some descriptive statistics for high growth owner controlled companies and high growth manager controlled companies.



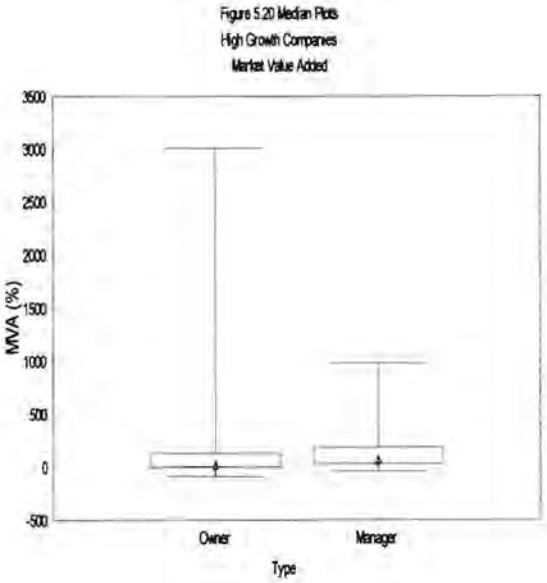


Table 5.10
Descriptive Statistics for High Growth Companies
Market Value Added

Statistics	Owner	Manager
Count	16	30
Mean	246.59	167.98
Median	19.34	71.68
Standard Error	186.52	43.01
Quartile Range	128.76	154.81
Lower Quartile	0.29	28.30
Upper Quartile	129.06	183.11
Minimum	-88.22	-36.62
Maximum	3005.97	978.77
Mann-Whitney U Test		
u-stat	167.00	
p-value	0.09	

The median plots (Figure 5.20) reveal some overlapping in MVA but it is important to take note of the following. The quartile range of 128.78% for owner controlled companies is lower than that of manager controlled companies. Although the spread is almost the same in the median plots, both groups have quite different medians. Owner controlled companies have a median of 19.34% as against 71.68% of manager controlled companies. A greater percentage of owner controlled companies destroy value than manager controlled companies. This can be seen from the stretch of the minimum point to the lower quartile in Figure 5.20. These are not clearly shown in the diagram due to extreme observations.

The major difference in medians perhaps points to the success of managerial discretion over the investment policies of companies. In the first place, manager controlled companies invest a greater portion of FCF than owner controlled companies. Apart from the benefits shareholders derive from the appreciation of their investments,

professional managers also enjoy immense benefits from the increased market value of the company. While Jensen (1989) notes that it enhances the power and status of managers, Barker, Jensen & Murphy (1988) contend that it enhances the remuneration of managers.

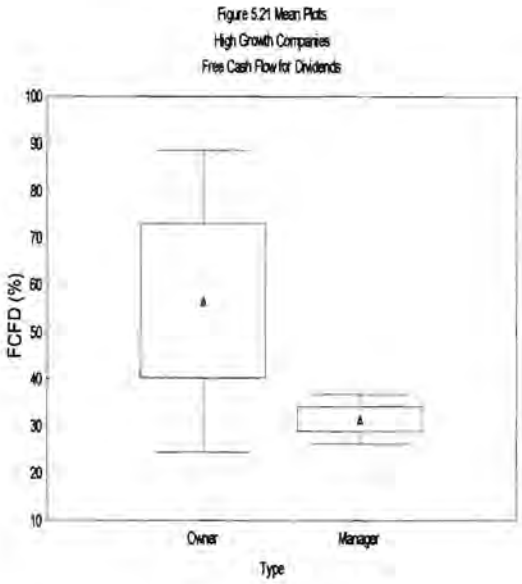
The test of significance does not report a significant difference at the level of 5%, ($p = 0.09$) between the MVA of both groups. This finding diminishes the importance of the proposition that owners who are also principals will safeguard the interests of stakeholders by achieving high economic values.

5.7 DIVIDEND POLICY OF HIGH GROWTH COMPANIES

The investment opportunities of high growth companies are likely to put a strain on FCF. For that matter, these companies may not pay dividends. But when control is introduced into this argument then dividend policy can be parted on this ground. Owner managers would want to maintain control over assets so they may not deplete FCF through dividend payments. This is because the more they deplete FCF, the more likely it is that they will require additional finance which may dilute their interest.

5.7.1 Free Cash Flow for Dividends

The box and whisker plots of high growth owner controlled companies and high growth manager controlled companies are presented in Figures 5.21 and 5.22 and Table 5.11 lists some descriptive statistics.



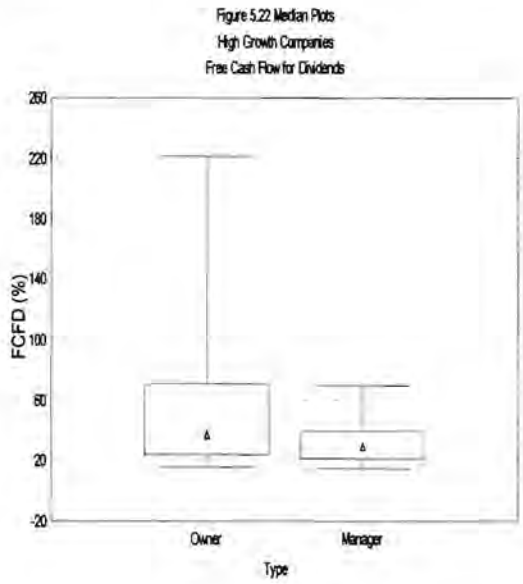


Table 5.11
Descriptive Statistics for High Growth Companies
Free Cash Flow for Dividends

Statistics	Owner	Manager
Count	12	24
Mean	56.49	31.42
Median	36.73	29.15
Standard Error	16.37	2.67
Lower Quartile	23.23	20.86
Upper Quartile	70.90	38.95
Quartile Range	47.68	18.09
Skewness	2.57	1.13
Kurtosis	7.43	1.63
T-TEST		
t-stat	1.83	
p-value	0.08	

The box and whisker plots reveal a marked difference in the payout of FCF between high growth owner controlled companies and high growth manager controlled companies. Contrary to speculation, high growth owner controlled companies release more surplus cash to shareholders than high growth manager controlled companies. The mean and median of the owner controlled group are 56.49% and 36.73% whilst those of the manager controlled group are 31.42% and 25.88% respectively. On the

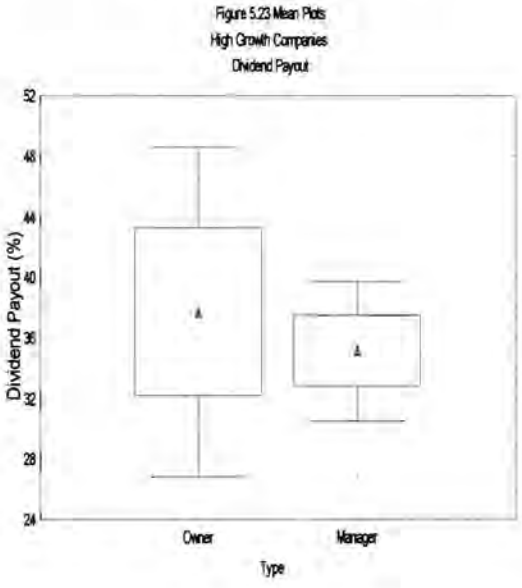
other hand, manager controlled companies display a very close quartile range of 18.09% as against 47.68% for owner controlled companies. It is evident from the lower and upper quartiles of manager controlled companies that they retain a high proportion of FCF. These companies pay between approximately 21% and 39% of FCF.

The t-test does not reveal any significant difference in the level of FCF paid out by these groups. The reported t-stat is 1.83 and the p-value is 0.08. The retention of FCF by managers is in line with the proposition by Easterbrook (1984) that managers may not want to subject themselves to the scrutiny of capital markets when in need of additional funds. But owner managers pay out a larger proportion of FCF and this exemplifies the willingness of owner managers to undergo the scrutiny of the capital market.

What is not clear at this juncture is why owner controlled companies would prefer external sources of finance to the internal alternative of retention. For example new equity issues are a relatively expensive source of capital as dividends are paid out from after tax income, and additional tax liability in the form of STC is imposed on the company. However, it is possible that owners are drawing benefits from their companies in the form of cash dividends.

5.7.2 Dividend Payout

The payout of both high growth owner controlled companies and high growth manager controlled companies are compared in box and whisker plots in Figures 5.23 and 5.24. Table 5.12 lists the descriptive statistics for the groups.



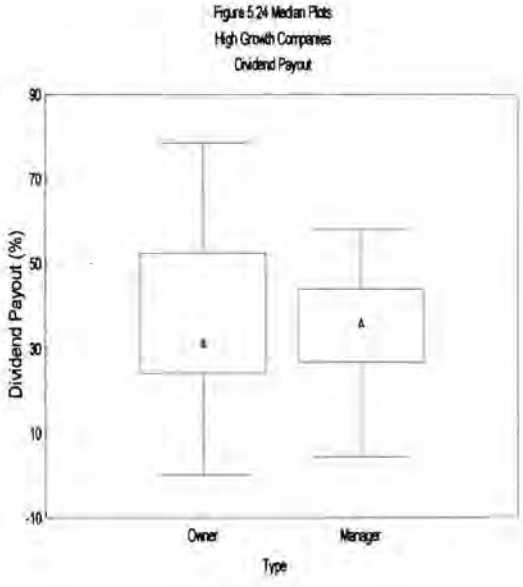


Table 5.12
Descriptive Statistics for High Growth Companies
Dividend Payout

Statistics	Owner	Manager
Count	16	30
Mean	37.68	35.10
Median	31.40	36.08
Standard Error	5.56	2.35
Lower Quartile	24.00	26.63
Upper Quartile	52.45	43.93
Quartile Range	28.45	17.30
Skewness	0.47	-0.21
Kurtosis	-0.47	-0.20
T-TEST		
t-stat	0.50	
p-value	0.62	

To very a large extent, high growth owner controlled companies and high growth manager controlled companies have similar dividend payout ratios. This is the situation presented by the box and whisker plots (Figures 5.23 & 5.24). The means of high growth owner controlled companies and high growth manager controlled companies are 37.68% and 35.10% respectively. High growth manager controlled companies seem to have fairly close payout ratios. This can be seen from the quartile range of 17.30% as opposed to 28.45% for high growth owner controlled companies.

The t-test results confirm the observation that there is no significant difference in the payout of high growth owner controlled companies and high growth manager controlled companies. Control structures do not seem to affect the payout policies of the companies.

5.8 SUMMARY

In a large measure, high growth manager controlled companies exhibit a greater dependence on debt than high growth owner controlled companies. From the above, it was expected that high growth manager controlled companies would make higher investments than their counterpart owner controlled companies. However, both groups display no significant difference in FCFI. The groups are quite different in terms of MVA. Manager controlled companies add higher values than owner controlled companies. The FCF paid out by the owner controlled group is slightly higher than the payout of the manager controlled group. This indicates the preparedness of owner managers to raise additional capital on the market. But this is not supported by the debt policy of owner controlled companies.

CHAPTER SIX

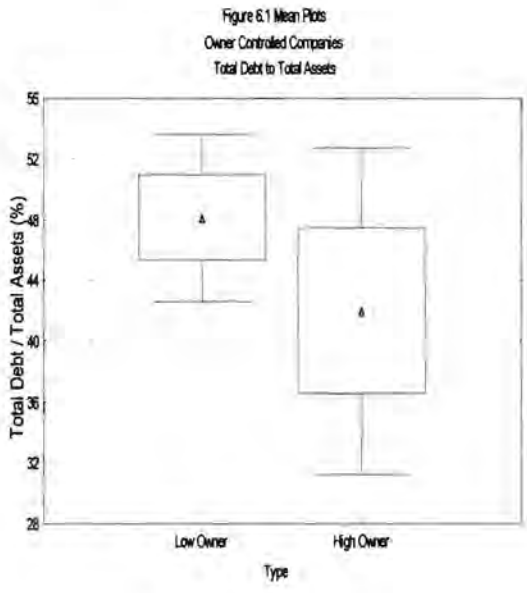
EFFECT OF GROWTH ON THE FINANCIAL POLICIES OF OWNER CONTROLLED COMPANIES AND MANAGER CONTROLLED COMPANIES

6.1 DEBT POLICY OF OWNER CONTROLLED COMPANIES

Owner controlled companies are assumed to have a common attitude to debt so they are isolated in this section to investigate the impact of growth on debt policies. It is hoped that any difference arising from this comparison will be traced to the different levels of growth. The hypothesis in this regard is that low growth owner controlled companies and high growth owner controlled companies assume the same proportions of debt.

6.1.1 Total Debt to Total Assets

Figure 6.1 displays the mean plots of the groups and Figure 6.2 presents the median plots. Table 6.1 reports the descriptive statistics for low growth owner controlled companies and high growth owner controlled companies.



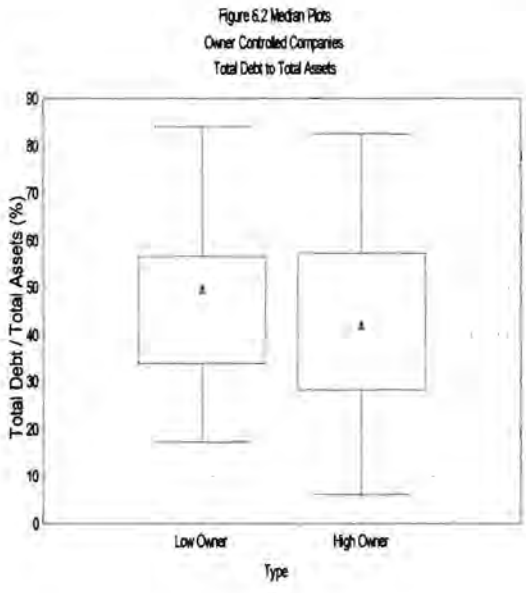


Table 6.1
Descriptive Statistics for Owner Controlled Companies
Total Debt to Total Assets

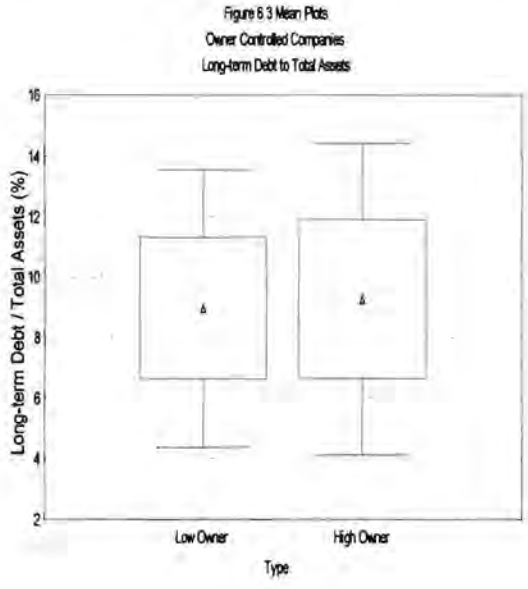
Statistics	Low	High
Count	35	16
Mean	48.13	41.98
Median	49.67	42.02
Standard Error	2.80	5.50
Lower Quartile	33.64	28.02
Upper Quartile	56.48	57.14
Quartile Range	22.84	29.12
Skewness	0.23	0.12
Kurtosis	-0.42	-0.49
T-TEST t-stat 1.33 p-value 0.19		

The mean and median of low growth owner controlled companies are higher than those of high growth owner controlled companies. The means are 48.13% and 41.98% for low growth and high growth companies respectively. The low growth group median of 49.67% is slightly higher than the high growth group median of 42.02%. The most noticeable feature of the box and whisker plots is the smaller spread of low growth owner controlled companies. The quartile range of 22.84% is

smaller than the quartile range of high growth companies, that is 29.12%. It must be noted that the lower quartile of low growth owner controlled companies is 33.64% and is also slightly higher than 28.02% for high growth companies. This in itself suggests that majority of low growth companies assume high proportions of debt. The t-test does not report any significant difference in the debt policy of these two groups. The p-value of 0.19 shows that the results are not necessarily explained by the growth factor.

6.1.2 Long-term Debt to Total Assets

The long-term debt ratios of both groups are compared in box and whisker plots in Figures 6.3 and 6.4. Table 6.2 shows the descriptive statistics of the two categories.



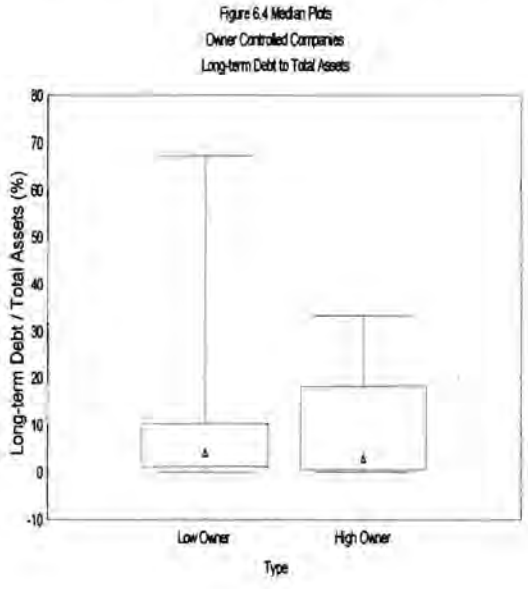


Table 6.2
Descriptive Statistics for Owner Controlled Companies
Long-term Debt to Total Assets

Statistics	Low	High
Count	35	16
Mean	8.95	9.25
Median	4.17	2.91
Standard Error	2.34	2.63
Lower Quartile	1.05	0.30
Upper Quartile	10.20	18.25
Quartile Range	9.15	17.95
Skewness	3.02	0.87
Kurtosis	10.19	-0.28
T-TEST		
t-stat	0.57	
p-value	0.57	

The mean of both groups are very close. These are 8.95% for low growth owner controlled companies and 9.25% for high growth owner controlled companies. The median plots (Figure 6.4) however reveal 50% of companies in both groups assume low proportions of debt, that is below the median. Low growth companies and high growth companies have median ratios of 4.17% and 2.91% respectively.

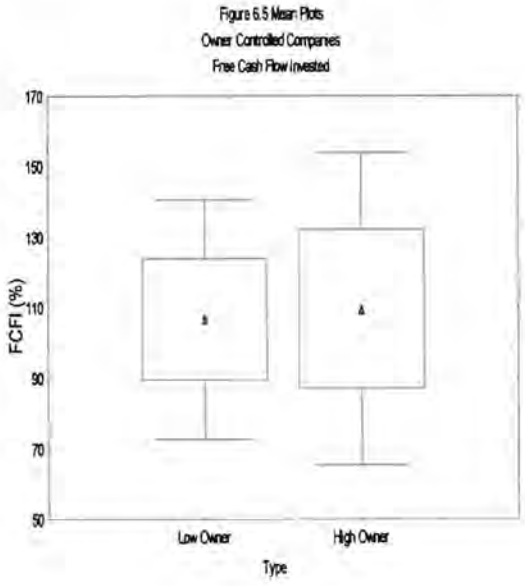
The t-test confirms that the level of long-term debt assumed by low growth owner controlled companies is not significantly different from that of high growth companies. On this basis, therefore, no distinction can be made between the proportions of long-term debt adopted by the groups. The growth factor therefore fails to bring a clear distinction between the proportion of assets financed by long-term debt.

6.2 INVESTMENT POLICY OF OWNER CONTROLLED COMPANIES

The rationale of this section is to identify how growth levels affect the investment of FCF by owner controlled companies. Therefore, the hypothesis to be tested is that the level of FCF invested by low growth owner controlled companies and high growth owner controlled companies are similar.

6.2.1 Free Cash Flow Invested

The box and whisker plots of low growth and high growth owner controlled companies are depicted in Figures 6.5 and 6.6, and Table 6.3 provides a list of descriptive statistics for both groups.



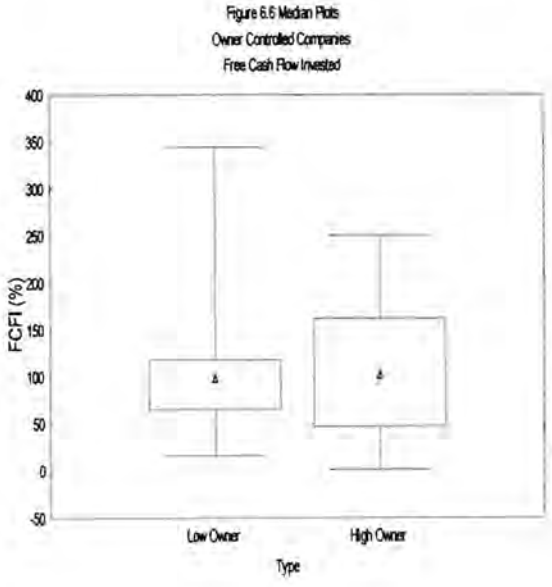


Table 6.3
Descriptive Statistics for Owner Controlled Companies
Free Cash Flow Invested

Statistics	Low	High
Count	18	12
Mean	106.65	109.51
Median	98.93	102.20
Standard Error	17.26	22.58
Lower Quartile	64.47	46.48
Upper Quartile	117.51	161.50
Quartile Range	53.04	115.03
Skewness	2.14	0.31
Kurtosis	6.21	-0.63
T-TEST		
t-stat	0.86	
p-value	0.40	

It is notable that almost 50% of the companies in both groups make investments beyond the level of FCF (Figure 6.6). That is FCFI above 100%. This presupposes that these companies use debt to finance investments. The similarity in FCFI is underscored by the closeness of the means and medians. Low growth owner controlled companies have a mean of 106.65% and high growth owner controlled companies have a mean of 109.51%. For the medians, they are 98.93% and 102.56% for low growth and high growth owner controlled companies respectively.

The box and whisker plots show a major overlap between the two groups. As expected though, high growth companies invested slightly higher proportion of FCF than low growth companies. The upper quartile of 161.50% for high growth companies as against 117.51% for low growth companies clarifies this point. But the difference observed is not significant (p=0.40) at the 95% confidence level.

6.2.2 Market Value Added

Box and whisker plots for low growth and high growth owner controlled companies are depicted in Figures 6.7 and 6.8. Table 6.4 provides some descriptive statistics.

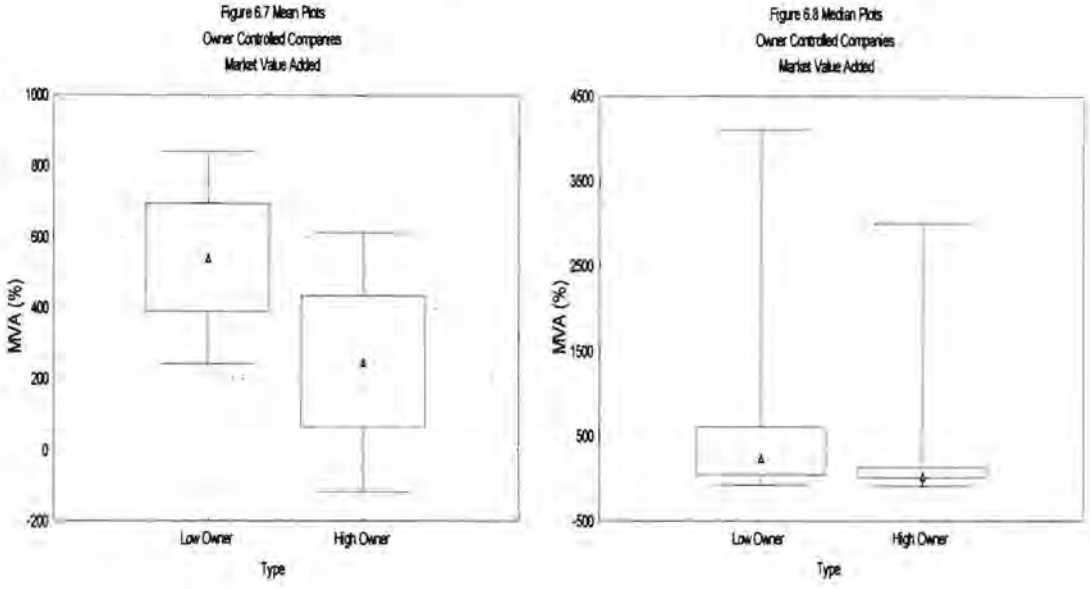


Table 6.4
Descriptive Statistics for Owner Controlled Companies
Market Value Added

Statistics	Low	High
Count	35	16
Mean	540.33	246.59
Median	234.78	19.34
Standard Error	152.52	186.52
Quartile Range	567.32	128.78
Lower Quartile	36.68	0.29
Upper Quartile	604.00	129.06
Minimum	-72.84	-88.22
Maximum	4098.39	3005.97
Mann-Whitney U Test u-stat 154.00 p-value 0.01		

The box and whisker plots show that low growth companies add more value to the investment of shareholders than high growth companies. The mean of 540.33% for low growth owner controlled companies contrasts sharply with 246.59% reported for high growth owner controlled companies. The medians also show a large difference in the MVA of the two groups. These are 234.78% for low growth companies and 19.34% for high growth companies. The above differences are statistically significant at 95% confidence level. The p-value of 0.01 shows that these groups of companies are highly distinct from each other.

6.3 DIVIDEND POLICY OF OWNER CONTROLLED COMPANIES

This section examines the impact of growth on the dividend policy of owner controlled companies. The hypothesis to be tested is that low growth owner controlled companies and high growth owner controlled companies follow similar payout policies.

6.3.1 Free Cash Flow for Dividends

The box and whisker plots are shown in Figures 6.9 and 6.10. Table 6.5 lists the descriptive statistics of both groups.

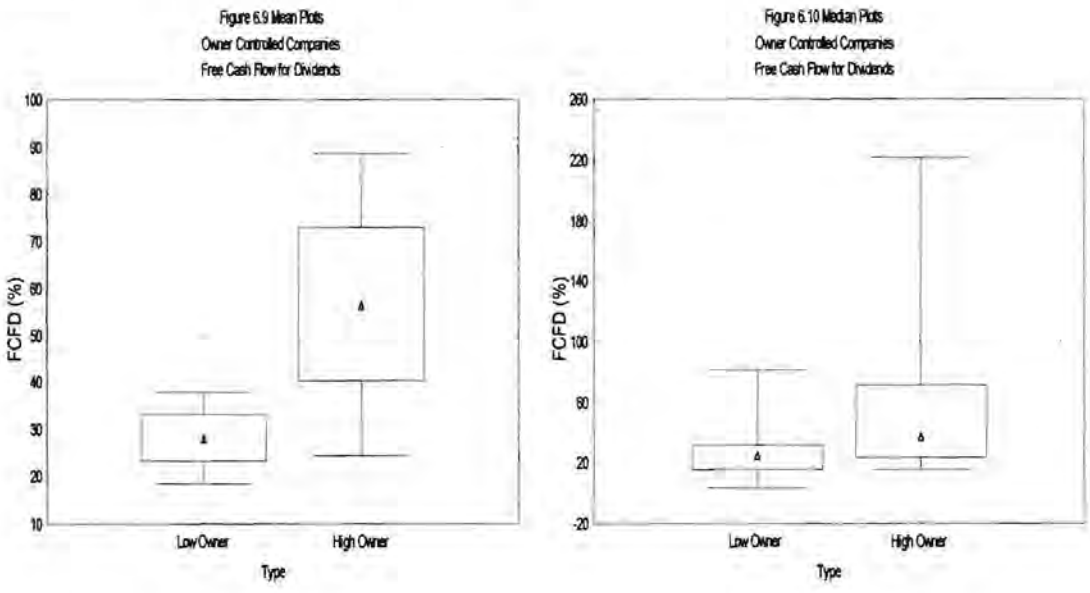


Table 6.5
Descriptive Statistics for Owner Controlled Companies
Free Cash Flow for Dividends

Statistics	Low	High
Count	18	12
Mean	28.07	56.49
Median	24.44	36.73
Standard Error	4.97	16.37
Lower Quartile	14.93	23.23
Upper Quartile	31.42	70.90
Quartile Range	16.49	47.68
Skewness	1.42	2.57
Kurtosis	1.78	7.43
T-TEST		
t-stat	-2.23	
p-value	0.03	

It can be seen from Figures 6.9 and 6.10 that high growth owner controlled companies pay a greater proportion of FCF as dividends than low growth owner controlled companies. The mean of high growth companies which is 56.49% is far greater than the mean of 28.07% recorded for low growth companies. In like manner, the median plots reveal that most low growth companies pay out only a small fraction of FCF as dividends. Whereas the middle 50% of low growth companies pay between 14.93%

and 31% of FCF, the corresponding range of high growth companies is 23.23% to 70.90%.

It can also be observed from the median plots that all low growth owner controlled companies do not pay dividends beyond the level of FCF obtained. Upon the basis of the t-stat of -2.23 and the associated p-value of 0.03, the difference in FCFD is significant at the level of 5%. That is high growth companies pay a greater percentage of FCF than low growth companies. A possible reason is that the P/E ratio is an insufficient measure for gauging growth.

6.3.2 Dividend Payout

The box and whisker plots comparing low growth and high growth owner controlled companies are shown in Figures 6.11 and 6.12 and Table 6.6 reports the associated descriptive statistics.

Figure 6.11 Mean Plots
Owner Controlled Companies
Dividend Payout

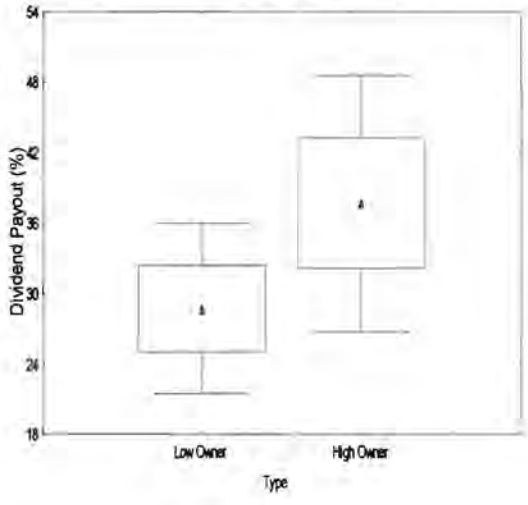


Figure 6.12 Median Plots
Owner Controlled Companies
Dividend Payout

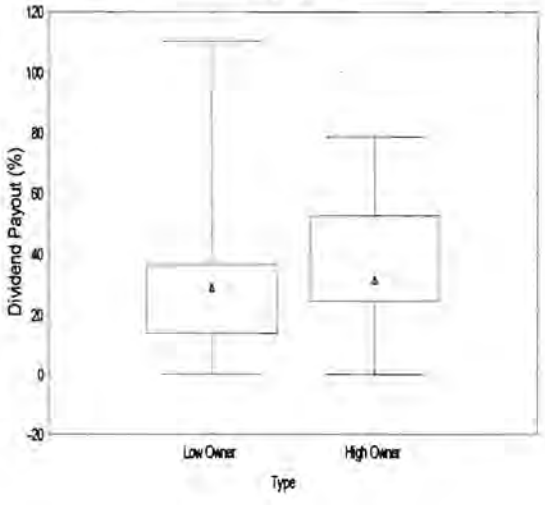


Table 6.6
Descriptive Statistics for Owner Controlled Companies
Dividend Payout

Statistics	Low	High
Count	34	16
Mean	28.70	37.68
Median	28.93	31.40
Standard Error	3.71	5.56
Lower Quartile	13.64	24.00
Upper Quartile	36.42	52.45
Quartile Range	22.78	28.45
Skewness	1.55	0.47
Kurtosis	4.84	-0.47
T-TEST		
t-stat	-1.36	
p-value	0.18	

As depicted by Figures 6.11 and 6.12, high growth owner controlled companies appear to pay higher dividends than low growth owner controlled companies. From Table 6.6, the mean and median of high growth companies are higher than those for low growth companies. The means are 28.70% and 37.68% for low growth and high growth companies respectively. The medians are 28.93% for low growth companies and 31.40% for high growth companies. The median plots show that 50% of low growth owner controlled companies are concentrated in the lower half of the plot while the same fraction of high growth companies are found in the upper half of the plot. This implies that the payout of high growth companies are generally higher than those for low growth companies. The evidence obtained does not support the conjecture that low growth companies would pay higher dividends than high growth companies. The difference in means between the two groups is not significant ($p=0.18$).

6.4 SUMMARY

Low growth owner controlled companies take on similar proportions of debt as high growth owner controlled companies. Also, the proportion of FCF invested across the groups is quite similar. This raises the question of how low growth companies utilised the borrowed funds. The suspicion that managers of low growth companies may be investing in negative NPV projects was not sustained because they achieved higher MVA for shareholders. Surprisingly, the percentage of FCF paid out by high growth companies is greater than the payout of low growth companies. This finding implies that managers of high growth companies would depend on external finance for investment purposes. But this is not clearly explained by the debt position of high growth companies. The significant differences observed in MVA and FCFD seem to undermine the accuracy of the P/E ratio as a measure of growth.

6.5 DEBT POLICY OF MANAGER CONTROLLED COMPANIES

The debt policy of low growth manager controlled companies and high growth manager controlled companies are compared in this section. The emphasis here is on the growth factor and the results will determine whether low growth manager controlled companies differ from high growth manager controlled companies in terms of the proportion of debt assumed.

6.5.1 Total Debt to Total Assets

The box and whisker plots for low growth and high growth manager controlled companies are shown in Figure 6.13 and Figure 6.14, and descriptive statistics are reported in Table 6.7.

Figure 6.13 Mean Plots
Manager Controlled Companies
Total Debt to Total Assets

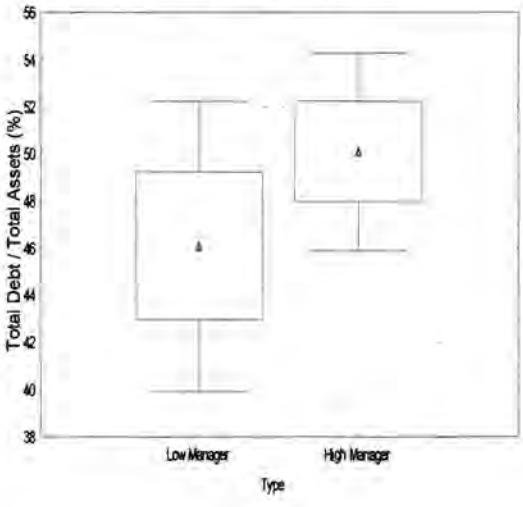


Figure 6.14 Median Plots
Manager Controlled Companies
Total Debt to Total Assets

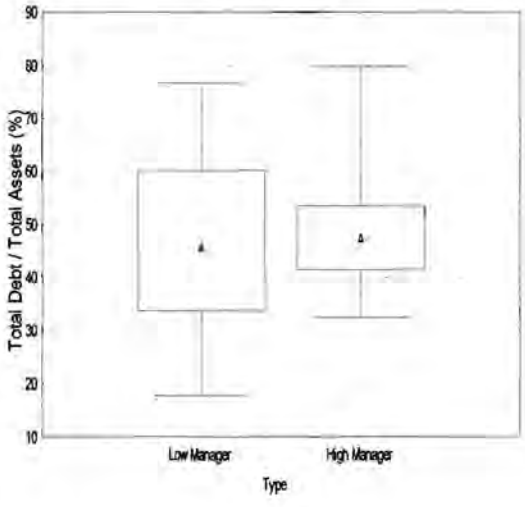


Table 6.7
Descriptive Statistics for Manager Controlled Companies
Total Debt to Total Assets

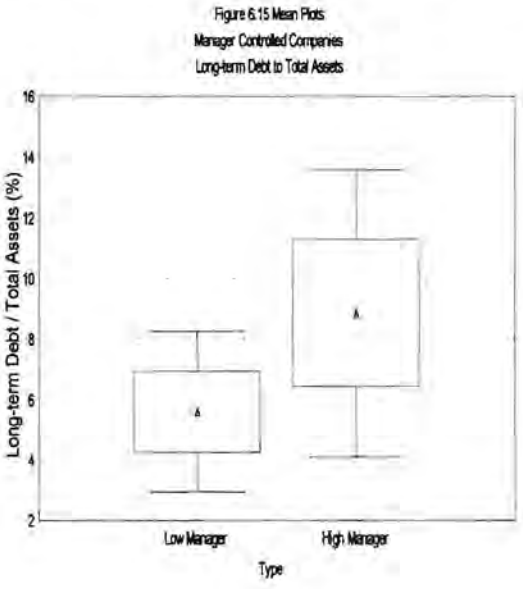
Statistics	Low	High
Count	28	30
Mean	46.07	50.07
Median	45.65	47.49
Standard Error	3.15	2.15
Lower Quartile	33.60	41.32
Upper Quartile	60.01	53.47
Quartile Range	26.41	12.15
Skewness	0.15	0.81
Kurtosis	-1.02	0.15
T-TEST		
t-stat	-1.14	
p-value	0.26	

There is only a little variation in the mean and median of both categories. This feature is reflected in the median plots which show an extensive overlapping. The means are 46.07% for low growth manager controlled companies and 50.07% for high growth manager controlled companies. The median of the low growth category is 45.65% and that of the high growth category is 47.47%. From Table 6.7, the quartile range is the only statistic that seem to be quite different. This means that high growth companies tend to have closer debt ratios than low growth companies.

No significant difference is detected by the t-test. In terms of agency costs, no real distinction can be made by the growth factor. However, it is important to note that both categories finance approximately half of the company's assets with debt. This in a way provides a guarantee for shareholders that managers would not waste FCF. On the part of low growth companies, it is rather surprising that the level of debt adopted is close to that of high growth companies. It remains to be seen what kind of investment strategy they adopt and the economic gains achieved for shareholders.

6.5.2 Long-term Debt to Total Assets

Box and whisker plots for both groups are presented in Figures 6.15 and 6.16. A table of descriptive statistics is presented in Table 6.8.



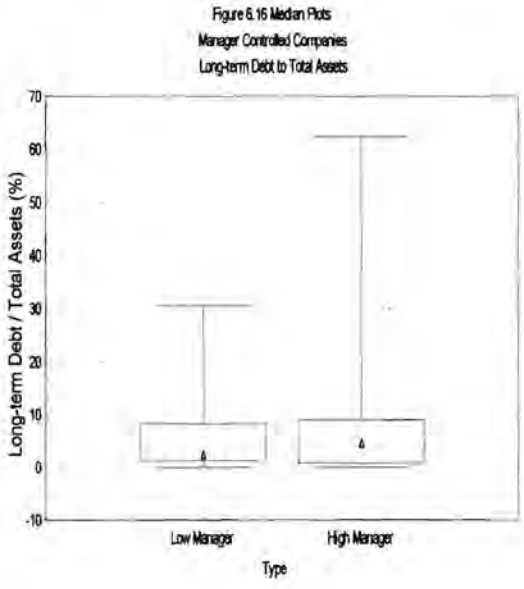


Table 6.8
Descriptive Statistics for Manager Controlled Companies
Long-term Debt to Total Assets

Statistics	Low	High
Count	28	30
Mean	5.60	8.84
Median	2.38	4.53
Standard Error	1.35	2.42
Lower Quartile	1.15	0.70
Upper Quartile	8.08	8.86
Quartile Range	6.94	8.16
Skewness	1.98	2.70
Kurtosis	4.34	8.64
T-TEST		
t-stat	-1.55	
p-value	0.13	

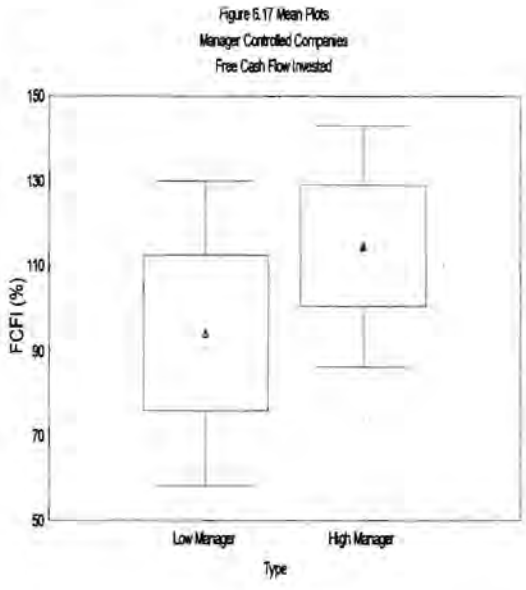
Low growth and high growth manager controlled companies display very low long-term debt to total assets ratios (Figure 6.16). Only a few of the companies have ratios above 10%. High growth manager controlled companies acquire more long-term debt than low growth manager controlled companies. This can be seen from the higher mean of 8.84% for high growth companies as opposed to 5.60% for low growth companies. The results of the t-test show that there no significant difference in the long-term debt policy of both groups. The low ratios of both groups however suggest that long-term debt does not play an important bonding role.

6.6 INVESTMENT POLICY OF MANAGER CONTROLLED COMPANIES

The hypothesis to be examined in this section is that low growth manager controlled companies and high growth manager controlled companies invest similar levels of FCF. The main issue, that is the effect of different levels of growth and the utilisation of FCF is expected to be revealed in the analysis.

6.6.1 Free Cash Flow Invested

The box and whisker plots comparing low growth and high growth manager controlled companies are depicted in Figures 6.17 and 6.18. Table 6.9 provides a list of descriptive statistics for both groups.



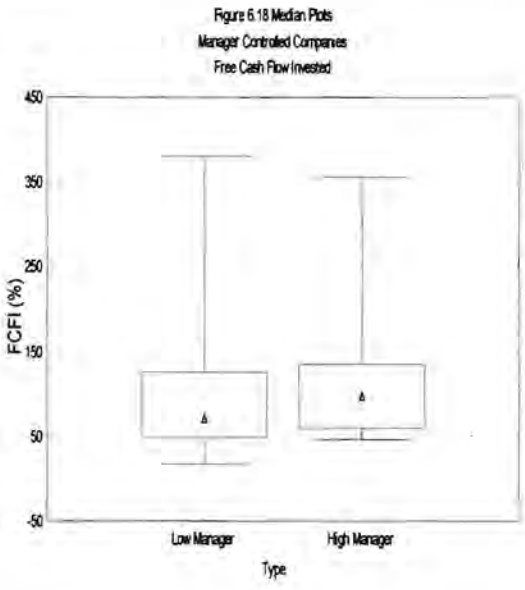


Table 6.9

Descriptive Statistics for Manager Controlled Companies
Free Cash Flow Invested

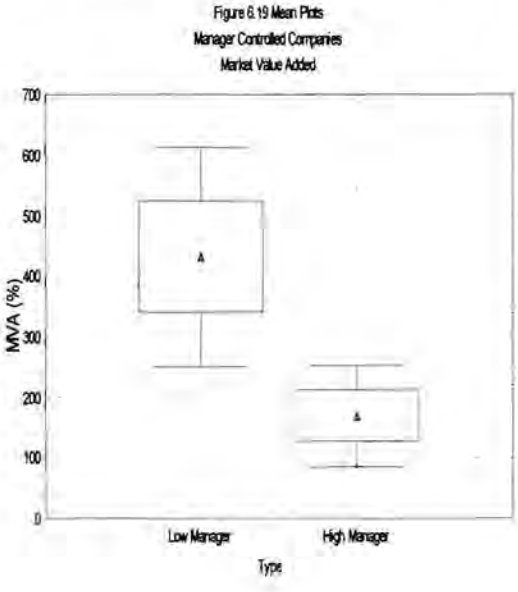
Statistics	Low	High
Count	19	24
Mean	94.05	114.61
Median	71.10	97.53
Standard Error	18.35	14.47
Lower Quartile	47.09	58.61
Upper Quartile	125.98	134.74
Quartile Range	78.89	76.13
Skewness	2.72	1.91
Kurtosis	9.42	4.79
T-TEST		
t-stat	-1.58	
p-value	0.12	

The box and whisker plots show that high growth companies invest a greater proportion of FCF than low growth companies. The means are 94.05% and 114.61% for low growth and high growth companies respectively. The median plots depict an overlapping which hints at similarity in the proportion of FCF invested. This characteristic is symbolised by the close quartile ranges of both groups. Low growth companies have a quartile range of 78.89% and the quartile range for high growth

companies is 76.13%. In this case, agency costs of FCF should be low for low growth companies as they invest less FCF. This is because the tendency to waste FCF on unprofitable investments should be low. The results of the t-test do not reveal any significant difference in the proportion of FCF invested by low growth and high growth companies. The p-value is 0.12 and the t-stat is -1.58.

6.6.2 Market Value Added

The means and medians of both groups are compared in box and whisker plots in Figures 6.19 and 6.20. Table 6.10 reports the descriptive statistics for the two groups.



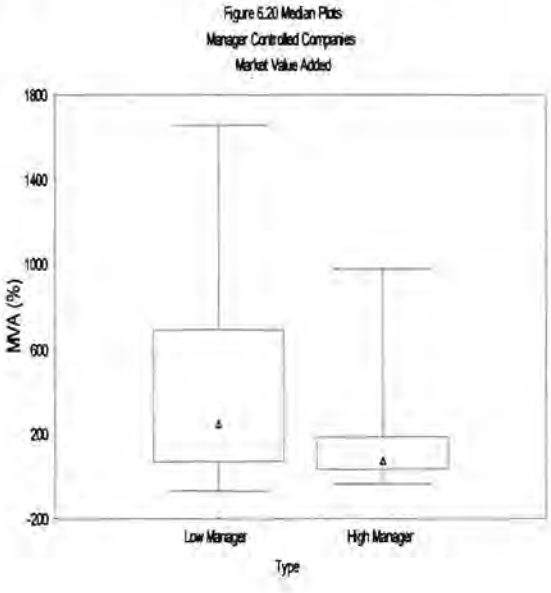


Table 6.10
Descriptive Statistics for Manager Controlled Companies
Market Value Added

Statistics	Low	High
Count	28	30
Mean	431.78	167.98
Median	246.58	71.68
Standard Error	92.37	43.01
Quartile Range	627.41	154.81
Lower Quartile	64.57	28.30
Upper Quartile	691.98	183.11
Minimum	-69.79	-36.62
Maximum	1657.14	978.77
Mann-Whitney U Test		
u-stat	292.00	
p-value	0.04	

It can be seen from the box and whisker plots that low growth manager controlled companies create greater wealth for shareholders than high growth manager controlled companies. Whereas the mean MVA of low growth companies is 431.77%, that of high growth companies is 167.98%. The medians are 246.58% and 71.68% for low growth and high growth companies respectively.

The statistics presented in Table 6.10 show substantial variability between the two categories. Low growth manager controlled companies have a wide quartile range of 627.41%. This is approximately four times the quartile range of high growth companies. From this it can be concluded that high growth companies achieve very low returns for their shareholders.

The Mann-Whitney U test confirms that the differences between low growth and high growth manager controlled companies are significant at 95% confidence level. This result follows the same trend as owner controlled companies in Section 6.2.2. The results may be influenced by the effectiveness of the P/E ratio as a measure of growth.

6.7 DIVIDEND POLICY OF MANAGER CONTROLLED COMPANIES

In this section, the dividend policy of low growth manager controlled companies and high growth manager controlled companies are compared. The hypothesis to be examined is whether or not the dividend payout of both groups are similar.

6.7.1 Free Cash Flow for Dividends

The groups are compared in box and whisker plots in Figures 6.21 and 6.22. Table 6.11 reports the descriptive statistics for low growth manager controlled companies and high growth manager controlled companies.

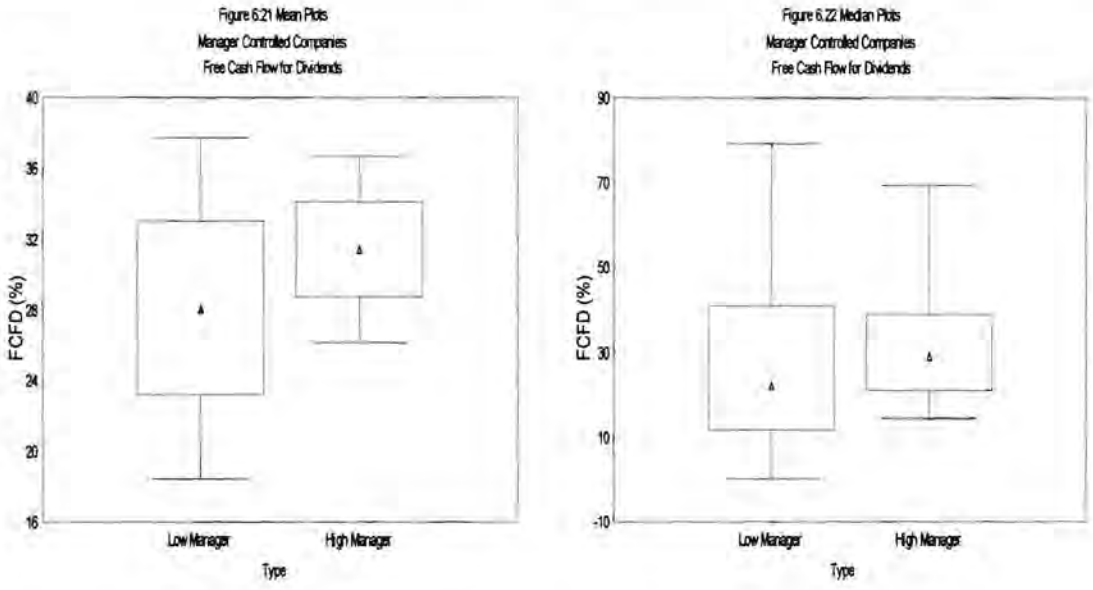


Table 6.11
Descriptive Statistics for Manager Controlled Companies
Free Cash Flow for Dividends

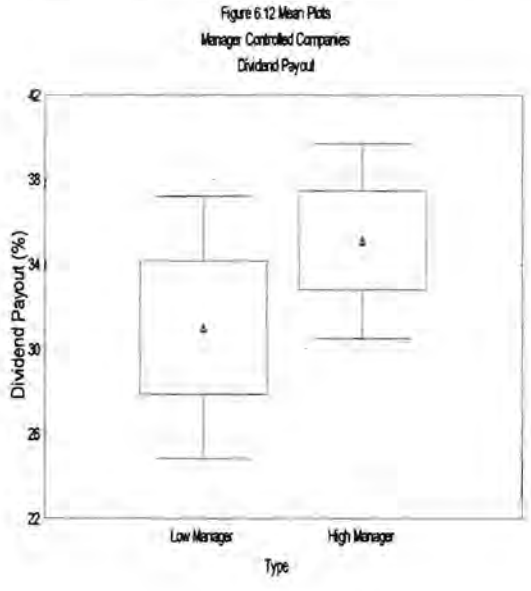
Statistics	Low	High
Count	19	24
Mean	28.05	31.42
Median	22.04	29.15
Standard Error	4.93	2.68
Lower Quartile	11.55	20.86
Upper Quartile	40.99	38.95
Quartile Range	29.44	18.09
Skewness	1.12	1.13
Kurtosis	0.47	1.63
T-TEST		
t-stat	-1.20	
p-value	0.24	

High growth manager controlled companies pay a higher proportion of FCF as dividends than low growth manager controlled companies. In addition, high growth companies are concentrated in a small range as indicated by the relatively low quartile range of 18.09%. Both the mean and median FCFD of high growth companies are slightly higher than those of low growth companies. The means are 28.05% and 31.42% for low growth and high growth companies respectively. The medians are

22.04% for the low growth group and 29.15% for the high growth group. It can be deduced from the median plots that majority of low growth companies pay below 30% of FCF as dividends. Fifty per cent (50%) of high growth companies pay out FCF between the range of 20% and 40%. In spite of the observation that high growth companies are quite distinct from low growth companies, the t-test does not report any statistically significant result. The null hypothesis of no difference in the level of FCF paid as dividends is therefore accepted.

6.7.2 Dividend Payout

Figure 6.23 compares the means of low growth and high growth manager controlled companies and Figure 6.24 compares the medians of both groups. Table 6.12 lists the descriptive statistics for both groups.



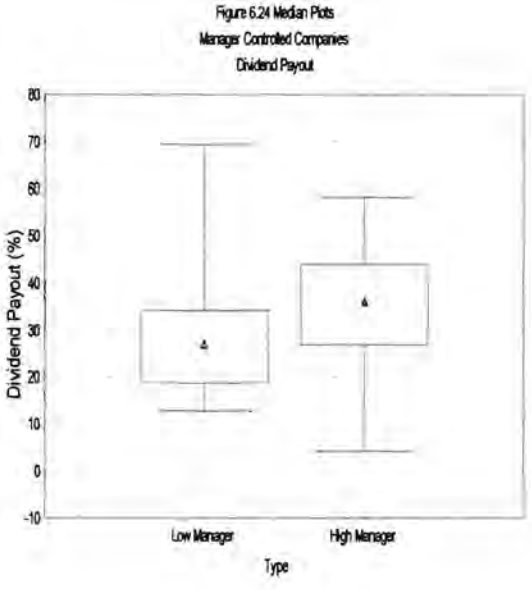


Table 6.12
Descriptive Statistics for Manager Controlled Companies
Dividend Payout

Statistics	Low	High
Count	26	30
Mean	30.10	35.10
Median	26.99	36.08
Standard Error	3.16	2.35
Lower Quartile	18.59	26.63
Upper Quartile	33.99	43.93
Quartile Range	15.40	17.30
Skewness	1.20	-0.21
Kurtosis	0.66	-0.20
T-TEST		
t-stat	-1.06	
p-value	0.29	

The impression obtained from the box and whisker plots is that high growth manager controlled companies pay slightly higher dividends than low growth manager controlled companies. The mean payout of low growth companies is 30.10% whilst the mean payout of high growth companies is 35.10%. The medians also follow this trend. They are 26.99% for the low growth group and 36.08% for high growth group. These differences are however not significant. The t-stat is -1.06 and the p-value is 0.29.

6.8 SUMMARY

The debt policy of low growth manager controlled companies is not different from the debt policy of high growth manager controlled companies. It can therefore be inferred that growth prospects have limited influence on debt policy. Thus the bonding role of debt is diminished in this respect. Also, high growth companies invest a greater percentage of FCF than low growth companies. The above findings are consistent

with the projections put forward and do not indicate the presence of agency costs. But the findings on MVA and dividend payout do not correspond to the conjectures made. Low growth companies added more value to the investment of shareholders than high growth companies. This finding is in line with the observations on MVA in previous sections. For dividend policy, both groups pay out similar percentages of earnings and FCF. Thus there is the possibility that high agency costs are associated with the cash retention in low growth manager controlled companies.

CHAPTER SEVEN

CONCLUSION

7.1 INTRODUCTION

The relationship between shareholders and managers is believed to affect the financial policies of companies. Within the agency framework, shareholders are considered as the principals and managers are regarded as the agents. The main issue arising from this relationship is whether the agents will always place the interests of the principals above their own interests. The interest of shareholders lies in the maximisation of their wealth. Ideally, the decisions of managers should contribute positively to the wealth of shareholders. But there could be deviations from this course due to certain factors. These deviations bring about agency costs. Agency costs are the sum of the losses suffered by shareholders as a result of managerial actions which are not value maximising. Some factors which influence the cost of deviations include the tastes of managers, the laws of the land and the environment in which the company operates. To limit the degree of losses incurred by shareholders, some mechanisms aimed at aligning the interests of managers and shareholders have been suggested. These measures range from monitoring mechanisms such as internal control systems to bonding mechanisms such as the code of ethics of managers. This study proposed that the percentage of shareholding of managers is likely to affect the debt, investment and dividend policies of companies.

7.2 THE OBJECTIVES ADDRESSED

The objectives set out at the beginning of this study were to identify and evaluate the usage of FCF. FCF was defined as the cash generated from the operations of a company and available for distribution to shareholders. Various ratios indicating different aspects of the financial policies of companies were computed. These ratios were used to test the overall hypothesis that there were no differences in the usage of FCF by owner controlled companies and manager controlled companies. One factor which was thought to influence the findings was the growth potential of companies. It was presumed that companies with similar growth prospects will possess similar characteristics. The P/E ratio was used as a proxy for growth, and companies with the same growth levels were paired and analysed. Companies with different growth levels were also paired and analysed. The purpose of the latter analysis was to cross-examine the influence of growth prospects on financial policies.

The main conclusions of the study can be divided into two groups. Firstly, out of three sub-hypotheses tested in three planes of data, the results did not reveal any significant difference in the financial policies of owner controlled companies and manager controlled companies. Upon this basis therefore, the main hypothesis of no difference in the usage of FCF between owner controlled companies and manager controlled companies is accepted at the 95% confidence level. It must however be pointed out that certain major differences were observed in some aspects of debt, investment and dividend policies of the companies. These will be dealt with in Section 7.3.

Secondly, out of three sub-hypotheses tested in another three planes of data, the results revealed significant differences in aspects of investment policy and dividend policy of low growth companies and high growth companies. The null hypotheses were rejected in respect of MVA and FCFD.

The most consistent finding throughout the series was that low growth companies added more value to the investment of shareholders than high growth companies. MVA was used as a composite measure of the degree of success of managerial discretion over the investment policy of companies. The results obtained tend to suggest that managers of low growth companies were more successful than managers of high growth companies in creating economic value for shareholders. Another consistent finding was that high growth companies pay a greater percentage of FCF as dividends than low growth companies. This was considered to be contrary to normal expectation.

The significant differences observed between the MVA and FCFD of low growth and high growth companies were not supported by evidence from other measures employed in the study. Hence they could not be interpreted within the agency framework. These results could be product of the inadequacy of the P/E ratio as a measure growth.

7.3 FINDINGS AND EXPECTATIONS

The findings are summarised under three headings namely debt policy, investment policy and dividend policy. Many propositions were put forward in respect of these policies for certain category of companies but most were not sustained. Apart from the significant findings discussed above, some of the major findings are briefly stated in this section.

7.3.1 Debt Policy

- On the broader margin, there was no major difference in the debt policy of owner controlled companies and manager controlled companies. But the finer classifications of companies provided contrasting results. Low growth owner controlled companies took more debt than low growth manager controlled companies. This led to the view that the tendency to waste FCF should be lower in low growth companies than high growth companies. Also, high growth manager controlled companies financed a greater proportion of assets with debt than high growth owner controlled companies. Thus indicating that high growth owner controlled companies will tend to experience lower agency costs of FCF.

- For companies classified by growth, no major difference was identified in the first step of analysis. But the second step of analysis showed that low growth owner controlled companies surprisingly carried more debt than high growth owner controlled companies. Within the manager controlled group, the expectation that

high growth companies apply more debt than low growth companies was confirmed.

- Long-term debt did not appear to play an important monitoring role in all the series of data analysed. This is because the level of long-term debt assumed by all the companies was very low and could not be deemed to exert any real influence on management.

7.3.2 Investment Policy

- Control structures did not affect the proportion of FCF invested. In all the three planes where owner controlled companies were matched with manager controlled companies, no major difference was revealed in the investment of FCF.

- It was envisaged that high growth companies will invest a greater proportion of FCF than low growth companies. But this notion was only supported by manager controlled companies. The rest of the comparisons, that is low growth companies versus high growth companies, and low growth owner controlled companies versus high growth owner controlled companies revealed similarity in the level of FCF invested.

7.3.3 Dividend Policy

- It was proposed that owner controlled companies will pay higher dividends than manager controlled companies. The weight of evidence did not confirm this proposition.

- An interesting finding was that high growth companies paid remarkably higher percentage of earnings as dividends than low growth companies. This was taken to mean that high growth companies depended on external borrowing to finance investment opportunities.

7.4 CONCLUSION

Taken as a whole, the evidence presented in this study did not demonstrate a clear distinction between the utilisation of FCF by owner controlled companies and manager controlled companies. However, it identified certain attributes within the agency framework which indicate whether managers are creating value or destroying value for shareholders. In accepting these results, it must be admitted that the ratios used in the study are suggestive but not conclusive indicators of agency costs of FCF.

The results obtained through the matching of low growth companies to high growth companies suggest some puzzles for future research. Specifically, the measurement of growth deserves close attention. The ideal measure of growth should be uniform for all companies. A relatively high degree of uniformity was achieved in terms of the numerator of the P/E ratio, that is the market price. But the same cannot be said of

the accounting earnings which constitute the denominator of the P/E ratio. It is possible that the accounting systems of companies affected its magnitude in different ways. A resolution of this problem will help in understanding the effects of growth on the financial policies of companies within the agency framework.

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APPENDIX 1

Price/Earnings Ratios for companies in the Industrial Sector							
	1993	1994	1995		1993	1994	1995
ABI	25.74	23.37	20.05	CHUBB	3.49	4.55	9.49
ACREM	0	2.03	2.18	CITYHLD	12.82	6.35	8.41
ADCOCK	22.25	17.78	15.69	CITYLDG	17.26	23.96	22.35
ADMIRAL	0	0	0	CLINICS	5.26	7.25	7.05
ADONIS	71.11	10.44	3.27	CLYDE	2.47	3.12	6.76
ADVTECH	0	8.64	8.5	CMH	2.76	4.62	6.3
AECI	13.05	14.6	8.21	CMI	0	0	7.79
AF-&-OVER	4.22	7.65	6.31	CNAGALO	15.9	21.84	18.42
AFCOL	7.34	11.48	13.7	COASTAL	0	0	0
AFROX	22.18	26.8	22.35	COATES	7.48	8.89	7.95
AKJ	4.05	4.74	8.22	CONCOR	2.89	6.35	9.47
ALEXNDR	8.15	8.55	8.97	CONFRAM	0	13.17	4.47
ALEXWYT	3.39	5.67	10.71	CONSOL	15.82	20.85	16.46
ALLWEAR	1.47	5.17	5.44	CONTRAV	8.33	8.21	0
ALTECH	15.76	16.66	15.72	CONTROL	11.2	21	11.05
ALTRON	14.44	14.9	11.99	COPI	33.74	28.71	21.01
AMREL	9.11	15.25	8.42	CORNICK	0	0	0
ANBEECO	3.27	6.89	5.21	CRENDEL	52.94	0	1.66
ANG-ALPHA	15.09	20.14	18.35	CROOKES	7.51	15.2	10.47
ARIES	8.12	9	9.55	CTP	6.65	8.98	9.68
AROMA	6.25	9.17	10.39	CUTRITE	5.07	4.15	3.87
ASEAN	0	0	0	DA-GAMA	5.89	8.24	7.88
AUKLAND	0	0	10.67	DAEWOO	5.58	25	13.63
AUTOMKR	0	0	0	DALYS	73.82	59.18	61.03
AUTOPGE	8.04	13.14	61.67	DATATEC	0	0	13.31
AUTOQIP	2.78	3.01	3.45	DECHOLD	1.46	3.86	1.55
BASREAD	0	0	0	DELFOOD	11.98	11.45	0
BATECOR	0	0	21.61	DELSWA	2.58	6.18	3.55
BATEPRO	0	2.76	3.45	DELTA	17.38	18.83	15.36
BEARMAN	4.32	10.14	15.92	DIALMOV	0.77	0	0
BELL	0	0	0	DIDATA	23.8	21.12	24.52
BERTRAD	0	0	0	DISTIL	9.7	9.09	11.73
BERZACK	6.91	16.01	9.26	DON	14.02	10.74	0
BEVCON	19.83	25.45	21.21	DORBYL	7.38	30.99	0
BICAF	1.04	2.26	2.56	ED-LBATE	15.73	16.92	15.96
BIVEC	8.81	17.03	8.83	EDGARS	18.37	25.88	23.04
BOLWEAR	4.02	6.08	6.86	ELLERINE	9.26	20.19	12.84
BONNITA	0	0	10.58	ENGEN	15.62	15.54	18.6
BOUMAT	7.08	8.98	9.3	ENSIGN	0	0	0
BOWCALF	15.88	15	16.98	ESIC	0	0	51.67
BRENMIL	6.98	8.67	7.38	EVERITE	17.73	42.46	15.67
BURLINGTN	4.87	6.25	9.21	EVHOLD	19.01	41.04	16.38
CADSWEP	25.4	21.67	22.26	FINTECH	10.92	10.41	14.17
CARE	0	16.12	9.37	FMCOTEC	4.14	8.93	0
CARGO	6.84	4.91	4.33	FOODCRP	15.27	16.24	17.08
CASHBIL	31.84	15.25	27.37	FOSCHINI	23.52	28.24	23.83
CAXTON	6.21	13.17	10.24	FRALEX	7.34	8.56	7.96
CEMENCO	11.85	51.79	7.5	FRAME	0	12.77	4.63
CERAMIC	3.93	7.85	6.39	FRANSAF	10.47	25.58	12.05
CGS-FOOD	15.65	17.17	16.71	FRIDGEM	0	0	0
CHEMSERVE	11.5	12.75	1.23	G5HOLD	1.92	12.23	8.51
CHOICE	0	6.73	10.52	GEN-OPTIC	4.94	10.14	19.82
CHROME	0	0	0	GENTECH	0	46.55	0

	1993	1994	1995		1993	1994	1995
GENTYRE-A	5.38	6.61	16.97	MASHOLD	0	0	3.83
GENTYRE-B	0	0	0	MASONITE	7	7.29	9.51
GLODINA	3.6	3.83	3.41	MAST	3.96	6.55	0
GOLDSTEIN	2.06	11.88	8.46	MATH-ASH	0	47.82	0
GRINAKER	6.86	12.69	10.76	MATHOMO	0	0	0
GRINTEK	7.5	8.62	9.15	MCCARTHY	4.97	12.96	14.21
GROUP-5	2.08	12.48	9.41	MCRTAIL	4.55	13.9	15.53
GUBINGS	8.23	4.08	5.56	MEDCLIN	13.19	7.34	6.57
GYPSUM	7.6	6.12	9.22	MEDEX	6.76	0	6.58
HAGGIE	9.99	12.52	8.49	MEDHOLD	7.86	6.72	7.7
HARVEYS	9.19	0	20.48	METAIR	3.12	4.65	7.65
HARWILL	18.65	31.85	15.12	METCASH	17.59	19.47	19.39
HICORL	6.92	6.55	5.25	METKOR	19.84	23.85	0
HIVELD	18.56	29.58	10.94	MGX	0	0	0
HLH	0	21.89	53.84	MIDAS	0	4.91	9.34
HOECHST	0	0	12.59	MIH	0	0	0
HORTORS	6.56	9.68	16.41	MOBILE	15.69	18.71	16.72
HOWDEN	0	0	0	MORKELS	3.86	6.98	7.6
HSEWARE	0	0	12.47	MOTOLNK	3.27	3.73	20.31
HUDACO	9.15	16.33	14.98	MULTI	7.72	9.26	9.67
HUNTCOR	29.11	22.2	53.59	NAMFISH	11.16	5.93	0
I-&-J	18.04	16.61	16.82	NAMPAK	15.94	18.54	18.08
IBJOFFE	0	28.67	18.75	NAMSEA	4.28	5.65	6.54
IBMSA	8.83	12.75	17.67	NASPERS	0	0	14.41
ICS	10.06	13.01	11.16	NATCHIX	0	0	0
ILCO	5.68	20.11	0	NATRAWL	7.2	0	0
ILLOVO	8.83	15.23	11.62	NEI-AFR	0	10.93	0
INDNEWS	0	0	0	NEIHOLD	0	10.64	0
INMINS	3.39	12.83	4.53	NINIAN	5.15	2.88	3.28
INTELES	16.43	20.61	19.9	NORBAKE	5.75	0	0
INVICTA	17.86	0	11.34	NUCLICKS	21.21	33.18	22.82
ISCOR	8.15	12.56	10.88	NUWORLD	16.77	18.11	22.35
ITLTILE	3.45	7.43	9.56	OAKFLDS	0	0	0
JADE	15.08	18.13	17.7	OCEANA	19.81	18.94	18.99
JASCO	4.02	6.67	13.33	OCFISH	8.57	8.95	9.97
JDGROUP	3.17	0	13.47	OMEGA	0	0	0
KAROS	4.3	0	0	OMNIA	8.27	11.07	0
KERSAF	15.64	22.03	11.97	OMNICOR	12.92	15.64	20.57
KJARO	0	0	13.59	OPUS	26.74	0	0
KOHLER	11.2	15.13	14.13	OTIS	5.26	8.63	8.83
KOLOSUS	0	0	7.23	PALS	3.38	2.5	4.31
KWV-BEL	8.67	11.07	10.19	PENROSE	0	0	0
L-T-A	3.48	14.42	15.06	PEP	24.14	18.35	24.27
LANGEBERG	8.91	9.13	9.68	PEPGRO	21.16	15.65	53.56
LASER	5.77	6.32	0	PEPKOR	23.12	18.5	16.77
LEFIC	22.24	26.55	21.78	PERSBEL	0	0	8.55
LESRNET	0	0	0	PERSKOR	6.74	9.25	8.31
LITHO	4.52	5.02	6.44	PERSTEL	0	0	14.19
LOGTEK	8.19	5.97	7.48	PICKNPAY	22.66	20.76	17.89
LONSUGR	10.51	14.38	12.67	PIKWIK	40.73	34.4	26.67
M-CELL	0	0	0	PLASTAL	0	11.03	4.38
M-NET	0	0	0	PLESSEY	0	0	0
MACADAM	2	4.04	4.87	POINTER	13.33	0	0
MACMED	14.64	10.27	12.67	POLIFIN	0	0	0
MASCON	0	0	0	PORT	9.73	28.29	8.07

	1993	1994	1995		1993	1994	1995
PORTHLD	0.29	1.6	1.18	TELJOY	8.5	9.85	329.33
POWTECH	13.81	12.58	16.15	TEX-MILLS	0	0	0
PPC	15.45	24.82	18.6	TIGR-OATS	16.49	17.16	17.35
PREM-GRP	16.67	20.76	18.59	TIHOLD	6.02	10.29	17.53
PREMPHARM	17.61	20.62	16.58	TIWHEEL	6.06	10.15	18.56
PRESMED	19.43	11.97	9.21	TMX	113.06	70	154.34
PRIME	0	410	95.75	TOLARAM	9.45	7.51	5.1
PROFURN	4.35	6.09	6.98	TONGAAT	10.59	17.61	14.97
PROGRESS	0	0	0	TOYOTA	8.57	8.89	6.47
PUBHOLD	10.96	6.04	6.28	TPN	4.68	9.43	6.25
PUBLICO	9.42	6.53	4.43	TRADHLD	18.79	16.36	12.08
PUTCO	4.53	5.92	4.81	TRENCOR	16.13	19.12	16.16
Q-DATA	16.11	25.56	18.83	TRNPACO	4.11	0	2.54
RAINBOW	0	77.02	60.41	UNIHOLD	11.82	6.73	6.32
REGGIES	5.77	0	5	UNISPIN	0	6.67	3.33
REUNERT	11.62	18.14	19.29	UNITRAN	10.24	13.49	11.73
REX-TRUE	4.99	8.53	7.05	USKO	0	6.76	7.3
ROADCOR	0	3.03	0	VALAUTO	0	4.17	5.77
ROMATEX	4.37	11.96	7.78	VALCAR	0	5.13	8.33
S&SHOLD	3.13	7.66	9.71	VENTEL	7.03	4.48	3.47
SA-BREWS	20.07	25.57	21.56	VENTRON	15.38	16.39	15.17
SA-DRUG	20.98	19.97	16.9	VOLTEX	7.27	16.03	10.23
SAB-IND	4.82	6.94	0	WALHOLD	22.07	28.86	0
SAPPI	11.44	10.51	7.51	WALTONS	7.48	9.77	9.08
SASOL	7.92	9.78	9.3	WBHOLD	0	8.3	11.32
SCHAMIN	8.2	10.42	13.65	WBHOVCO	2.56	7.93	8.39
SCHARIG	6.1	10.09	13.46	WESCO	8.33	8.17	7.11
SEAHARV	11.28	13.68	9.98	WINBEL	6.67	12.38	0
SEARCON	9.62	29.29	21.65	WINHOLD	4.5	8.93	3.33
SEARDEL	2	6.58	4.81	WOOLTRU	23.68	25.11	23.87
SEARTEC	0	0	8.78	YORKCOR	0	10.95	6.79
SENTRCHEM	11.34	14.77	11.31				
SERVGRO	11.99	14.77	17.56				
SFW	5.76	19.17	7.73				
SHARIND	0	16.7	13.86				
SHOPRIT	21.1	18.09	13.47				
SHOREDITS	1.61	9.91	5.62				
SILTEK	9.07	13.68	11.32				
SISA	12.64	20.35	9.82				
SMART	16.38	15.44	17.2				
SOLCHEM	4.61	6.49	7.41				
SONDOR	4.2	7.03	8.33				
SOVFOOD	0	0	0				
SPECLTY	8.94	16.16	21.77				
SPESCOM	7.82	7.94	9.62				
SPICER	0	6.32	8.19				
SPUR	23.57	18.12	15.45				
SPURHLD	22.96	19.6	16.69				
STEERS	0	0	18.14				
STERLING	10.34	23.33	0				
STOCKS	3.21	7.91	9.04				
STORECO	23.55	44.97	62.25				
SUNCRUSH	111.53	18.26	20.51				
T-E-J	0	0.74	1.87				
T-M-L	16.57	14.24	29.65				

APPENDIX 2

Low Growth Owner Controlled Companies	High Growth Owner Controlled Companies	Low Growth Manager Controlled Companies	High Growth Manager Controlled Companies
Arthur Kaplan Jewellery	Allied Technologies	Bicc Cafca	Amalgamated Beverages
Allwear	Bowler Metcalf	Chubb Holdings	Adcock Ingram
Anbeeco	Canadian Overseas	Coates Brothers	African Oxygen
Aries Packaging	Edward Bateman	Concor	Anglo Alpha
Autoquip	Foschini	Conshu Holdings	Cadbury Schweppes
Bolton Footwear	Harwill Investments	CTP Holdings	Cashbuild
Boumat	Mobile Industries	Da Gama Textile	CG Smith Foods
Brenner Mills	Nuworld Holdings	Decor Invesment	City Lodge Hotels
Burlington Industries	Oceana Investment	Distillers	CNA Gallo
Cargo Carriers	Pick 'N Pay	Grintek	Consol
Ceramic Industries	Spur Holdings	Gypsum Industries	Delta Electronics
Clinic Holdings	Storeco	Langeberg Holdings	Dimension Data
Clyde Industrial	Suncrush	Lithosaver Systems	Edgars Stores
Combined Motor Holdings	Telemetrix	Masonite	Engen
Cutrite Investments	Trencor	Metair Investments	Foodcorp
Delswa	Ventron	Morkels	Huntcor
Fraser Alexander		Namibia Sea Products	Irvin & Johnson
Glodina Holdings		Oceana Fishing	Interleisure
Gubb & Inggs		Otis Elevator	Metro Cash & Carry
Hicor		Perskor Group	Nampak
Italtile		Portland Holdings	New Clicks
Log Tek Holdings		Protea Furnishers	Pep
Macadams Bakery		Sasol	Pretoria Portland
Medhold		Shoredits Holdings	Premier Pharmaceutical
Multisource Holdings		Solchem Investments	Q Data
Ninian & Lester Holdings		Tolaram 2000	South African Druggists
Publico		Toyota	Smart Centre
Putco		Waltons Stationery	Times Media
Rex Trueform			Tiger Oats
Seardel Investment			Wooltru
Sondor Industries			
Spescom Electronics			
Stocks			
TPN Investments			
Ventel			

APPENDIX 3

Specimen Cash Flow Statement

	(R'000s)
701 Operating Profit/loss	139521
702 Depreciation & Non Cash-items	73633
703 Cash Ex Operations	213154
704 Plus: Investment Income	9410
705 Other Income	0
706 Decrease/increase Working Capital	3170
707 Decrease/increase In Stock	7394
708 Decrease/increase Account Receivable	-5733
709 Increase/decrease Account Payable	1509
710 Increase/decrease Interest free Loans	0
711 Cash Ex Operating Activity	225734
712 Less: Net Int Paid/received	-9537
713 Taxation Paid	55439
714 Cash Available	179832
715 Less: Ordinary Dividend	10406
716 Preference Dividend	0
717 Net Retained Cash	169426
718 Less: Cash Invested	154541
719 Fixed Assets Acquired	133993
720 Increase In Investments	0
721 Net Investment In Subsidiaries	20134
722 Other Expenses/losses	414
723 Plus: Cash Ex Invest Activity	6954
724 Proceeds Disp Fixed Asset	6954
725 Proceeds Disp Investment	0
726 Other Proceeds	0
727 Cash Generated	21839
728 Increase/decrease Long Term Liabilities	0
729 Increase/decrease Short Term Liabilities	-21839
730 Change In Share Capital	0
731 Other	0
732 Cash Utilised	-21839