TMT BEHAVIOUR AND WAYS OF FIRM'S GROWTH: IS THERE ANY CONNECTION?

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ABSTRACT
A serious dilemma for firms has always been how much discretion should be granted to their managers so that they have sufficient decision-making latitude to respond to market changes. At the same time, managers are also under appropriate monitoring while they are seeking competitive advantages for the company so that they do not make decisions that may harm shareholders' interests. In this paper the concept of perceived managerial discretion, which has been long neglected by academics, and proposed that the fit between perceived managerial discretion and market competition would significantly impact on firms' growth strategy is investigated. Based on prior literature, we have tried to explain the relationship between perceived TMT motives for firms' growth. The significance of diversification implementation can be seen through potential increase of firm performance or through managerial motives to diversify (an increase in compensations). Motives for the implementation of the diversification are numerous and vary from company to company. Existing research has identified several common motives for the diversification strategy, such as firm growth, survival of the company, risks reduce and increase in profitability, depending on the type of diversification (related or unrelated) they are implementing. Managers can perform unrelated takeovers in order to increase their own compensations. The fact that large firms CEOs generate higher compensations does not imply itself that increase of firm size leads to the increase of their own revenues (Werin and Wijkander, 1992). The obtained results from the sample of Croatian firms showed that in large companies there is a difference in the type of diversification strategy they are applying in addition to the way of implementation of the growth strategy, that distinguish depending on the industry in which the firm operates.
Keywords: *firm's growth, top management team, M&A, diversification*

1. INTRODUCTION

Dynamic business environment drives firms towards practicing different growth strategies in order to successfully position themselves on the market. Growth strategies are concerned with increasing the size and viability of the business over time with the final aim of building and sustaining their competitive market position. A successful growth strategy will allow firms to increase its customer base, market segments, geographical scope, and/or product lines, which should lead to revenue growth. Permanent growth enables them to build and sustain their competitive market position.

In planning growth strategies, managers should be concerned with three key issues: (1) where do we allocate resources within our business in order to achieve growth, (2) what changes in business scope do we see as compatible with growth and overall strategic decision, and (3) how do we time our growth moves compared to competitors (Harrison and St. John, 2008)?

This study points out that in order to increase personal compensations; managers sometimes evaluate firm's growth not considering its profitableness. Managers can perform unrelated takeovers in order to increase their own compensations. Mentioned managerial reasons for diversification are based on the existence of certain imperfections in corporate governance, namely the mechanisms by which stockholders control corporations and their managers. If stockholders could assess those takeovers that would increase profits, and those that wouldn`t, and focus management only on those takeovers that increase stockholder value, the possibility of acquisitions managed by managers would disappear (Besanko et.al., 2007).

Hambrick and Finkelstein (1987) introduced and elaborated the concept of managerial discretion. They defined managerial discretion as executives' latitude of action and argued that the latitude is formed during the multiple process of a repeated game about their rational action between the executives and the stakeholders of the firm. Managerial action is determined by three sets of factors: the task environment, the internal structure of organization and the manager himself or herself.

In prior studies it has been suggested that greater managerial discretion enables managers to shape firms more significantly, and moreover increases the influence of managerial characteristics on organizational outcomes (Finkelstein & Hambrick, 1987). From the perspective of agency theory, high managerial discretion allows managers to work for personal benefits rather than for those of shareholders. While contingency theory points out that executive in diversified firms ask for more compensation than that in non-diversified firms as their more complicated environment, executives adopt some strategies such as mergers and acquisitions (M&A) and diversification in order to increase their compensation. According to Hambrick and Finkelstein's opinion, the degree an executive can affect the organizational behavior and performance, depends on particular environment, and the organizational performance is the function of environment and executives' behavior. Different organizational environment or executive will lead to different organizational performance.

Reviewing from the conclusions above we confirmed that, there is a common view behind the factors such as ownership structure, degree of supervision, diversification and enterprise' scale, which is such factors determined the difference of managerial discretion. Higher managerial discretion means higher marginal product, higher risk and also means that executives' higher compensation.

2. BEHAVIOUR OF TOP MANAGEMENT TEAM IN ORDER TO ENHANCE FIRM GROWTH

The relationship between managerial behaviour and firm's growth has long been a critical issue in management research. In the previous literature researchers have found that the impact of managerial actions on firm performance depends on several managerial factors, among which managerial discretion is the most commonly cited. Managerial discretion refers to the ability of executives to affect key organizational outcomes (Hambrick & Finkelstein, 1987). Because the influence of managers on organizational outcomes differs according to

their level of decision making authority, the subject of managerial discretion has led to important theoretical explanations of several phenomena of interest to scholars researching organizations and strategies, such as chief executive officer (CEO) compensation (Finkelstein & Boyd, 1998; Magnan & St-Onge, 1997), executive profiles (Haleblian & Finkelstein, 1993), and management team tenure (Finkelstein & Hambrick, 1990). In prior studies it has been suggested that greater managerial discretion enables managers to shape organizations more significantly, and moreover increases the influence of managerial characteristics on organizational outcomes (Finkelstein & Hambrick, 1990). Since the managerial discretion hypotheses argued that managers diverted some of the profits of the firm to the pursuit of their own interests, and that these interests were often closely tied to the size of the firm, the early studies of compensation tended to test whether profits or sales were more closely correlated with compensation. Studies have shown that top management fees do not depend primarily on business results of the firm, but may also depend on size of the firm, usually measured by sale (Barney and Hesterly, 2006: 234). Thus encourages managers who want to increase their income to ensure firm growth. One of the easiest ways to achieve growth is by diversification, which is usually unrelated, through merger and acquisition. With large acquisitions firms may grow continually in a short period of time, and thereby provide higher revenues to top management. Top management only needs to take care of economic profit, i.e., that profit level is not so low that the firm becomes a potential target for a hostile takeover, or to encourage owners to make change of management. In recent years, the influence of firm size on managerial compensations became less important, while in the same time compensations of senior management are becoming more associated with firm performance. Especially, the use of stock options and other forms of deferred compensations highlights firm growth as the most important interest to managers.

Therefore, the desire for higher compensations and managerial risk reduction are two basic managerial motives for firm diversification (Combs and Skill, 2003). In other words, top managers may opt for a diversified firm with the aim of diversifying their own job risk as long as profitability does not suffer.

However, diversification provides additional benefits for managers, the ones that owners don’t have. Research results have shown that diversification and firm size are much related, and if firm size increases, compensations of management will increase also (Gray and Cannella, 1997). Furthermore, large firms are considered to be more complex, and therefore more difficult to manage, which leads us to significant compensations to managers. Higher levels of diversification can increase complexity of firm, as well as managerial compensations for managing diversified firm. Corporate governance mechanisms, such as the board of directors, supervisory board or market for corporate control can limit management in overextend diversification.

But sometimes the above mentioned mechanisms are not strong enough, allowing managers to diversify firm to the point where even the average returns can`t be achieved (Janney, 2002). Loss of adequate internal mechanisms can result in lower relative success of a firm, and a possible threat of takeover. Despite the fact that takeovers can increase efficiency by changing ineffective top management, managers can avoid takeovers by using various defensive tactics (e.g., poison-pill or golden parachute).

Therefore, the threat of takeover may restrict managers, but can`t completely control motives of managers for diversification (Duane Ireland, Hoskisson and Hitt, 2009).

Jensen indicates that managers simply enjoy leading large firms, because corporate growth entails social eminence, public reputation and influence, and political power of top managers Jensen, 1989). Stockholders want firm growth only if such growth leads to increased profit. Therefore, Jensen also indicates that managers evaluate firm growth, regardless of whether it is profitable or not.

Diversification can create value also in the case when the managers are able to identify firms undervalued in the stock market. There is often scepticism towards such a reason for diversification, especially if target firm operates in the field unrelated to activities of an acquirer. There is a possibility that market value of targeted firm is incorrect and that other investors have not yet realized this fact. Also, the mere announcement of takeover draws attention, often leading to other potential acquirers bidding for targeted firm. Biddings as such, are not rare, and serve to reduce the potential takeover gains for the acquirer. Probably the biggest problem is perception of how winning bidders, in auctions and similar sale arrangements, usually overpay targeted firm value, unless diversified firm owns much more IT about targeted firm than other bidders (Besanko, Dranove, Shanley and Schaefer, 2007: 173).

Managers can perform unrelated takeovers in order to increase their own compensations. The fact that large firms CEOs generate higher compensations does not imply itself that increase of firm size leads to the increase of their own revenues (Werin and Wijkander, 1992). *Avery et. al.* found no difference in wages growth between CEOs who performed takeovers and those whose businesses naturally grew. On the other hand, *Bliss and Rosen* conclude that executive directors of banks who made acquisitions had a big increase of their own compensations (Bliss and Rosen, 2001). *Amihud* and *Lev* assume that managers perform unrelated takeovers to protect themselves from the risk (Amihud and Lev, 1981). They observe that stockholders are not inclined to change top management, except in case of bad business of the firm. In order to reduce the risk of job loss, managers must reduce the risk of bad business. One way to achieve this is through unrelated acquisitions. They showed how firms run by management participate in more conglomerate acquisitions than firms run by the owners. Although such acquisitions reduce risk of job loss for top management, they don`t always bring benefits for stockholders. These stockholders can reduce their own financial risk by managing their portfolio of investments (for example by investing in mutual funds) (Besanko et.al., 2007:175).

Mentioned managerial reasons for diversification are based on the existence of certain imperfections in corporate governance, namely the mechanisms by which stockholders control corporations and their managers. If stockholders could assess those takeovers that would increase profits, and those that wouldn`t, and focus management only on those takeovers that increase stockholder value, the possibility of acquisitions managed by managers would disappear (Besanko et.al., 2007:175). However, stockholders most often have a hard time detecting acquisitions that will increase profits, because they don't possess such IT, nor are they skilled enough to make such conclusions.

Furthermore, it is difficult to change management decisions, even if stockholders disagree with them. Formally, supervisory board is responsible for monitoring management in order to ensure that management actions increase stockholder value.

Market for corporate control is a mechanism of corporate governance. Its fundamental assumption is as follows: market price of the stocks adequately reflects the effectiveness of management (Manne, 1965). Model of market for corporate control assumes that managers have the right to manage a firm as long as its market value can`t be significantly improved by the alternative group of managers with an alternative business strategy (Tipurić, 2008: 299). *Manne* lies out that market for corporate control represents an important limitation for managers' actions (Besanko, et.al. 2007: 177). Managers who perform takeovers that don`t meet interests of stockholders will find stock prices of their companies falling for two reasons. First, if managers overpay diversified acquisition, value of their firm will be reduced by the same overpaid amount. Second, if the Stock Exchange expects that a firm will overpay additional takeovers in the future, the market value of firm stocks will fall today in anticipation of these events. This inequality between actual and potential stock price of firm presents an opportunity for some other entity (individual, other firm or specialized investment bank) to execute takeover. A potential acquirer can gain control of the respective firm by simply buying the firm stocks on the market. With sufficiently large package of stocks, acquirer may vote its own slate of directors and appoint managers who will work on increasing stockholders value. With the purchase of shares at the actual price and later introducing changes that will return shares to the potential value, acquirer can gain some earnings.

Observation of the market for corporate control as the market in which alternative groups of managers are competing for the rights to manage corporate resources represents a shift from traditional understanding of the mechanism. According to traditional understanding suppliers of financial resources and active stockholders (alone or in coalition) "buy" control of corporation and hire and dismiss management in order to achieve better use of resources.

Inefficient business of management will be reflected in capital market by reducing the value of stocks. Thus market for corporate control represents a constant threat to management as a mechanism of disciplining their behaviour. Finally, an active and liquid capital market represents assumption of efficient functioning of market for corporate control.

3. METHODOLOGY

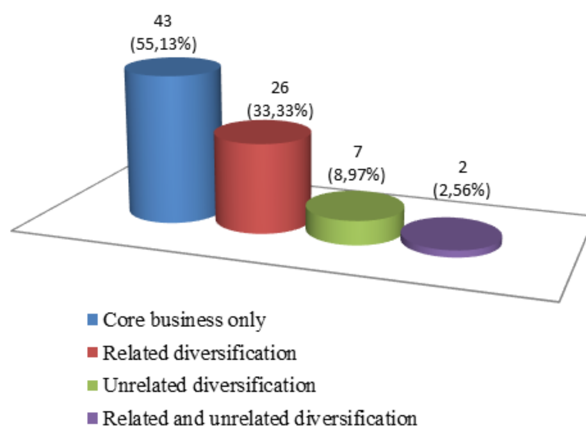
The subject of this research is focused on the analysis of managerial motives for growth through diversification by observing the macro-level factors, especially the industry as a guideline of implementing diversification strategy of large firms in Croatia. The characteristics of individual industry are very important determinants of the managerial decision on which type of the diversification, related or unrelated, the firm will apply.

In order to realize the objectives of the research the population of large firms in Croatia has been used. Analysis was conducted for 78 large Croatian firms (Daraboš, 2011).

The figure 1 shows the structure of the sample and the number of firms in relation to the scope and variety of businesses in which they operate. More than half of firms from the sample (55,13%) operates only within their core business, and do not apply the diversification

strategy. 33.33% of firm from the sample operates in other businesses that are associated with the core business of the company, and apply related diversification strategy, while 8,97% of companies from the sample operates in businesses different than the core business (unrelated diversification). From the results of research has arisen that there are companies in the sample (2,56%), which simultaneously use both, related and unrelated diversification strategy or operate in industries that are associated with the core business, but also in completely different industries that their core business is in.

Figure 1 Sample description

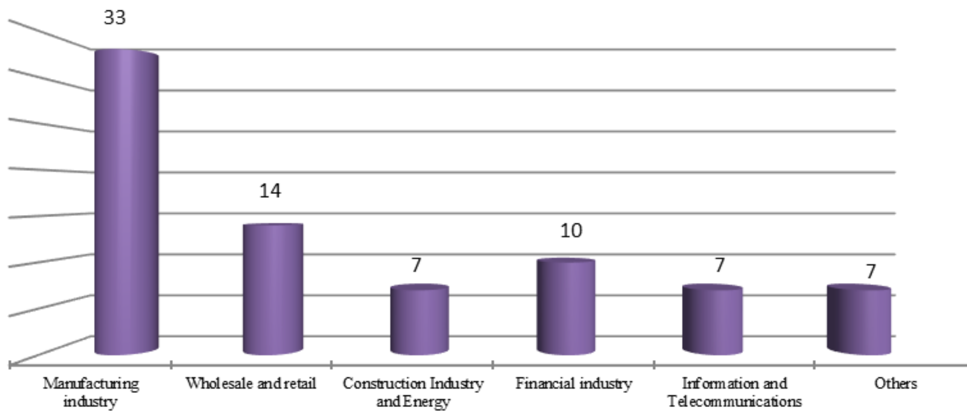


In order to improve the hypothesis, firms from the sample are grouped into industry groups, according to the core business they operate in. Industries are grouped into six groups: 1 - Manufacturing, 2 - Wholesale and Retail Industry, 3 - Construction Industry and Energy, 4 - The Financial Industry, 5 – IT and Telecommunications, 6 - Others. The sixth group consist of the companies that according to their core business we weren't able to group in any of the previous classes, thus we arrange them in the group named Others.

The figure 2 shows the distribution of firms from the sample into industry groups, regardless of implementing a diversification strategy or not. The Manufacturing industry makes 33 companies in the sample, Wholesale and Retail Industry 14 companies, 10 in Financial Industry companies, while in the group Construction Industry and Energy as well as IT and Telecommunications, and the group Others were 7 companies in each group.

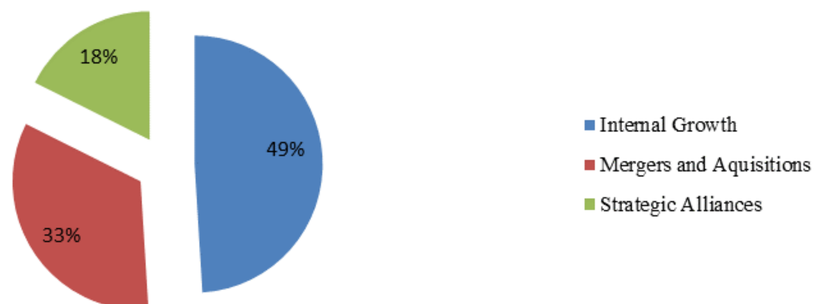
(Figure following on the next page)

Figure 2 Distribution of firms from a sample into industry groups



Afterwards, the ways of implementing a diversification have been examined (Daraboš, 2011). The most common way of implementing this strategy is internal growth (49% of companies from the sample), that is an expected result given the frequent use of diversification strategies associated with the companies from the sample. 33% of companies from the sample have implemented a diversification strategy through mergers and acquisitions, while strategic alliances are the least represented as a way of implementing a diversification strategy (18%).

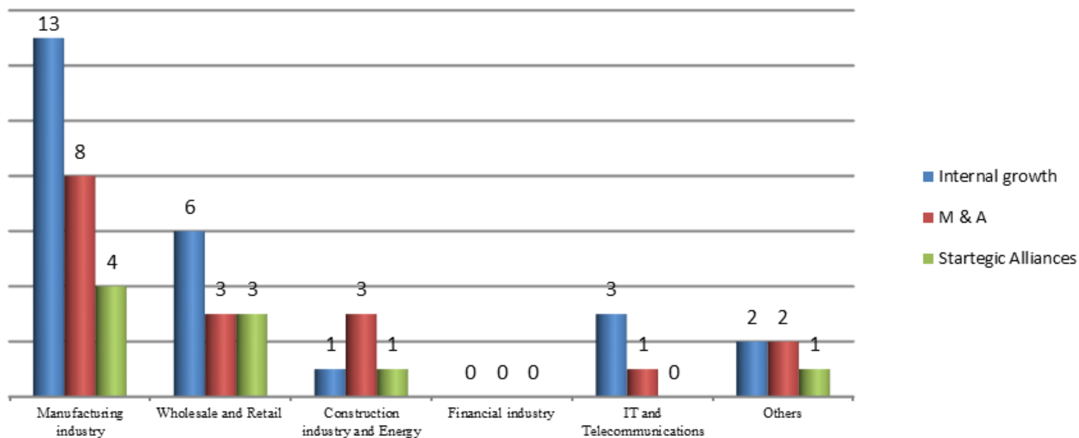
Figure 3 Ways of growth in firms from the sample



4. RESULTS AND DISCUSSION

Next figure is a graphical representation of the difference in ways of growth of firms from the sample in relation to industry in which firms operate.

Figure 4 Ways of growth of firms from the sample across industries



In order to test the frequency of using related and unrelated diversification in large Croatian firms we have selected firms from the sample that are implementing diversification as the growth strategy and grouped them depending on the type of diversification they are using. Firms were distributed into 3 groups for the purpose of descriptive analysis: (1) firms that are implementing related diversification, (2) firms that are implementing unrelated diversification, and (3) firms that are implementing simultaneously both, related and unrelated diversification strategy. We put that in the relation with types of growth they are using to implement diversification: internal growth, mergers and acquisitions and strategic alliance.

The number of firms from the sample that are implementing diversification was compared to the number of firms that are using certain way of growth to implement diversification. The results showed that the most common way of firms' growth is internal growth that is 43,02% of firms from sample were implementing diversification through internal growth. Mergers and acquisitions are the second common way of implementing diversification, i. e. 33,33% of firms from the sample used M&A's to pursue firm growth, while the smallest number of firms are pursuing growth strategy by participating in some strategic alliances, i.e. 17,65% of firms from the sample.

(Figure following on the next page)

Figure 5 Firms from the sample according to the type of diversification and the ways of growth

	Internal growth	M & A	Strategic Alliance
Firm is operating in other businesses that are connected to its core business (related diversification)	20	11	7
Firm is operating in other industries that are totally different to its core business (unrelated diversification)	3	5	2
Firm is operating in both, related and unrelated businesses	2	1	0
TOTAL	**43,02%**	**33,33%**	**17,65%**

In order to determine whether there is a difference in the frequency in implementation of a diversification strategy depending on the industry in which the firm operates the non-parametric test for independent samples - Kruskal - Wallis test has been applied, since the sample of firms that apply a diversification strategy was relatively small. Focus is on the fact that there are differences in the frequency of implementing diversification strategy and that the difference depends on the industry in which the firm operates. The results showed that there is a statistically significant difference in the implementation of a diversification strategy and that it varies across the industries (α=10%, $\chi 2$=9,545, df =5, p- value=0.089).

It is interesting to note that there is more common use of related diversification strategy than unrelated diversification strategy in all industry groups. Moreover, it's important to point out that it is highly represented in firms within the group Wholesale and Retail Industry, IT and Telecomunications, as well as in group Others (42,86%). While unrelated diversification strategy is the most frequently used in firms within the group Manufacturing Industry (15,15%).

The results obtained on a sample of large Croatian firms are in accordance with the results of previous research in the world that have shown differences in the implementation of the diversification strategy as well as different types of diversification strategy across different industries that can be explained by certain characteristics of particular industry, such as high entry barriers, number of competitors in the industry, higher transaction costs, industry volatility, etc. Therefore, we can conclude that presented results showed that in large Croatian companies there is a difference in the type of diversification strategy they are applying in addition to the way of implementation of the growth strategy, that distinguish depending on the industry in which the firm operates.

5. CONCLUSION

For companies involved in highly competitive industries, competitive advantage lies in being able to respond quickly to the environment. This capability requires top managers to allocate company resources rapidly to introduce competitive products into highly dynamic markets. Additionally, managers should be capable of quickly reinventing products and services in response to competitors. Managers must also be able to make correct decisions rapidly based on incomplete IT in order to promote long-term firm development. Under these conditions, granting managers greater discretion and making sure they are well aware that this can help them utilize fully the resources at their disposal to make correct decisions that affect long-term firm development. This situation also provides managers with strong motivation to work hard toward the goal of realizing their ambitions. On the other hand, when competition in the industry is weak, the competitive pressure on the companies and managers is generally low. Under such circumstances, high perceived managerial discretion might lead to self-exaggeration through abuse of power – for example, the private use of company resources. Managers may use this discretion for personal gain, negatively impacting on the firm's long-term performance. In this situation, firms should strengthen control over managerial discretion, to ensure that top managers work hard to realize company goals. By ensuring managers perceive the managerial discretion available to them accurately; firms are more likely to achieve better business performance. The significance of implementing diversification can be seen through potential increase of firm performance or through managerial motives to diversify (an increase in compensations). Motives for the implementation of the diversification strategy are numerous and vary from company to company. Existing research has identified several common motives for the diversification strategy, such as firm growth, survival of the company, risks reduce and increase in profitability, depending on the type of diversification (related or unrelated) they are implementing. Effective implementation of diversification may possibly increase firm value. However, diversification should be under the control of internal corporate governance mechanisms in order to avoid or minimize the potential costs that implementation can bring, as well as any intentions of managers for excessive diversification. The competitiveness of the firm could be improved through implementation of diversification, however the level to which they will diversify its resources, especially financial, as well as key competencies and the opportunities and threats within the institutional environment in which they operate need to be properly determined. This paper examined the difference the types of diversification the firm is pursuing to grow and the ways of implementing this growth strategy in relation to industries in which firm operates. Results showed there is a different frequency of implementing related under unrelated diversification strategy among different industries in large Croatian firms and this could be partially explained through different characteristics of particular industry in which the firm operates (the level of rivalry in the industry, high entry barriers, higher transaction costs, volatility of individual industries, etc).

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