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The Theory of Agency Applied to The Relationship Between Leader and Creditor

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Abstract - This article seeks to explain the managerial entrenchment of corporate by the debt policy using the theory of the Agency, the theory of transaction costs, the theory of the managerial entrenchment, debt structure, as well as the mechanisms of control and incentives in the relationship debt- managerial entrenchment, the results in theoretical work shows that leaders replace the internal capital market external market to avoid the control exercised by the creditors. Finally, we also found the impact of debt on the managerial entrenchment.

Keywords - Managerial entrenchment, Debt, The theory of Agency, Leader, Creditor.

I. INTRODUCTION

We will have the opportunity during this research to analyze how debt policy constitutes a competitive advantage for a strategy of managerial entrenchment. We will study how the relationship of debt which is regarded as an instrument of control of leaders, can constitute a competitive advantage of the members of a network, their entrenchment and its development.

In this paper, the interest allocated to financing contracts by debts among the mechanisms of Governments to businesses will be explained first and identify in a second time, the risk of collusion between leaders and creditors.

The arbitration between funding sources may depend on the willingness of leaders to keep their jobs in the company. Some may change the nature of the investment and financing of the firm to implement [1]. The debt of the firm when the leader is rooted should be lower to reduce the risk on its human capital. On the contrary, Stulz R. [2] proposed that the debt of the firm when the leader is rooted should be more important to reduce the number of voting rights and therefore the probability of the occurrence of a takeover.

The opportunistic leader will focus on the use of an increase of capital rather than to bank debt to finance its investments. Indeed, the increase in bank debt increases the level of dependency of the company to the Bank and greatly reduces the margin of manoeuvre of the leader (who must prove the profitability of its decisions by business plans and also, who must be able to pay regular interest and the repayment of capital). Conversely, an increase of capital can allow opportunistic leader (with sufficient capital) to strengthen its entrenchment through the purchase of shares of the company. Debt can be regarded both as a signal [3]or as a means of pressure on the leaders [4]. Accordingly, debt could be good or bad stress factor.

For Zwiebel J. and Berger P.G. ([5]-[6]), one must consider the dynamics of the links between financial decisions and managerial entrenchment. For example, leaders can impose their own debt increased, even if prior to the threats, they prefer to reduce debt, when they see a significant risk of rupture of the contract of employment.

This research has the objective to study and clarify the relationship between debt and the managerial entrenchment in the business. This objective leads to various questions about? How debt affects the strategy of the managerial entrenchment of the company? How the theory of Agency applied to the relationship between leader and creditor?

The rest of the paper proceeds as follows. The second section is devoted to a review of the literature of the theoretical perspectives used to study the relationship between debt and managerial entrenchment.The third section focuses on explaining the mechanisms of control and incentives in the relationship “ debt- entrenchment managerial”. The fourth section develops the limits of the Agency theory to analyze the relationship between the debt and the managerial entrenchment. We conclude the paper in section V.

II. THE RELATIONSHIP OF AGENCY ‘CREDITOR-LEADER’ AND ITS RELEVANCE TO THE STUDY OF THE RELATIONSHIP ‘DEBT-MANAGERIAL ENTRENCHMENT’

For after (Ross S.A.), (Gomez P.Y.) and(Jensen M.C. and Meckling W.H.) [7], [8]-[9], the agency relationship is a contract between the main agent in the to get a service (business management). In this agency relationship, the main (the owner, holder of the capital) and the officer (Executive Officer, holder of the jurisdiction of management) have different utility functions, and that they act to maximize their respective utilities. An agency relationship become confrontational because there is a divergence of interests between the principal and the agent, the asymmetry of information, rooting of the leaders and existence of costs of institutions and execution of contracts. Thus the founding element that induces the need to align the conduct officer - officer - on the interests of shareholders - the main-: agency costs (costs of mandate):

(1) Monitoring costs: principal ensures that the agent is in its interests.

(2) Costs of customs clearance: the officer must show that it is in the interest of the principal.

(3) Residual costs: of the losses incurred by the principal of the fact of the divergence of interest.

The costs incurred are theoretically incompressible below the threshold, beyond which, trained for their reduction obtained costs.

In this context, governance and the theory of the Agency have role is to align the behavior of leaders on the criterion maximize the wealth of shareholders through the mechanism of control and incentives. Indeed, leaders can take advantage of freedom and their special position in the company, have information that could encourage them to manage the Affairs of his principals in a logic which is more favourable over the latter, since the behaviour of the leader is supposed to be located in two contractual relations: the conflict realtion with shareholders and the adversarial relationship with creditors. Conflicts of interest can arise in this realtion and therefore leads to relationship management costs.

According different work on the theory of the Agency, debt plays a fundamental role in reducing these costs of funds own while the disadvantage is the increase of the costs of agency debt. Indeed, debt appears as a means of reducing the risk of behaviour potentially deviant diriegants by binding to act in the interest of the shareholders.

A. Agency Theory (Agence View)"AV"

The relationship between the creditors and the leaders are generally observed through the prism of the theory of Agency. The theory of this agency presents conflicts of interest that may arise between the creditors and the leaders, each of the players trying to maximize its utility function, the creditor is confronted with a risk of opportunistic on the part of the leaders. This phenomenon of moral hazard, due to the inability of the creditor to inform and monitor the decisions and actions taken by the leader, is associated with an asymmetry of information between the two actors (the leader may have an information to the creditor on the performance of its business for the duration of the Exchange). These conflicts of interest have a cost and the theory of the Agency proposes solutions to reduce. The theory of this Agency therefore the leader as a player opprtuniste which has as main objective to seek to maximize its usefulness.

According to The theory of the Agency, leaders are agents of the shareholders in the company and are designed to manage the business in the interest of the actionnaires [8] or leaders and shareholders have different utility functions and act to maximize their utility respective [7].

The company is represented by a node of contracts whose leaders and shareholders are the main actors. The leader is, to him, hired by the shareholder, it is subject to a contractual relationship with the company and he often has a vision focused on the long term of the company main objective being to maintain this level of power and maximize their level of compensation while shareholders have a short term vision insofar as they are obviously not of contract with the company (their objective as maximizing) fast of wealth conducted mainly by the potential capital gains related to the operations of purchase and sale of shares. In addition, leaders are responsible for the good or bad quality of management and the results that flow from. They may prefer the turnover growth to that of profit, employ more staff than nécessaire etc.

The theory of the Agency, the role of leaders is to take decisions in their interests before the interests of the shareholders (dividends distribution) or adjustment of securities. The leader occupies a central position between the different stake holders of the company (shareholders, executives, clients, providers, Bank, State and benefit)of an asymmetry of information.

This asymmetry associated with a divergence of interests gives rise to the problems of agencies. "*These problems of agencies are pre-contractual or post-contract and find their origin in the information asymmetry and unable to write complete contracts limited rationality and uncertainty*"[10].

These conflicts of agencies are exacerbated by the presence of a debt in the financial structure of companies. This debt constituted a mechanism for resolution of disputes between shareholders and managers, where he encouraged the leaders to be efficient to avoid the risk of bankruptcy and the loss of their jobs: leaders are forced to maximize profits and the value of the company [11].

B. The Transaction Costs Theory (Transaction Cost View)

The governance is defined, according to [12], as the explicit or implied contractual framework in which a transaction is located. Transaction costs theory thus distinguishes three different governance structures: the market, the firm and hybrid forms of organization. The market is the form of organization of the transaction which uses an economic agent to sell or buy a property. Conversely, the firm is subject to a preference relative and not absolute. It if avere preferred to the market because the functioning of the market involves costs that the company form to reduce. Thus, [13] says that the firm may swept an organization and that authority gives the right to direct resources, some of the costs can be avoided. However, such a firm must be led to internal organization costs. The same analysis tool, the cost of transaction thus explain the existence of hybrid forms (between market and firm Governance Structure). These hybrid forms have less attention because they are more complex to study hoped. They are many: contract of sale in the short term, manufacturing licence agreement, mark, more long term recurring contract. They are also used in industries that emergence as the treatment of waste, there are several types of hybrid arragement frequently found in the world of agriculture and agri-food . These include subcontracting.

Indeed, the transaction costs theory is a theory of contracts full ([14]- [15]), separate from the theory of incomplete contracts on many points [16].The purpose of this theory is, therefore, to explain the selection by the economic agents of the governance structures that minimize the costs attached to a specific transaction, these transaction costs are based on the combination of 4 factors that characterize the behavior of economic agents: uncertainty, limited rationality agents, opportunism of the agents and specificity of the assets

In this framework, there are the costs of transactions (or contracting): which are divided into two categories :

a) Les of transactions ex-ante costs: the signing of the contract: there are automatically bargaining costs, costs of a document, meeting, discussion. This leads the parties to consider two types of contracts :

(i) Firstly, a comprehensive contract providing the mix of costs after the assets.

(ii) Secondly , a (non-exhaustive) framework contract which leaves to the discretion of the parties the possibility to see how they distribute the costs and the solution to find in litigation.

At this level, should address the importance of the implementation of the legal procedures to anticipate the sources of conflicts between managers and shareholders to minimize costs.

b) The ex-post transaction costs: after the signing, to ensure the performance by a third party.

Williamson made three comments on this:
(1) Haggle if renegotiation to correct differences ex-post.
(2) Costs of remedies for conflict.
(3) Establishment of safe commitment costs (avocats).
The characteristics of transactions will directly determine the structures of governance, i.e. those that minimize transaction costs, the role of these governance structures is to resolve conflicts between managers and shareholders. The types of governance structures are:
(i) The market governance (conventional contracts): classic design of the contract, the disagreement is treated here, before a judge.
(ii) The trilateral governance (neoclassical Contracting): the two parties are addressed to a third party to resolve disputes by arbitration.
(iii) The bilateral governance: the autonomy of the parties is maintained. Can consolidate in this type of contractual relations between firms partnership agreements, subcontracting contracts, the alliances between firm, no recourse to a third party, example: Exchange of hostages.
(iv) The unified governance: management ex-post of the contract in a firm integrated , example: vertical integration.

C. Theory of Entrenchment Managerial: A Complementary Approach of the Agency Theories and theTtransaction Costs Theories

The theory of entrenchment managerial that is well known in the works on governance, is based on the "opportunistic" of actors carctére and is part of the system of Government of the companies, to express his opportunistic, the leader should be given a discretion [17] , the discretion of the leader, called also " latitude managerial " by [18] has been mainly studied by the financial, on the basis of work in economics; This discretion means the area of power of the leader which is beyond the control of one or other of the shareholders.
Gomez P.Y. [9] defines the entrenchment managerial as being a phenomenon resulting from the delegation of the power generated by the agency relationship, Pichard-Stamford J-P. [19] translated rooting as the will of the agent to the control of the shareholders to be able to grant greater personal benefits. In this context, the theory of entrenchment managerial to take into account the personal interest in the managerial thinking.

Fundamentally, the theory of the entrenchment managerial wondered about barriers to exit that leaders in place establish to circumvent the control mechanisms put in place by the shareholders, at the risk of losing any reference to the reality and effectiveness.
The strategies of the entrenchment managerial allow to generate actions which stakeholders are indirect beneficiaries and leaders in General designed to increase their cost of replacement and to compel the renewal of their mandate.
According to this theory, the leaders develop strategies to ensure their place in the company and force potential competitors (leaders using the company resources to take root and maintain their discretion). So the leader can take root in the evening ways made to make the exercise of his inevitable personal power for the survival of it. The leader as an agent is encouraged to increase its rooting to reduce his risk of revocation, making it therefore more difficult and more expensive for shareholders, its ultimate goal is to increase its necessary discretionary latitude further his personal strategy while reducing the risk of be penalised by the different disciplinary mechanisms, Therefore this type of behaviour of the leaders to set the roots as being an excess power of leaders on the partners. Charreaux distinguished two areas of research related to two types of objectives pursued by the leaders: entrenchment internal and external career: in the case of the first strategy, the leader will try to visit indispensable to the company, he often reacts by implementing measures allow to remain the most possible longtempss within the company by adopting a strategy of the entrenchment managerial (as well as the retention of information and sometimes information is synonymous with from pouvoir).
For the second external career strategy, the leader aims to increase his reputation for managerial competence, not to stay in the business, but rather to mount its rating and have access to positions intérressnates in another company. This represents a danger for the company because these diriegants do not necessarily have a longer-term view.

III. THE MECHANISMS OF CONTROL AND INCENTIVES IN THE RELATIONSHIP 'DEBT-MANAGERIAL ENTRENCHMENT'

A. Mechanisms of Surveillance or Customs Clearance (Monitoring)

Monitoring mechanisms are of two types: internal and external :

(i) The internal mechanisms which include CA and monitoring by the other members of the Organization, can complement the discipline provided by the market leaders, such as the hierarchy, mutual surveillance between leaders and especially the CA whose specific task is to control the main leaders if necessary in the replacement.

(ii) The external mechanisms which include the OPA, banks, labour market, allow banks to participate in the surveillance of the leaders and the more frequently the creditors control the policy of investment and financing of the company. They can increase their ability to control with a share capital or even in obtaining a seat of administrator.

Financial organizations require systematically the actual guarantees so that leaders use the funds (liabilities) to fund riskier activities, which would translate for them to take a risk greater than expected initially. However, this type of this financing advantage to protect the strategic activities of the company, but also allows managers to limit its discretionary space through various means, such as specific contractual terms. As shareholders, creditors, lenders can susiter of reorganizations in the business and encourage the CA to change leader [1].

Ravid S. and Sudit E.[20] explain that the leader is always seeking enlargement of its discretionary space, and he will choose based on their availability, firstly self-financing, secondly the capital own exterior, thirdly and finally the debt. When the latter is more reimbursed by the company, banks often become shareholders and are involved in the appointment of a new leader, resulting in half of the cases the revocation of the leader in place [21]. Indeed, debt led to better monitoring of the leaders by the shareholders, the theoretical model proposed by Heinrich R.P. [22] shows that debt to reduce the costs of monitoring opportunities.

Monitoring mechanisms developed to limit the opportunism, are no longer considered as being suffered by the leaders, these mechanisms represent a limit of the managerial latitude imposed to the leader by the other partners of the company, the leaders will try to handle, neutralise mechanisms of Government with aims to avoid sanctions following the discovery of their opportunistic behavior.

B. Remuneration of Leader

In corporate law, the term "leaders" includes several people (the Chief Executive, the Chief Financial Officer and and Vice-Presidents), to perform their duties, these leaders receive a pay that some consider excessive, because of the apparent imbalance between remuneration and performance of the company. The structure of the remuneration system should be designed in such a way that the leaders manage in the interest of the shareholders. However, sometimes the déquilibres information and gaps in monitoring exercised by shareholders again latitude to leaders, which are likely to act in their own interests.

The remuneration of the leaders is a form of incitement of the behaviour of the leader as explained by Jensen M.C. and Murphy K.J.[(1990a), (1990b)], [23]- [24]. The remuneration is considered as a tool of control and positive incentives, designed to guide the behavior of the leader in the interest of the shareholders. Thus, the structure of the remuneration system would be determined for an optimal way, which would allow a reconciliation of the interests of managers and shareholders. The compensation would be a tool for reducing the costs of Agency.

Compensation acts as a "lever-action" [25] to the available of the CA to discipline leaders. One of the reasons motivate the diriegants to take décsions as optimal for the shareholders, in terms of investment horizon, is related to the mode of remuneration which proposed them, but also to encourage the leaders to act in the interest of shareholders and selecting the projects risky in the long term, the shareholders through the CA, can obtain their remuneration to the prospects of the result of investments in in research. and development to reduce the moral hazard, the main transfer the risk to agents, in lieant the salary of employees (bonus etc.) to the revenus (for exemple, profits) that are important for the principal.

According to Ginglinger E.[26], optimal compensation contract must meet the following conditions:

(i) On the one hand , the contract must "attract and retain the best leaders".

(ii)On the other, it should "encourage them to behave in the interests of shareholders".

(iii) Finally, it should "minimize the overall costs of Agency."

(iv)"attract and retain the best leaders".

Ginglinger E. identifies three types of contracts of pay: those who are indémendants of realisé performance (wages, pensions and life insurance), those that are based on data boursiérés (allocation of the shares to the leaders and stock) and finally those that are indexed on the accounting results offering a strong incentive to the manipulation of these. Each of these terms and conditions of executive compensation has particular characteristics :

Remuneration fixed leaders => limit the variation in results => the use of debt => increase output fixed cash.

Variable remuneration of leaders => corporate performance. => wealth of shareholders.

Remuneration based on accounting measures => resolve conflicts related to the differences of horizon.

IV. THE LIMITS OF THE AGENCY THEORY TO ANALYZE THE RELATIONSHIP BETWEEN THE DEBT AND THE MANAGERIAL ENTRENCHMENT

A. Debt: Source of Good or Bad of The Entrenchment Managerial

Debt can be a strategy of the entrenchment managerial, traditionally analyzed as disciplinary by Jensen and Meckling in the shareholders-leadership conflict, its role is much more uncertain in the relationship between leaders and creditors.

According to Ravid S. and Sudit E. [20], an leader who wishes to take root, will choose based on their availability, first self-financing, then external own capital and finally debt :

*Self-financing allows leaders to expand their managerial latitude by avoiding the use of bank debt and enhance its human capital by good the entrenchment of the leader(positive).

* External own capital allow to extend the knowledge base and avoid debt.

* The use of debt is a means of discipline in the financial market leaders, for to limit the opportunism of the leadershipby reducing the excess cash to its discrétion(reduce costs of agencies of own funds and increase the value of the company), the debt is positively on the performance of the company. In this case, it would then be as a source of good stress, the role of debt is analyzed as a solution to the conflict of Agency, debt is seen as the way to align the interests of managers on those shareholders.

Studies of the capital held by the leader and the debt lead to different conclusions. Harris M. and Raviv A. [27] show that debt is positively linked to the capital by the leadership affects negatively the level of indebtedness of companies [28]. Indeed, when leaders hold an important percentage of the capital, they result in a significant non-diversifiable risk and are therefore encouraged to reduce the level of indebtedness, however for high levels of pariticipation in the capital of the leaders, the debt is reduced. Indeed, leaders become rooted davantges and seek to reduce their risk.

Debt is a factor of " financial distress", likely to jeopardize the business, in this case there, he would then present as a source of good stress [29]. Conversely, if the granting of debt as a result of the difficulties suffered by the firm, it becomes a factor of embrittlement of the capital and the reputation of the firm. Thus operational difficulties and the increase in the debt lead mechanically and performance degradation and the fragmentation of the company unintentionally.

B. Debt And Agency Cost

Among the solutions proposed to resolve the conflicts of agency that exist within the company, include the debt which is a major way of resolving conflicts between shareholders and leaders, it generates to other conflicts with creditors that generate them even of agency costs. Hirigoyen G. and Jobard J.P. [11] demonstrate that the debt is the best solution to reduce agency costs, it can be seen as effective to reduce, in part the costs of Agency of own funds because it aligns the interests of shareholders with those leaders.

According different studies on the debt, it will offer to present in this section agencies costs resulting from the existing conflicts between shareholders and leaders on the one hand and shareholders and creditors on the other hand. Finally, it will describe the impact of debt on the costs of agencies.

B1. The conflicts of Agency between shareholders and leaders

The divergence of interests between managers and shareholders is the main source of conflict between them, the dissociation of functions between managers and shareholders brakes the good performance of the company. Indeed, each group seeks to maximize his own of utility over another, for example leaders using funds from shareholders to maximize the investisssments (finance projects of the company).

A the following conflict of interest presented above appear that Jensen and Meckling call of the costs of Agency (agency cost). These costs are three:

(1) Bonding costs : the control expenses which are incurred by the principal to check that the management of the agent is consistent with maximizing its usefulness. Examples: fees of commissions to auditors, audit conducted by the actionnaires.

(2) Costs of customs clearance (Bonding costs): expenditures incurred by the manager to report the shareholder that it is indeed for the maximization of wealth. Examples: advertising costs, development and dissemination of a report annual.

(3) Residual costs : residual costs from the impossibility to exercise total control over the Manager, including, when the marginal cost of control exceeding his income marginal.

B2.The conflicts of Agency between shareholders and creditors.

The causes of conflicts between shareholders and creditors may be the risk. Indeed, shareholders and leaders engage in the riskiest projects, which result in the existence of agency costs. Behaviour of the leaders are not, indeed, perfectly controlled, or even controlled by creditors, leaders with good projects of investment must report to creditors to not undergo a strong asymmetry of information. Indeed, the diriegant which holds information on the value of the investment project, committed a significant portion of the funds of the company in the project.

Acoording to the theory of the Agency, the disclosure and transparency of information to minimize the cost of monitoring of the leaders by the creditors. Thus, the positive effect of reducing the costs on the benefit of the company would be an incentive for managers to publish more information on the market, this disclosure of information to reduce the level of asymmetry of information between shareholders and managers.

B3.The Impact of Debt on the Costs of Agency

Debt financing is the best way for the establishment of relations between the company and its bank, which also helps reduce agency costs. To this end, studies theories show that one of the ways to control these costs of Agency is to increase, within the company the level of debt to limit the enchantment deviant of the leaders. Thus, the mechanism of external control represents by the debt could respond that the where leaders are forced in its choice of financing, directly by the shareholders or the structure of ownership indirectly. Therefore the debt financing reduced the opportunistic of the diriegants behavior since any lack of payment of the debt will automatically the bankruptcy of the company. Therefore leaders interest of increasing debt to maximize its control over the activity of management of the leaders. Also, the payment of interest on fixed dates of the loan may reduce the possibility of investment under optimal for the leader who is not enough cash flow available.

As the debt may mitigate the problem of conflict of Agency between officers and shareholders on the one hand and between shareholders and creditors on the other hand, it is the best way to reduce agency costs since on the one hand it aligns the interests of shareholders with those of the diriegants and on the other, it is a signal to the market that reflects the management of the business and its performance.

V. CONCLUSION

The theoretical contribution is based on the completion of a review of the literature on a phenomenon hitherto little explored: is interested in the relationship between debt and managerial entrenchment. Our research has developed the importance on the theory of managerial entrenchment, she explained that the leader is always seeking enlargement of its discretionary space. Furthermore, it contributes to a better understanding of one of the most important explanations: debt can be a strategy of rooting of the leader. Indeed, the debt is seen as a disciplinary mechanism to align the interests of managers with those of shareholders and to resolve conflicts arising of informational asymmetry.

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