



**THE EFFECT OF A COMPANY'S MANAGEMENT ON ITS FINANCIAL
PERFORMANCE**

BY

Wen-Yu Chan

BBA., Okanagan University College, 2005

RESEARCH PROJECT

**Submitted in partial fulfillment of the requirements
for the degree of Master of Science in Management
in the Faculty of Business Administration
Lakehead University**

Thunder Bay, Ontario (2006)

**THESES
M.Sc.
2007
C4**

ProQuest Number: 10611947

All rights reserved

INFORMATION TO ALL USERS

The quality of this reproduction is dependent upon the quality of the copy submitted.

In the unlikely event that the author did not send a complete manuscript and there are missing pages, these will be noted. Also, if material had to be removed, a note will indicate the deletion.



ProQuest 10611947

Published by ProQuest LLC (2017). Copyright of the Dissertation is held by the Author.

All rights reserved.

This work is protected against unauthorized copying under Title 17, United States Code
Microform Edition © ProQuest LLC.

ProQuest LLC.
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106 - 1346

**THE EFFECT OF A COMPANY'S MANAGEMENT ON ITS FINANCIAL
PERFORMANCE**

**APPROVED BY
SUPERVISOR**

Name Signature Date

READER

Name Signature Date

Abstract

The purpose of this study is to explore the possible relationship between the management styles or practices of top management and organizational performance. It examines Return on Equity (ROE) and Return on Stock (ROS) of the top two-hundred Canadian companies in market capitalization on the Toronto Stock Exchange (TSX) each year in the past six years by using the data from *Canadian Business* magazine and relates these performance measures to the practices of the companies' top management. The finding shows that these 'great' companies views building the qualified team as the priority strategy, and they all appreciate and compensate for employees' hard work and performance. Finally, according to the analysis and findings, an organization's top management will influence a firm's long-term performance.

Acknowledgements

This paper was inspired by the research work of Dr. Bryan J. Poulin and Dr. Robert A. Willis when I helped them collect some data. I appreciate their generosity in allowing me to take part in their study as my research project. Dr. Willis is the supervisor for this project, and I thank him for his time and effort to help me completing this research. Both of them contributed valuable ideas and time to improve the quality of the paper, and I am deeply appreciative.

Table of Contents

Introduction	
<i>Statement of the Problem</i>	7
<i>Purpose of the Study</i>	7
<i>Research Question(s)</i>	8
<i>Definition of Key Terms</i>	8-9
<i>Delimitation and Limitations</i>	9-10
Review of Literatures	
<i>Introduction</i>	10
<i>Top Management</i>	10-11
<i>Return on Equity</i>	12
<i>Return on Stock</i>	12-13
<i>Summary</i>	14
Methods	
<i>Type of Research Designs</i>	14
<i>Sample, Population and Participants</i>	15
<i>Data Collection Instruments, Variables and Materials</i>	15-16
<i>Data Analysis Procedures</i>	16-17
<i>Significant of the Study</i>	17-18
Analysis	
<i>Introduction</i>	18-19
<i>Bonavista and Its Comparators</i>	20-24
<i>Peyto and Its Comparators</i>	24-28
<i>Home Capital and Its Comparators</i>	28-32
<i>Finding</i>	32-34
<i>Conclusion</i>	34
Reference	35-37
Appendix A	Raw list of the qualified companies 38
Appendix B	Selected companies and two set of comparator companies 39-40
Appendix C	Market averages 41
Appendix D	Selected companies and comparator companies 42-46
Appendix E	Mixed Charts 47-49

Introduction

Statement of the Problem

This study is about partially replicating Jim Collins' (2001) U.S. work in his book of *Good to Great* within a Canadian context. He examined American companies that were consistently listed in the *Fortune 500* for the past 30 years and which consistently beat the market average in return on equity (ROE) and return on stock (ROS). His goal was to find what made these companies consistently beat the market average and he found that it was superior top management which he labeled level 5 leadership. I will partially duplicate his study to test whether top management influences organizational performance in Canada and whether Collins' findings hold in the Canadian context.

Purpose of the Study

The purpose of this study is to explore the possible relationship between the management styles or practices of top management and organizational performance. It examines ROE and ROS of the top two-hundred Canadian companies in market capitalization on the Toronto Stock Exchange (TSX) each year in the past six years by using the data from *Canadian Business* magazine and relates these performance measures to the practices of the companies' top management. As well, this study is trying to determine if a more detailed and deeper examination of the 'problem' and question(s) is warranted and/or feasible: if the result will provide meaningful insights into Canadian organizational management comparable to Collins's (2001).

Research Question(s)

Does top management influence long-term organizational performance as measured by ROS and ROE in the Canadian context? (And, if so, how do the key characteristics of these top managers compare with the Collins study in the U.S., as evidenced in publicly available sources?)

This research question is about exploring the possible relationship between a firm's management practice and its financial performance, and to find out what kind of management style or practice leads a firm to success. It will fill the gap in our knowledge that a firm's management makes the difference in a firm's performance. It will also find out whether Collin's finding of the level 5 leadership hold in the Canadian context.

Definitions of Key Terms

Return on Equity is a measure of a firm's profitability, and shows how much money a company makes with the money that shareholders have invested in the firm. It is calculated as follows: $ROE = \text{net profit} / \text{shareholder's equity}$

Return on Stock refers to the gain or loss on the stock price, and shows a company's stock performance in the market. It is calculated as follows:

$ROS = \text{net change in stock price} / \text{the original stock price.}$

In this study, the stock prices for the listed companies will be the value of the stock as of the date of publication of *Canadian Business Magazine*. Thus, the net change in price will be the change between stock prices taken annually, rather than an aggregated value based on daily, weekly, monthly or quarterly values for the stocks. It is believed that

using an annual measure will level out periodic fluctuations and market adjustments and provide a more legitimate estimate of the performance of the company over time. Annual measure will enable me to easily use the financial data “as the basis for more rigorous screening and analysis” (Collins, 2001, p.221). It will also allow me to reduce the number of selected companies to a manageable size since yearly data is more publicly available.

Delimitation and Limitations

Delimitation: This study will confine itself to collecting and examining the stock price fluctuation of the top two-hundred Canadian companies (listed on the TSX) in market capitalization over the past six years. Lack of complete records is part of the reason for this delimitation: Collins collected data for 15-plus years. However, narrowing the scope to only the stock performance in the past six years is seen as sufficient for a first, preliminary study and to concentrate on the two key variables of the companies’ financial performance and relate this to management styles or practices.

Similar to Collins, the equity return and stock price fluctuation are used as a first cut to select and determine the ‘great’ companies which outperform others in the market and exceed market average.

Limitations are: A) The sampling is selective and consists only of medium and large companies. The findings may not be representative for small companies.

B) The review period consists of only six years because Canadian data is only complete for this period. This varies from the fifteen years of the Collins’ study and thus the

results may not be strictly comparable. However it is expected that results will be sufficient for an exploratory study. Thus, an exploratory study using data openly available regarding the top companies listed on the TSX was seen as the appropriate place to begin. In addition, the complexities of the Canadian context – for example foreign ownership structures and governance structures – are difficult to unravel. Depending upon the results of this study, a more in-depth study that accounts for the complexities of the Canadian context, for example with regard to governance issues, for example, may be undertaken.

Review of the Literature

Introduction

This literature review “includes the scholarly literature that relates” to the problem, in this case management, ROE, and ROS and provides “a summary of the review that highlights the most important studies, captures major themes in the review, and suggests why we need more research on the topic” (Creswell, 2003, p.45).

Top Management

Collins (2001) stated that every good-to-great company has a ‘level 5 leadership’. Good-to-great companies are those whose “fifteen-year cumulative stock returns at or below the general stock market, punctuated by a transition point, then cumulative returns at least three times the market over the next fifteen years” (Collins, 2001, p.6). Collins classified corporate executives in a five-level hierarchy, and Level 5 leadership “refers to the highest level in a hierarchy of executive capabilities” (p.21). Level 1 to level 4 leaders

are described as highly capable, contributing, competent, and effective individuals respectively, while level 5 leaders include all these four attributes and two others: humility and will. A Level 5 leader is a top executive who “builds enduring greatness through a paradoxical blend of personal humility and professional will” (Collins, 2001, p.20). Every one of the good-to-great companies examined by Collins had a level 5 leaders in the critical transition phase that the company’s cumulative stock return begins to soar and beats the market average by at least three times in the next fifteen years. None of the comparison companies did, in his study. Comparison companies are the selected direct comparators to great companies, and they have similar capabilities and resources. Comparison companies are used to determine the differences in management in good and leadership in great companies. These leaders are described as being modest with a fierce, unwavering commitment to high standards (Collins, 2001).

This study will examine the management style of Canadian companies which are judged to match Collins’s opening criteria for greatness: those which consistently beat the market average for ROE and ROS over the time period under study. He defined the criteria for selection of good-to-great company: the company ,which has existed for fifteen years before the transition point of from good to great in performance, had “a cumulative total stock return no better than 1.25 times” of the general stock market (Collins, 2001, p.219). After the transition point, the company would have a cumulative total stock return of three times greater than the market average in the next fifteen years. I am not using all of Collins’ criteria, and mine is only partially similar to his. Because I only have the stock data for the past six-years, I have to use more strict criteria to select

the qualified company, which has to beat the general market and industry averages in both ROS and ROE every single year.

Return on Equity

Leng (2004) recognized the impact of corporate governance practice on firms' financial performance. "Poor governance standards in both private and government-owned firms were blamed in part for the East Asian financial crisis" of 1997-98 (p.309). The central purpose of Leng's study was to identify primary factors relating to corporate governance that affected return on equity. The sample consisted of 77 Malaysian listed companies over the period 1996-99.

Leng found that the factors which significantly influenced return on equity were "the degree of ownership of shares in a company by institutional investor (INST), the gearing ratio or the level of debts, and the size of the company" (p.315). These environmental factors may have been significant though Collins' study suggests other even more significant factors (e.g., top management characteristics and style) may be at work.

Return on Stock

Cooper, Gutierrez, and Marcum (2005) tested the evidence on predictability of stock return in real time, in order to confirm or disconfirm this 'common' understanding: "In the last 30 years, financial economists have documented ample evidence that both the time series and the cross section of stock returns are predictable" (p.469). The sample of this study was "all NYSE, AMEX, and NASDAQ nonfinancial firms listed on the Center

for Research in Security Prices (CRSP) monthly stock return files and the Compustat annual industrial files from 1963 through 1997” (Cooper, Gutierrez, & Marcum, 2005, p.472). Based on the findings, a real time investor could not use standard methods - such as book to market equity, firm size, and one year lagged return - to forecast the return of stock over the period of 1974 to 1997. Using a recursive out of sample method, which is a procedure used to simulate an investor’s real time decision making process, they concluded that “the market is difficult to beat” and that “the notion of predictability currently in the literature is exaggerated” (p.492).

If the market is difficult to beat, and yet some companies’ ROS consistently beat the market average and overall returns, it follows that there must be something which influences the firms and their stock performance other than strictly technical ‘fixes’. It also means that the book ratio, firm size one-year return and other fundamental factors can not dependably be used to forecast the stock return. According to Collins’ (2001) study, it is top management who affect the company’s stock performance more than these other factors.

The major hypothesis of this exploratory study, like that of Collins’ is that the firm’s top management has influence on the firm’s performance, thus affect its stock performance and stock price. It is this phenomenon that is examined in this study.

Summary

Cooper, Gutierrez, and Marcum (2005) studied the evidence of predictability of stock return in real time only to find that the concept of predictability of stock return in the literature is exaggerated and the market is difficult to beat. If a company's ROS consistently beat the market average and overall return, there must be something which influences the firm's stock performance and this is likely associated with the firm's top management which, after all has influence on the firm and its performance, including its stock performance.

According to Collins (2001), there is a level 5 leader in every company that has gone from 'good to great.' However, his study is based on American firms and executives, and it is not clear if his findings hold in the Canadian context. Therefore, this research is required to explore the relationship between a firm's top management and its performance in Canada. I will compare and contrast the 'good' company and the 'great' company to see whether there are differences in management style or practice, and executive's characteristic. The result of this finding will be used to analyze whether a firm's management affects its earning and stock performance. In addition, I will compare the finding to Collins' (2001) study to see if there are similar, and report any difference.

Methods

Type of Research Design

The research design for this study is the use of statistics, documents, and secondary analysis (Neuman, 2003). This research is non-reactive because subjects being studied are unaware of that fact. Secondary analysis will be used in the proposed study since the data exists and is public and I am able to "examine the data in new ways to address new questions without reactive effects" (Neuman, 2003, p.309). The existing data of ROE

and ROS from *Canadian Business* are examined to address the relationship of management and performance of these 'great' companies, i.e., those which consistently beat the market averages for ROE and ROS.

Sample, Population and Participants

The population is estimated at 2000 plus Canadian companies listed on the TSX. This study uses a single-stage sampling procedure, and the researcher has access to information in the population and can sample the company directly from the companies' websites or any stock information website. The largest 200 of these 2000 companies, in terms of market capitalization as listed on the TSX are sampled because these large companies can be expected to have more influence on the industry and economy and the results may be better generalized to the whole population than any other sample of this size.

A six-year term used in the analysis should be long enough to make the preliminary observations that are consistent with such an exploratory study and reflect the typical business cycle and planning horizon of many firms, namely five to six years. As well, most investment-analysis tools only look back as far as the past five-year period.

The companies not included in the top two-hundred are all small-capitalization companies, and these are viewed as having limited influence on the market. The study will not involve stratification of the population before selecting the sample because the selecting process is based on market capitalization only. Finally, there are no participants

used in the proposed study, as the data are drawn from secondary, publicly available sources.

Data Collection Instruments, Variables and Materials

ROE and ROS are financial variables of this study, and they will be used to examine the research question. Management style or practice is another variable, although its complexity might make it better described as a factor, rather than a variable. The past six-year data from *Canadian Business* magazine's annual investor report is a major source of the data. Other sources will be publicly available annual reports, where these will be examined for evidence of top management characteristics. There are no 'experimental' instruments and materials required to collect this data and, therefore, confidentiality of data and findings will not be at issue.

Data Analysis Procedures

The data analysis is presented as a series of the following seven steps.

Step 1. Sample the top two-hundred listed companies in market capitalization at TSX, collecting the six-year data of the ROE and ROS of the top two-hundred companies from *Canadian Business* magazine's annual report and/or the companies' websites. *Canadian Business* magazine's annual report is the only source which provides the data of ROE and ROS of TSX. It is similar to the magazine of *Fortune 500*, which was used by Collins.

Step 2. Eliminate companies with missing ROE and ROS data. Missing data often mean the information is not available, and the company with missing data has less value for this study.

Step 3. Calculate the average returns of equity and stock for the market for each year. This is the basis for the selection of 'great' companies, which have to perform better than the market averages in the given time frame.

Step 4. Select potential candidate 'great' companies, i.e., those which beat both averages at least five out six years and overall returns. Since there are only one company beats both averages every year, I lower the standard in order to get more qualified companies.

Step 5. Check these companies' websites or search online to see whether or not their top executives or management practices have changed, and check through news articles, press releases, and companies' website to determine if their management, management style or practice, and organizational structure have changed at any given time. If there is a change in the top management, then we can track any change in the company's performance after the transition point.

Step 6. Compare each 'great' company with one direct competitor and one indirect competitor to see whether there are differences in management style or practice among those companies, and check through my data to find appropriate rivals (similar size, capability and industry) from TSX for each 'great' company, comparing their management style or practice, ROS, and ROE. This step is similar to Collins', but he only compared the 'great' companies with their direct competitors.

Step 7. Report the differences and similarities from analysis of the findings, and draw conclusions and implications. Finally, I will be able to compare my findings to Collins' to see whether they are similar or not.

Significance of the Study

This study will explore whether there is a relationship between management and organizational performance. This study will add “to the scholarly research and literature in the field” for the following reasons (Creswell, 2003, p.149). First, the finding of this study will support or contradict the research question. Second, it can help to reveal some of the underlying logic of the stock market, as well as potentially find what factors influence the stock performance. Third, it may reveal some of the characteristics of the top managers of these ‘great’ companies.

Analysis

Introduction

There are four companies, which meet the selection criteria and are qualified as ‘great’ companies. Three out of these four companies are in the oil and gas industry, and the other is in the mortgage business. Since the majority of these ‘great’ companies are in the oil and gas industry, it is believed their superior performance is likely to be the result of rising oil and gas price in recent years. Higher price possibly contribute to the higher ROS and ROE for this industry. One of these three oil and gas companies, Compton Petroleum Corporation, will not be used as a demonstration case because its average ROS (46.95%) does not beat the industry average (50.43%), and its average ROE (19.95%)

does not beat the industry average (15.94%) significantly. The other two (Bonavista: 28.80% & Peyto: 38.64%) do beat the industry averages which are calculated from the 24 oil & gas exploration/production companies in the top two-hundred list of TSX of year 2000 to 2005.

This study uses a total of nine companies as evidence to demonstrate the possible relationship between top management and organizational performance as measured by ROS and ROE.

‘Great’ Companies V.S. Comparison Companies

‘Great’ company	Direct comparator	Indirect comparator
Bonavista Energy Trust (G-177, L-21,865)	Provident Energy Trust (G-80,466, L-21,691)	Paramount energy trust (G-145)
Peyto Energy Trust (G-103,043, L-4,337)	Advantage Energy Income Fund (G-86,350, L-6,892)	BlackRock Ventures Inc (L-8309)
Home Capital Group Inc	Equitable Group Inc	Home Equity Income Trust

(The production volumes are based on each company’s first quarter report of 2005.)

G = nature gas (mcf/d) million cubic feet per day

L = crud oil and liquid gas (bbls/d) barrel per day

I classify Provident Energy Trust and Advantage Energy Income Fund as direct comparators for the two ‘great’ companies in oil and gas industry by their production capacity and focus of production. Although there are differences in the production volume, these two direct comparators have the most similar production capacity to these ‘great’ companies. Paramount Energy Trust and BlackRock Ventures Inc are classified as indirect comparators because they only produce a single resource with much less production volumes than Bonavista and Peytos’, and they have different focus of production as compared to these ‘great’ companies. These two ‘great’ companies

produce both resources and their production volumes in particular resources are much greater than indirect comparators'. Therefore, they do not compete directly.

Collins (2001) uses two comparators in his study, which are direct comparisons and unsustained comparisons. He compares each good-to-great company to one direct comparison in similar capacity and industry, and then compares all unsustained great companies to all good-to-great companies. The similarity between my study and Collins' is that we both compare the management practice of the subject to two comparators', and look for both similarity and difference among these companies.

Equitable Group Inc is the direct comparator to Home Capital Group Inc because they are the only two enterprises of the top 500 listed on TSX, which focus on mortgage lending business. Home Equity Income is classified as indirect comparator, and it focuses on the reverse mortgage business. Reverse mortgage is only available for home owner of 60 years old and older who do not have to pay back the loan until they move or sell their home. Home Capital and Equitable Group's target customers are those of first time home buyers who cannot get mortgages from big Canadian banks. Both operate in niche markets and, therefore, can be viewed as comparable businesses, given a lack of direct competition.

Bonavista and Its Comparators

Bonavista Energy Trust is one of the three 'great' companies, and it has average ROS of 188.65% and average ROE of 28.80%. The high average ROS is the result of its extremely high ROS in the year of 2000. Taking out the year 2000 performance as an outlier, the average ROS in other years is still above the industry average. Bonavista is a Calgary-based oil and gas royalty trust, which was created through reorganization of

Bonavista Petroleum Limited in July 2003 (Bonavista Energy Trust, 2006). Its base of production focuses geographically in Alberta, Saskatchewan, and northeastern British Columbia. It is also one of the largest energy trusts in North America with a market capitalization of \$3.7 billion as of January 1, 2006. It claims to achieve the success in the past eight years by following these strategies:

- Building a qualified and experienced team to apply to strong technical and operational expertise;
- Creating operational strength and dominance in select core regions;
- Developing low cost, low risk, economic opportunities with commodity balance;
- Enforcing capital efficiency and strict cost controls;
- Maintaining financial flexibility; and
- Pursuing selective, long reserve life, low decline asset acquisitions.

(Viewpoint, 2006, p.4)

The board and management are determined to create sustainable and growing business by paying a high cash dividend of \$3.96 per share (a yield of 12%). The company's management and employees hold 17% of its distribution unit, and this limits their interest with their unitholders'. The management and employees will likely work hard because their interests are involved with the firm's performance. The firm adopts a flat organizational structure, and has fewer layers of management between top management and field worker than other companies. It appreciates its employee's hard work and

rewards bonus according to their performance. The CEO, Keith A. J. MacPhail who joined the company in 1997, leads the firm to success by following the strategies of qualified team, low production cost, and low risk of production. The company achieves growth goal by reinvesting 40 to 50 percent of its cash flow into its operations, and this is considered a very high portion of reinvestment in the industry.

Provident Energy Trust is the direct comparator of Bonavista Energy Trust. Provident has average ROS of 45.17% and average ROE of 5%, and both figures are below the industry and Bonavista's averages. The company was originally founded by the CEO, Thomas W. Buchanan, in 1993, and it converted into Provident Energy Trust in 2001 (Provident Energy Trust, 2006). It is a Calgary-based trust company with investments in oil & gas production and energy infrastructure. The company adopted a balanced portfolio strategy, which is to invest in diversified, long life, and low risk assets of its three business units: oil & gas production, production property, and energy infrastructure service. The firm achieves sales growth by acquisition or issuing debt and equity, not through reinvesting of its cash flow. The firm issues cash distribution to unitholders from its cash flow of \$1.44 per share (a yield of 10.6%). The company claims to manage the business by these value: respect, integrity, creativity, and excellence (Provident Energy Trust, 2006). At Provident, top managements treat all stakeholders with respect, and provide a supportive and cooperative environment to its employees. Title is less important in this firm, and it may value performance more than employees. The firm is also flexible enough to adopt into the changing environment, and often think outside of the box to increase shareholder value. As well, the firm is striving for excellence, and its stated goal is to be the best in the business.

Paramount Energy Trust is considered as the indirect comparator to Bonavista. Paramount is a natural gas royalty trust company, and it has average ROS of 36.55% and average ROE of 11.75%. Both figures are below the industry average (ROS: 50.43%, ROE: 15.94%), and this implies that its operation is not as efficient as others in the industry. I choose this company as the indirect comparator to Bonavista because they have the closest market capitalization to the other two and different focus of production. Paramount focuses on natural gas production, and Bonavista focuses on crude oil and liquid gas production. Therefore, they do not compete directly in their core businesses. According to the president and CEO, Susan Riddell Rose, the goal of the organization is to maximize cash distribution and create value to unitholders by following its business plan:

- Asset optimization
- Maximize cash flow
- Accretive acquisitions
- Healthy balance sheet

(Paramount 2005 Annual Report, 2006, p.3)

The firm issues cash distribution of \$2.88 per share in one year (a yield of 15.6%). The pay out rate is about 79% of its cash flow. It achieves its growth goal by capital financing and acquisition. The company achieves its goal of maximizing shareholder value by paying out a huge portion of its cash flow. However, its business plan seems simple and universal, which is to diversify its investments and focus on low risk, low cost, and long life assets, mentioning increasing shareholder value and “your investment choice” in energy trust, but not mentioning its management team and employees. The

president and CEO, Rose, only said that their people make the difference, but she did not say what's the difference and what's their contribution to achieve the goal. It seems that the company only cares about its unitholders. Unitholders will probably like to hear that, but not employees, who may feel that they are not appreciated by top management.

In summary, the differences among Bonavista and its comparators are building a qualified team and achievement of growth goals. Bonavista put building the qualified and experienced team as its priority strategy, and the other two choose the assets optimization. Bonavista's strategy is similar to the level 5 leadership, which is "a genius with a thousand helpers" and its competitors are more like the level 4 leadership (Collins, 2001, p.47). Level 5 leaders begin building up the company by setting the strategy through people, and then the vision (Collins, 2001). The priority strategy is to get the right people in the management team, and then setting up the vision to greatness. However, the comparison companies (Provident and Paramount) begin setting the goal of asset optimization, and then getting the highly capable people to make it happen. Bonavista achieves growth goal by primarily reinvesting large portion of its cash flow and the other two by acquisition or issuing debt. By doing this, Bonavista is able to avoid future interest cost, and lower the impact of business risk of operating on borrowed funds. One thing in common among these firms is that they all focus on low cost, low risk and long life assets. I believe this is the nature of this industry since the costs of acquisition and exploration of oil and gas fields are high.

Peyto and Its Comparators

Peyto Energy Trust is a Calgary-based oil and gas royalty trust company. The firm has great performance on both figures as average ROS of 126.51% and average ROE of

38.64%. The president, CEO, and founder, Don Gray, describes how Peyto works: “It starts with a team who has their interest aligned with our investors,” and they make Peyto unique among others (Peyto Energy Trust, 2006). Employees at Peyto are compensated for their performance on market and reserve value growth. Gray is a very confident business man who says, “I am able to look at things with typically 100 per cent return” (McEiheran, 2004, p.B.2).

I always wanted to show that you could do it a different way, to prove that you didn't have to cater to the analysts, that you could focus solely on what made good strong business sense, and that shareholders were smart enough to flush out the guys that were BS- ing them versus the guys who were running truly, honestly, a good solid business.

(McEiheran, 2004, p.B.2)

The above quote indicates McEiheran is determined to run the business and confident on his ability to make it work his way. Unlike other energy trusts who distribute most of their cash flow to unitholders, Peyto reinvests a large portion of its cash flow into operation to ensure the growth. Gray is unafraid to challenge the industry norm by insisting on maintaining a pay out rate of 50% instead of the industry average of 85 to 90%. The firm distributes an annual dividend of \$1.68 (a yield of 7.2%), which is considered a low yield of cash distribution among energy trusts (usually around 10%). Under his way of management, the firm has grown rapidly in the past few years. He believes that if you set up things right, then you can do it right, and you do not have to look for acquisitions regularly (Verburg, 2004). Although he is open for ideas, he always does what he thinks is right. His personality is contrary to the characteristic of level 5 leaders who have a blend of personal humility and professional will. Gray has professional will, but he does not have personal humility, though he is determined to create superb results, and set “the standard of building an enduring great company”

(Collins, 2006, p.36). He believes that he can make the company prosper under his way of management without other people's opinions, and he sounds like that he should take the credit for prospering the firm because he is the one who leads the firm to success. According to Collins (2001), level 5 leaders attribute the success of the firm to luck or other peoples' hardworking, and they do not claim for the credit. The board, director, and top management own about 24% of its outstanding units, and this creates aligned interest of its management team with its unitholders.

Advantage Energy Income Fund is a Calgary-based oil and gas royalty trust company. This trust issues monthly cash distribution, and the total pay out is \$1.7 per unit in 2006 (a yield of 9.38%). The firm has average ROS of 40.93% and average ROE of 11.90%. Although these two figures seem reasonable, they are somewhat below the industry averages. The company was renamed to Advantage from Search Energy in April 2001, and the president and CEO, Kelly I Drader, joined the company in May 2001 (2005 Corporate Review: Advantage Income Fund, 2006). Prior joining the firm, she had over 27 years of experience in this industry. The organizational contributes its success to the following factors:

- Low cost acquisitions of quality, long-life properties
- Successful, low risk, development drilling
- Nature gas focus
- Highly experienced and dedicated technical staff

(Advantage Energy Income Fund, 2005)

Its success factors seem quite common in the industry, and almost every oil and gas company's strategy is to acquire low cost, low risk, and long life assets. Since the costs

of acquisition and drilling are high in this industry, these oil and gas firms need to adopt a strategy in order to keep costs down and ensure growth. Drader mentions that the management team is committed to create unitholders value and they own about four percent of the outstanding units. This sounds contrary. If the management team is dedicated to create value or believes in the prosperity of the firm, then they would also invest in the company themselves. For example, the 'great' companies of Bonavista and Peyto's management and directors own approximately 17 and 24 percent of their outstanding units. I view this as they are committed to the company's performance because their interests are also tied in with unitholders.

BlackRock Venture Inc is a Calgary-based company that focuses "on the exploration, development and production of heavy oil in western Canada" (BLACKROCK, 2004). The president of this firm is John Festival, and he was promoted to the current position from the position of vice president in January 1st, 2001 (Anonymous, 2000). The company did not mention the reason for this change. I highly suspect the reason for the change is the poor performance of previous president, Bruce Burton. The earning per share at year 2000 under Burton's management is only \$0.02, and it grew to \$0.21 in year 2005, and earnings growth of more than ten times over five year. Prior to the year 2000, the earning is either few cents per share or negative. However, one could argue that the current 'high' earning per share is due to the rising oil price, and it has not much to do with management. Although the oil price has risen in current few years, the oil price is not ten times higher than few years ago. Therefore, I believe there must be something to do with Festival's management for the change in the company's performance. He was later replaced in June 21st, 2006 due to the acquisition

by Shell. The firm has a strong average ROS of 53.02% and a weak average ROE of 3.91%. I believe the low ROE may be due to less than stellar management because sales are growing every year, and the management team was not able to bring down cost. It is still not clear why these two figures are so contrary. The possible reasons for outstanding stock performance are the rapidly increase in production volume and oil reserve in the past few years, and these may catch investors' attention. The top management was also not able to keep their promises. For example, Festival has promised at the year 2002 annual shareholder meeting not to issue more equity to raise the capital; however, the firm kept issuing new shares from 2002 to 2005 (BLACKROCK, 2004). Festival said in 2005 that the management team insists on the debt free strategy in order to achieve the organizational goals, which are to maintain good financial control and strong balance sheet, but the firm just financed a debt of \$100 million in 2005. I see this result as poor management because the management team has to break its promise to keep the company going, which is to borrow money. These two events (issuing new share and getting loan) are all associated with money.

In summary, the difference among Peyto and its comparators is the management team. Gray identifies the management team is what makes the firm unique and successful, and he mentions it starts with the team. He seems to be a level 5 leader in setting up the team, which is "first who and then what" (Collins, 2001). He begins by getting the right people in his management team, and then finds the path to greatness. The comparison companies do not include or mention the management team as the organization's success factors or strategies. They only mention in their annual report that they appreciate their management and employee's hard work and contribution to the firm.

It sounds to me that they are saying so to make them feel better. The similarity among three firms is the low risk, low cost, and long life properties strategies, and every acquisition or drilling has to meet this strategy in order to ensure growth. Failure in these activities will bring the firm into serious financial trouble due to the high development cost.

Home Capital and Its Comparators

“Home Capital Group Inc is a holding company and operates through its principal subsidiary, Home Trust Company” (Home Capital Group Inc, 2006). The firm focuses on the mortgage lending business, and experienced rapid growth in both stock and earning since inception in 1987. The firm has average ROS of 77.64% and average ROE of 25.25%. These two figures are much higher than the general market performance (ROS: 26.91%, ROE: 11.10%). It shows the company is doing well under the current management. Gerald M. Soloway has been president and CEO since 1987. The firm offers stock option to employees as the compensation for their performance. The target customer of Home Capital Group Inc is usually the first time home buyers who cannot get a mortgage from big banks. The firm’s strategy is to work in partnership with banks. The banks get referral commission if they refer rejected customers to Home Capital, and banks are happy doing so because they want to keep goodwill with the customer for future business. The firm also offers high interest rate deposit service to finance the required capital for mortgage lending. Soloway commented on the success of the firm that “we work very hard on sticking to what we do know how to do. ...you have to do it slowly and patiently” (Critchley, 2005, p.FP.2). He is proud of the service level of the firm, and he believes we can serve the public better than big Canadian banks. He

believes that customer service is one of the success factors in the financial service business. He does not like to take risk, and he only does what he knows. He said that the firm has never made an acquisition, and acquisition involved great risk. He believed his management team could do better by themselves instead of through acquisition. He said that hiring good people has been critical to the firm's success. He adopts an open door policy in his office, and everyone can come to talk to him anytime. There is not a lot of formality in Home Capital, and everyone is treated the same regardless position.

Equitable Group Inc is the direct comparator of Home Capital, and they are the only two firms in the Investor 500 which focus on mortgage lending business. Equitable is very similar to Home Capital. Both companies focus on sub-prime residential mortgage lending and offer deposit service. Their head offices are both in Toronto. Although the nature of business is very similar, Equitable does not perform as well as Home Capital. Equitable has average ROS of 9.9% and average ROE of 15.54%. Although the average ROE is higher than the market average, its average ROS is much lower than the market average. It is unknown why as its ROE has increased steadily in the past few years. The long term goal of the firm is to maintain high quality growth, profitability, and sustainability (2005 Annual Report, 2006). Its goal sounds like telling me that they only care about making money. Should they say something like being the number one in the business? The firms will perform the following activities in 2006 in order to achieve its goals.

First, we intend to use a prudent mixture of Tier 1 (Equitable Trust's shareholders' equity) and Tier 2 (Equitable Trust's subordinated debt) regulatory capital to improve Return on Equity (ROE).
Second, we will capitalize on opportunities in each of our four core lending segments.

Third, we will continue to focus efforts in our primary geographic market and on building momentum in the Calgary alternative single family dwelling niche. Fourth, we will introduce our new cashable GIC to a broader number of deposit agents.
(Equitable 2005 Annual Report, 2006, p.5)

Its planned activities seem fine and reasonable. I think the major difference between Equitable and Home Capital is the management team. I do not see any information about its management or how they value employees. In their company's reports, they are saying what they will do and what are their strategies, nothing about the management.

Home Equity Income Trust (HOMEQ) is an unincorporated open-end investment trust created under the laws of Ontario to invest in reverse mortgages. HOMEQ was created in 2002 as a long-term funding vehicle for the reverse mortgage business developed by Canadian Home Income Plan Corporation (CHIP), which has been the main underwriter of reverse mortgages in Canada since pioneering the concept in 1986.
(Home Equity Income Trust, 2006, Trust Overview)

The reverse mortgage is for senior homeowners who are 60 years of age or older, and are able to borrow up to 33% of the value of their home without making repayment as long as they live in their house. The firm has average ROS of 13.3% and average ROE of 3.81%. Both figures are lower than the market's averages, and I suspect the firm has issued too many shares. Its recent net earnings are about 12% of its revenues, and this is not considered low in the market. The firm's objective is to provide unitholders with sustainable cash distribution of more than 90% of its cash flow while preserving capital. The firm's growth strategy is to wait for the aging Canadian population, and the number of seniors will automatically grow over time. According to Home Equity, there is only one firm doing the reverse mortgage in Canada, and it would mean no competition for the firm. As well, the firm has experienced 10% annual compound rate increase in the reverse mortgage business in the past five years. Steven K. Ranson was appointed as the

president and CEO in August 8, 2002, and the firm's earning per share has grown from \$0.29 in 2002 to \$0.39 in 2005. He is trying hard to explain the benefit of the reverse mortgage to seniors, and the CHIP advertising can still be seen on TV. In the company's report, he mentions that the reverse mortgage is managed by the professional team, and he identifies their contribution to the firm's success.

In summary, the differences among Home Capital and its comparators are the management and the management style. Soloway is the president and CEO of Home Capital, and he is also the co-founder of the company. Other two companies' president and CEO are appointed few years ago. Soloway has been the president for almost 20 years, and he should have a better sense for the business and know what he should do. Another difference is the management style, Soloway adopts the open door policy, and anyone can talk to him anytime. Employees are valued the same in his company regardless their position. The similarity is the service level. They are all dedicated to provide good service to their clients, which is better service than big Canadian banks do. These firms believe that service level is the success factors for this business because they have to compete with banks and local credit unions.

Findings

There are four things in common among these three 'great' companies: right people, compensation, acquisition, and ownership. Bonavista identifies that building qualified team is the priority strategy of the firm. The president and CEO of Peyto Energy comment on the firm's success that it starts with management team. Home Capital's president and CEO say that hiring the right people has been crucial to the firm's success. They all begin with finding the right people for their management team, and then work

toward the vision. The comparison companies do not do so, and they only mention that their employees are important to them without explicitly stating what this means. This finding is similar to the 'level 5' leadership, which are first who and then what. However, there is not enough information and evidence about these CEOs and their management styles, so it is still not clear whether they are level 5 leaders. Another similarity is the compensation. They all appreciate employees' contribution and reward bonus according to their performance. However, not all comparison companies reward employees with bonus. The third thing in common among these 'great' companies is that they do not like to achieve growth goal by acquisition; however, the comparison company like to do so and look for acquisition constantly as part of their strategies. The president of Bonavista does not like the idea of acquisition, and he prefers to grow the company by reinvest large portion of its cash flow. The president of Peyto says that if you are setting the things right, you will do it right. As well, you do not need to look for acquisition constantly. The president of Home Capital dislikes acquisition, and he think there are too much risk and cost involved with that. He believes he can make the company grow without acquisition. However, most of the comparison companies do so to grow their companies. The last thing in common among these 'great' companies is the high ownership of the management team. The management team of Bonavista, Peyto, and Home Capital own 17, 24, and more than 20 percent of their companies' shares. All these companies distribute cash dividend either monthly or quarterly. The higher ownership ties the interests of the management team with those of the shareholders, and it shows they believe in the future of their companies. The management teams of the

comparisons have lower ownership of the firm's shares, and they own less than 15 percent of the outstanding shares. (2005 Annual Reports, 2006).

Conclusion

According to my analysis and finding, the management has influences on an organization's long-term financial performance as measured by ROS and ROE. The firm's performance will be changed after the top management being replaced. These 'great' companies achieve rapid growth in both ROS and ROE under the management of the current president and CEO. All these 'great' and comparison companies have similar business strategy and resources, and the only difference is the management. Moreover, all these 'great' companies have four things in common, and none of the comparison has all of them. There is not enough information available to indicate that the presidents and CEOs of these 'great' companies are 'level 5' leaders, but they possess the characteristic of first who and then what. Due to the time constraint of this project, it may not reveal the detailed relationship between an organization's management and its long-term performance. A longer time frame of study will be required to better explore this phenomenon.

Reference

- Advantage Energy Income Fund. (2005). Retrieved June 24, 2006, from <http://www.advantageincome.com>.
- Anonymous. (2000) BlackRock Announces Management Changes. *Canadian NewsWire*, November 16, 2000, p.1.
- BlackRock Ventures Inc. (2004). Retrieved June 25, 2006, from <http://www.blackrock-ven.com>.
- Bogomolny, L. (2005). Gerald Soloway & Roy Vincent. *Canadian Business*, 78, 50-51.
- Bonavista Energy Trust. (2006). Retrieved June 23, 2006, from <http://www.bonavistaenergy.com>.
- Collins, J. C. (2001). *Good to great*. New York: HarperCollins Publishers Inc.
- Copper, M., Gutierrez, R. C. & Marcum, B. (2005). On the predictability of stock returns in real time. *The Journal of Business*, 78, 469-499.
- Creswell, J. W. (2003). *Research design: Qualitative, quantitative, and mixed method approaches*. Thousand Oaks: Sages Publications, Inc.
- Critchley, B. (2003). Doing the 'right thing by all shareholders.' *National Post*, December 16, 2003. FP.05
- Critchley, B. (2005). No place like home. *National Post*. July 29, 2005. FP.2.
- Equitable Group Inc. (2006). Retrieved June 24, 2006, from <http://www.equitablegroupinc.com>.
- Fama, E. F. (1995). Random walks in stock market prices. *Financial Analyst Journal*, 51, 75-80.

- Hill, C.W.L. and Jones, G.R. (2004). *Strategic Management: An Integrated Approach* (6th ed.) New York: Houghton Mifflin.
- Home Capital Group Inc. (2006). Retrieved June 25, 2006, from <http://www.homecapital.com>.
- Home Equity Income Trust. (2006). Retrieved June 24, 2006, from <http://www.homeeq.ca>.
- Iqbal, Z & Hamid, S. A. (2000). Stock price and operating performance of ESOP firms: A time-series analysis. *Quarterly Journal of Business and Economics*, 39, 25-47.
- Leng, A. C. A. (2004). The impact of corporate governance practices on firms' financial performance: Evidence from Malaysian companies. *ASEAN Economic Bulletin*, 21, 308-318.
- Malkiel, B. G. (2003). *A random walk down wall street: Including a life-cycle guide to personal investing*. New York: W. W. Norton & Company, Inc.
- McEelheran, G. (2004). President, CEO of Peyto energy trust. *Calgary Herald*. January 1, 2004, B.2.
- Neuman, W.L. (2003). *Social research methods: Qualitative and quantitative approaches*. Boston: Pearson Education, Inc.
- Paramount Energy Trust. (2006). Retrieved June 24, 2006, from <http://www.paramountenergy.com>.
- Peyto Energy Trust. (2006). Retrieved June 24, 2006, from <http://www.peyto.com>.
- Provident Energy Trust. (2006). Retrieved June 23, 2006, from <http://www.providentenergy.com>.
- Verburg, P. (2001). A junior on the go. *Canadian Business*. 74, 36-39.

Verburg, P. (2004). Striking it rich-his way. *Canadian Business*. 77, 17-19.

Appendix A

Raw list of the qualified companies

The top 200 companies average (2005-2000)
Average ROS: 26.91%, ROE: 11.10%

Bonavista Energy Trust: ROS: 188.65%. ROE: 28.80% (high average ROS due to extremely high ROS performance in 2000.)

Peyto Energy Trust: ROS: 126.51%, ROE: 38.64%

Compton Petroleum Ltd.: ROS: 46.95%, ROE: 19.95% (This 'great' company is not used to make the comparison because its average ROS does not beat the industry average, and its average ROE does not beat the industry average significantly like the other two).

Home Capital Group Inc (mortgage lending business)
Average ROS: 77.64%, ROE: 25.25%

Appendix B

Selected companies and two set of comparator companies

	Direct comparator	Indirect comparator
Bonavista Energy Trust (1700) (G-177, L-21,865)	Provident Energy Trust (1823) (G-80,466, L-21,691)	Paramount energy trust (1091) (G-145)
Peyto Energy Trust (2231) (G-103,043, L-4,337)	Advantage Energy Income Fund (566) (G-86,350, L- 6,892)	BlackRock Ventures Inc (923) (L-8309)
Home Capital Group Inc (1098)	Equitable Group Inc (244)	Home Equity Income Trust (167)

(All data above are based on each company's first quarter report of 2005.)

G = nature gas (mcf/d) million cubic feet per day
L = crud oil and liquid gas (bbls/d) barrel per day

The top 200 companies average (2005-2000)
Average ROS: 26.91%, ROE: 11.10%

Home Capital Group Inc (mortgage lending business)
Average ROS: 77.64%, ROE: 25.25%

(No industry averages for Home Capital because there are only 3 companies in the top 500, which focus on mortgage business)

Equitable Group Inc (mortgage lending business)
Average ROS: 9.9% ROE: 15.54%

Home Equity Income Trust (Reverse mortgage lending for 60 & over)
Average ROS: 13.3% ROE: 3.81%

Oil and Gas exploration/production industry (2005-2000)
Average ROS: 50.43%, ROE: 15.94%

Bonavista: ROS: 188.65%. ROE: 28.80% (high average ROS due to extremely high ROS performance in 2000.)

Compton: ROS: 46.95%, ROE: 19.95% (This 'great' company is not used to make the comparison because its average ROS does not beat the industry average, and its average ROE does not beat the industry average significantly like the other two).

Peyto: ROS: 126.51%, ROE: 38.64%

Provident Energy Trust
ROS: 45.17%, ROE: 5%

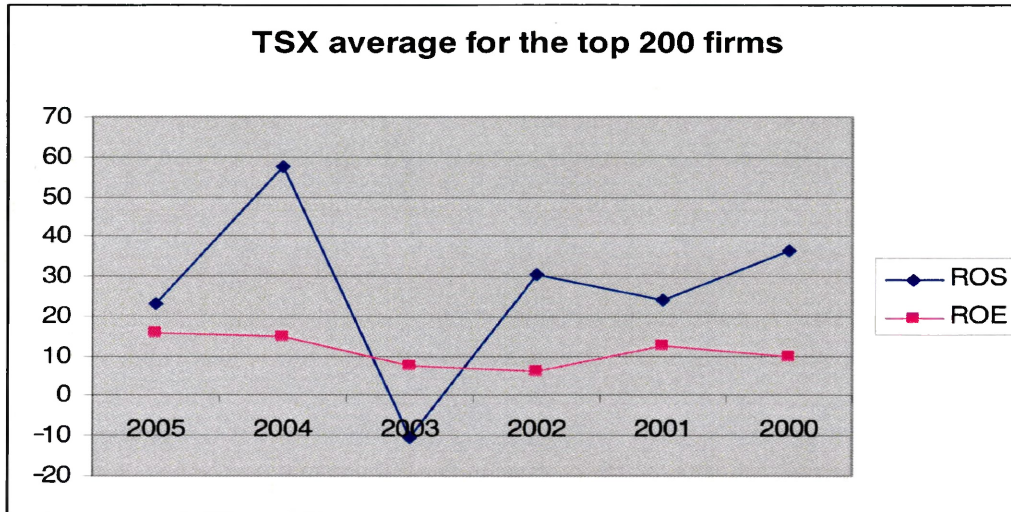
Paramount Energy Trust
ROS: 36.55% ROE: 11.75%

Advantage Energy Income
ROS: 40.93% ROE: 11.90%

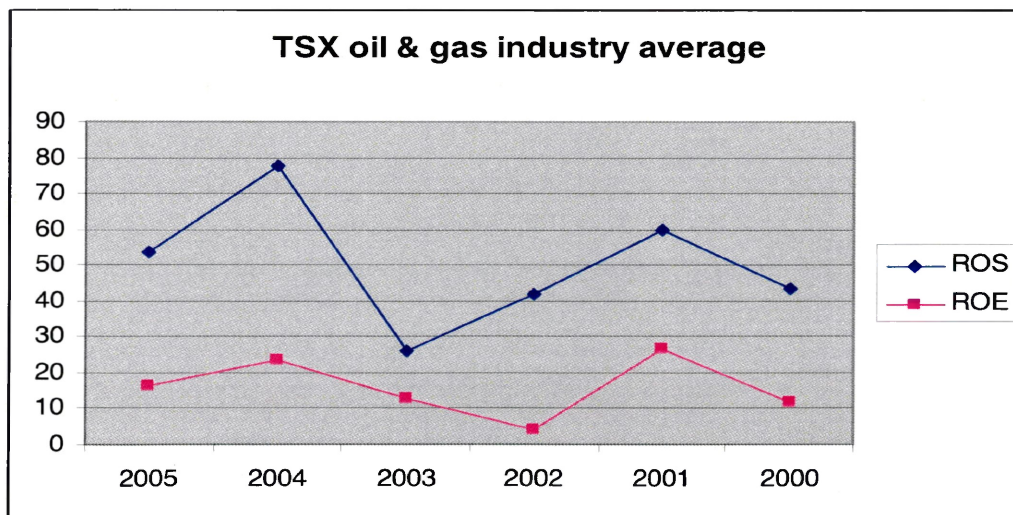
BlackRocks Venture Inc
ROS: 53.02%, ROE: 3.91%

Appendix C

Market Average



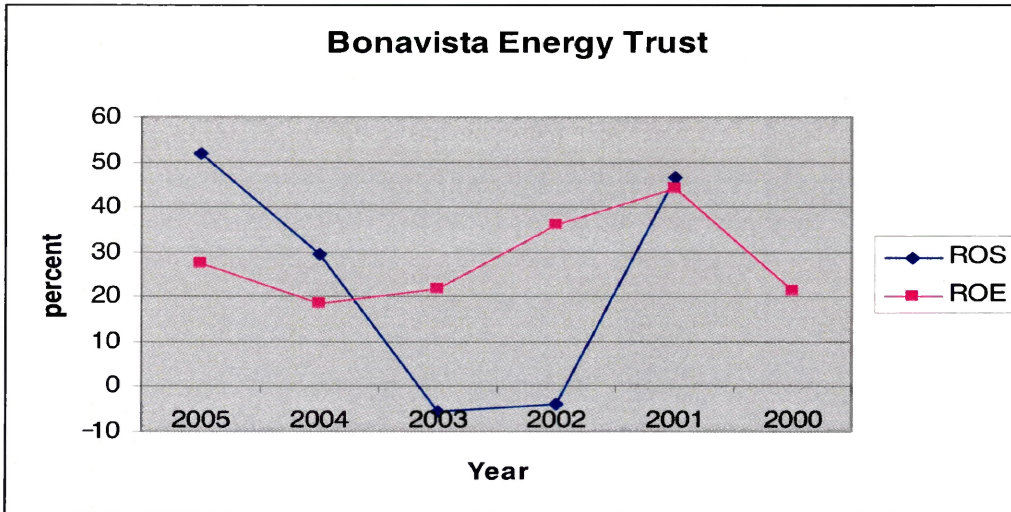
The above chart shows TSX ROS and ROE averages of the top 200 companies in market capitalization from year 2000 to 2005. The relationship between ROS and ROE is not clear.



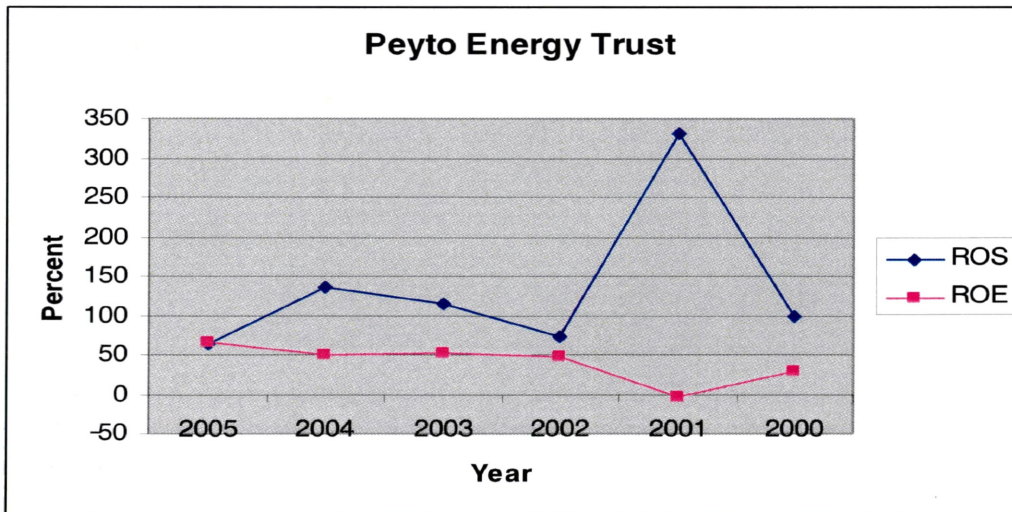
It shows that oil & gas companies' ROS and ROE are positively correlated except the year of 2003. The TSX has a growth rate of more than 20% every single year in the past six years, but the stock market dropped more than 10% in 2003.

Appendix D

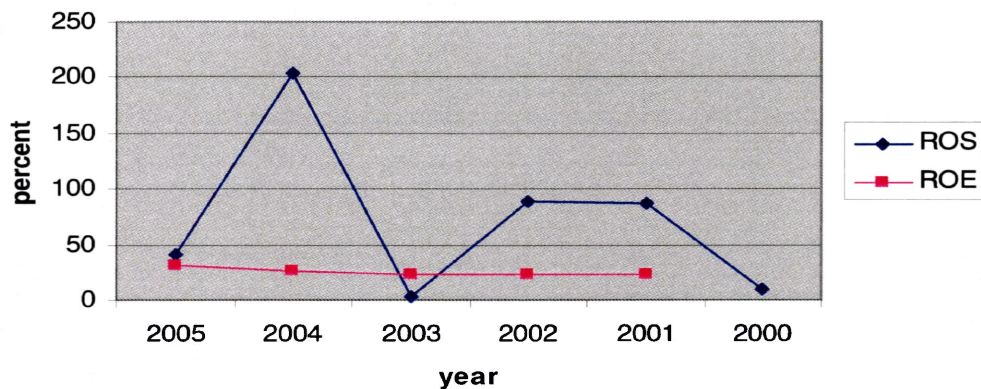
Selected companies and comparator companies



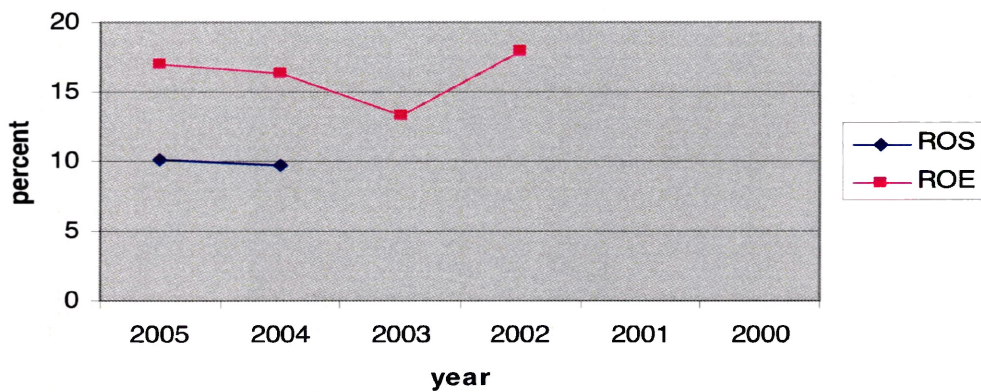
Bonavista's year 2000 ROS is not used to make the above chart because of its extremely high value (983). This will make the chart more apparent.



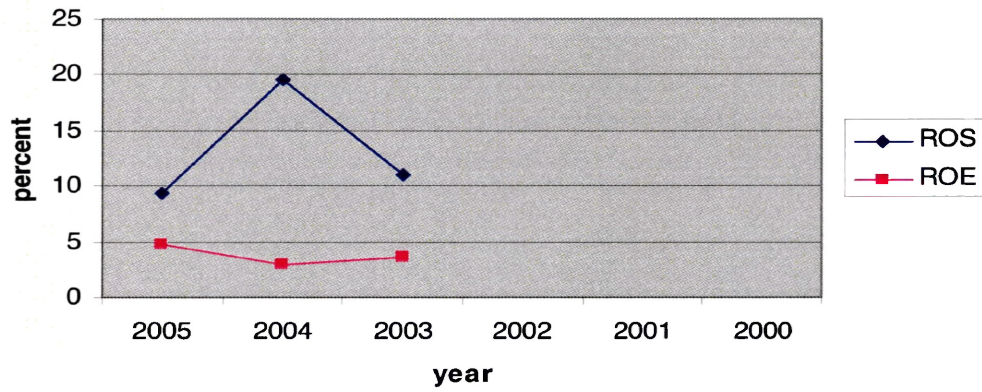
Home Capital Group Inc



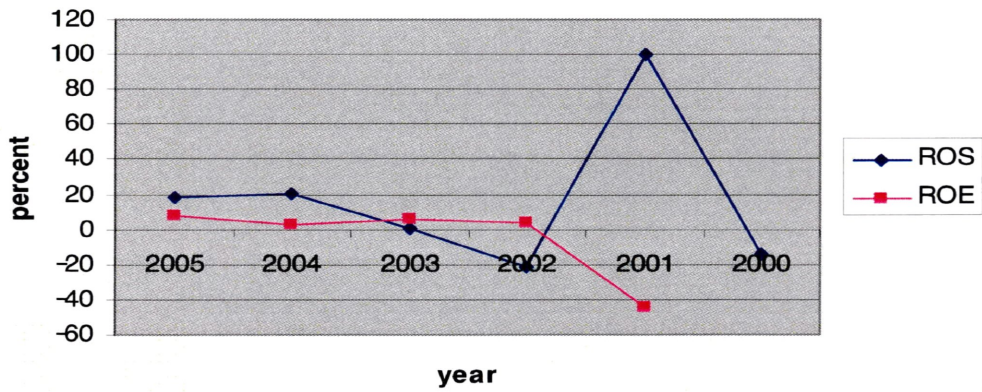
Equitable Group Inc



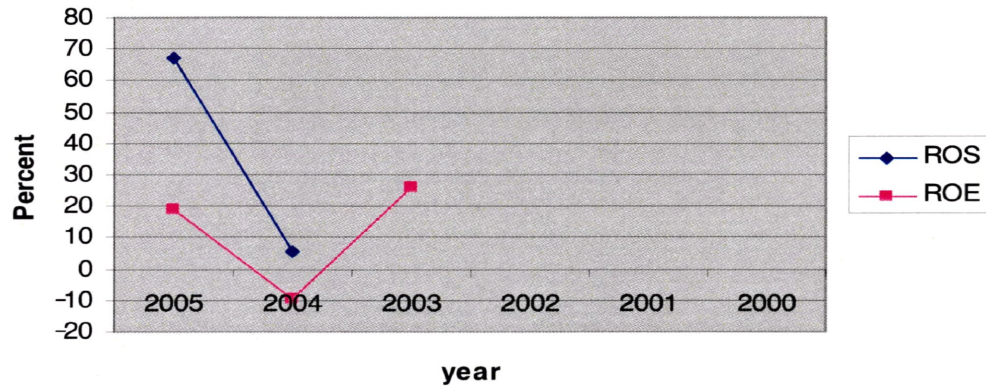
Home Equity Income Trust



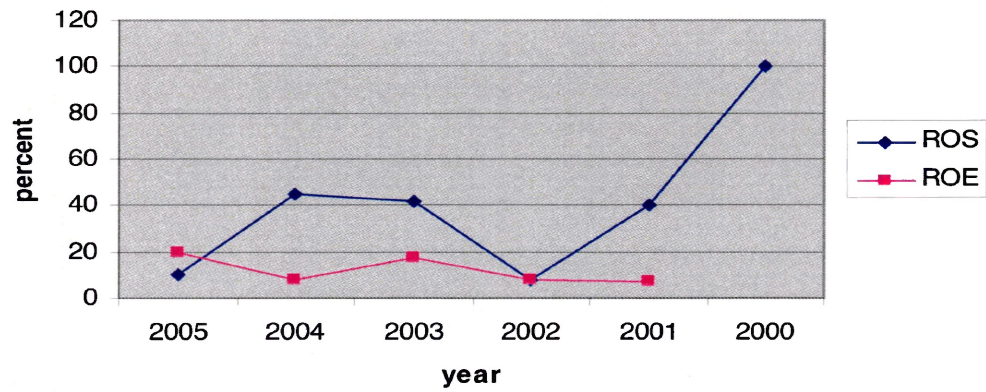
Provident Energy Trust



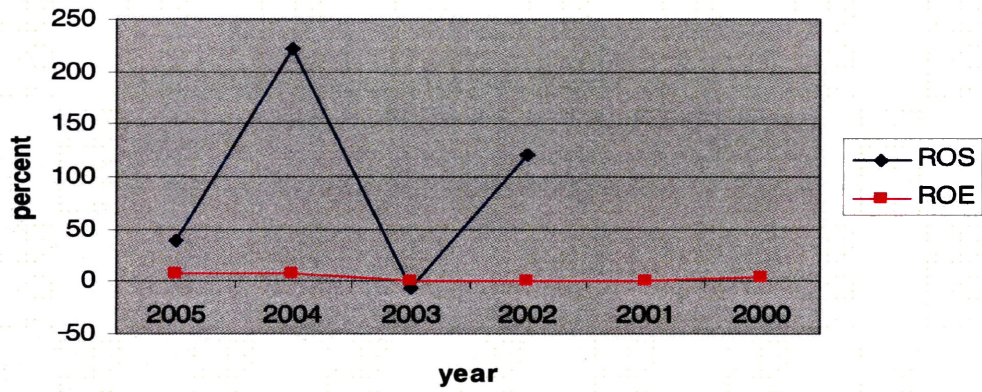
Paramount Energy Trust



Advantage Energy Income Fund

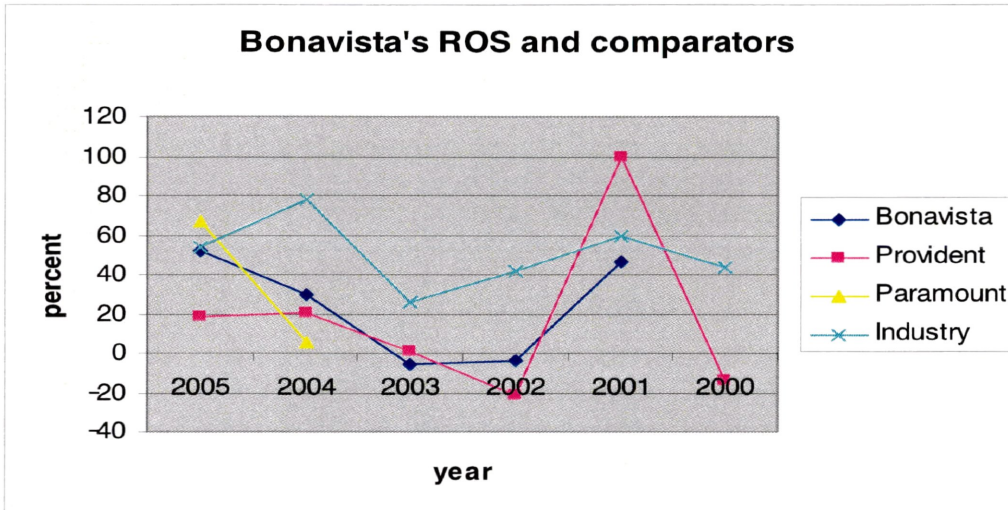


BlackRock Ventures Inc

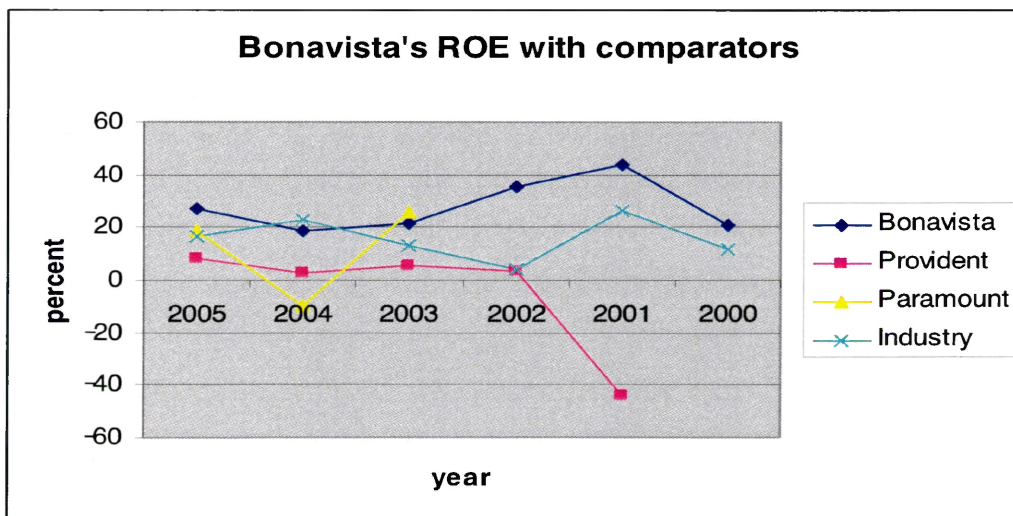


Appendix E

Mixed Charts

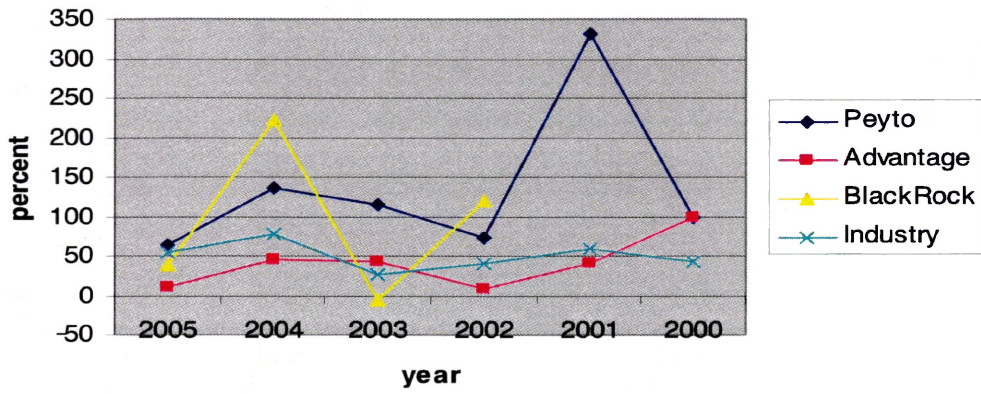


In the above chart, Bonavista's performance is below the industry average and its comparator, but it still beats the general market average. Bonavista's year 2000 performance is not used to make this chart because of its extremely high value (983%).

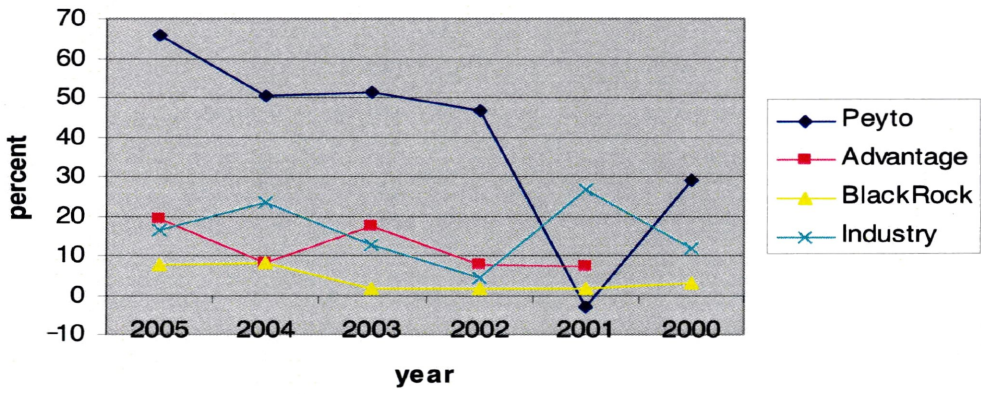


Although Bonavista's ROS performance is lower than comparators and industry average, but it maintains an above average ROE over the past six years. The reason for lower ROS performance is possibly the result of the already high price, so the growth rate is not very apparent.

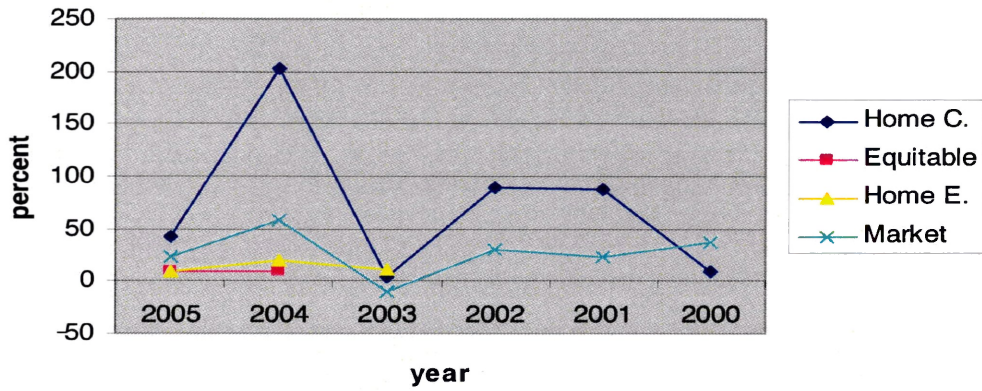
Peyto's ROS with comparators



Peyto's ROE with comparators



Home Capital's ROS with comparators



Home Capital's ROE with comparators

