MANAGEMENT ENTRENCHMENT AND PERFORMANCE: CASE OF TUNISIAN FIRMS

Rym Hachana*, Jamila Hajri**

Abstract

Since entrenchment strategy has a real impact on performance, we examine in this paper the relationship between entrenchment and performance. This study is based on cross-section data of 21 quoted Tunisian companies (from both manufacturing and service sector) over the period 2000 to 2006. Our evidence contributes to understanding the role played by several entrenchment pathways, such as the ownership structure, the debt policy and the structure of the board of directors. In this paper, we aim to shed light on these governance's features by indicating by which channel entrenchment strategy is carried out in Tunisian companies.

Keywords: management entrenchment, Tunisia, board of directors

**Fiesta, Institut Supérieur de Gestion, Hachana_rym@yahoo.fr*
***Fiesta, Institut Supérieur de Gestion, Hajrij@yahoo.fr*

1. Introduction

The prominent role that managers play in firms justifies the interest in analysing their rationality as economic agents more deeply and in studying the effects of their behaviour on these companies.

The dominant theories of corporate governance tend to see managers as agents who are interested in maximising their own interests at the expense of the legitimate of the company's owners, through opportunistic behaviour. The literature tends to construct theoretical structures that minimise the room for manoeuvre afforded to these managers.

More recent management theories show that maximising the job security, the reputation in order to increase their worth in the management job market and maximising their margin of discretion generate effects that are not necessarily at the expense of the owners and are not necessarily counter-productive for the survival of the company.

This lack of consensus has motivated this research, which contributes to better understanding of the role played by the managers in quoted tunisian firms. In fact, we try to verify the impact of the managerial discretion on the performance of these companies. In other words, we will answer to these followings questions: Are Tunisian managers entrenched? Do they serve only their own interests at the expense of the shareholders?

The contributions of our paper are at least three: First, we enlarge the firm-level database from emerging market economies. Second, we shed new lights on the important role of country-specific institutional setting in corporate governance and its impact on ownership structure and debt policy, Third, we measure performance through two variables (Market-T-Book and Return On Assets) in order to compare value created only for shareholders (MTB) to value created to all stakeholders (ROA).

Tunisia represents an ideal setting to examine these issues. In fact, Tunisian listed companies have similar ownership characteristics to publicly traded companies in most countries around the world. They are characterised by a high degree of ownership in general and are predominantly family-controlled. Tunisian economy is characterised by low institutional ownership and an inactive market for corporate control. Moreover, stockholders have fewer rights.

We try to provide insight into the entrenchment effects on the performance. To analyse this impact, we retain three corporate governance's features which are: the ownership structure, the debt policy and the structure of the board of directors.

More specifically, we try to analyse how Tunisian managers get entrenched? By possessing an important share in the capital? Or by adopting a specific financial policy? Or by manipulating the board of directors.

The remainder of this paper is organised as follows. The second section describes the entrenchment pathways and the expropriation effects. The third section summarises previous literature on the link between entrenchment and performance. The fourth section describes our empirical approach, presents the models and discusses the methodology. The results are discussed in the fifth section, and the last section presents the conclusion.

2. Entrenchment Pathways And Expropriation Effects

In a wider sense, managerial entrenchment means the various strategies that managers adopt to increase their margin of discretion in running the firm, which in turn increase their chances of maximising their managerial capital.

Managers have two main ways of becoming entrenched: financial way and social way which includes political and institutional aspect. We detail in the followings paragraphs each strategy separately.

2.1 Financial entrenchment strategies

Financial entrenchment strategies take the form of investment in three specific types of asset that only the managers can appropriate (Shleifer and Vishny 1989):

1. Controlling and filtering scarce strategic information on the company (e.g. investment plans and marketing strategy);

2. Controlling and filtering intangible strategic company assets (e.g. client portfolios, technology, and social networks);

3. Developing and accumulating know-how / experience of management functions in a company of this type.

The managers' progressive accumulation of these intangible assets places them in a position of information asymmetry compared to other firm assets, increasing their relative value, increasing the relative cost of dismissing them and increasing their value in the event of their moving to another company.

Financial entrenchment strategies have the greatest consequences from the point of view of corporate governance, as they attempt to change the ownership's structure. The change in ownership can be affected in two ways: One is by modifying its composition, diluting it with new owner-actors (e.g. by bringing in capital from outside or other types of members whose interests are contrary to those of the initial members) and enhancing the role of management. The other is by capturing the representatives of the owners, the Governing Council by different means (e.g. co-opting, connivance and cross-directorship). Through this type of strategy, managers will hold the power of information, so they will be able to serve exclusively their interests which reduce shareholders' value.

2.2 Social, political and institutional entrenchment strategies

Entrenched managers try to establish a solid network with employees, local communities, political lobbying and social communities to be protected from any threat or risk of removal.

Pagano and Volpin (2005) analyse the behaviour of incumbent managers and workers in a firm faced with a hostile takeover threat, and argue that incumbents are natural allies of workers: the former have an interest in offering long-term contracts to workers so as to discourage the takeover, while the latter are likely to support a lazy manager prone to low monitoring against a more efficient raider. So that, incumbent managers can commit to a stakeholder-friendly behaviour in order to obtain stakeholders' support against a replacement attempt through manager-specific investments (Shleifer and Vishny, 1989). One instance of such investment is the acquisition of expertise in implementing socially responsible policies and sustainable production process that will later turn stakeholder-friendly projects into "pet projects" for the CEO.

A further example is that of a manager who spends time gathering the advice of, and building relationships with, NGO representatives, local communities, and environmentalists. Finally, the CEO can start a parallel career in a social activist organization, and enjoy personal gratification from being praised by other members.

In fact, when good corporate governance deprives managers of standard tools to protect their jobs (such as anti-takeover defenses and CEO-dominated boards) CEOs turn to subtler ways to stay in power. Moreover, as the effectiveness of social activists' campaigns increases, investments in Corporate Social Responsibility expertise and close relationships with stakeholder representatives become powerful entrenchment tools.

More specifically when stakeholder protection is left to the voluntary initiative of managers, relations with stakeholders and social activists may turn into a powerful entrenchment strategy for incumbent CEOs (Cepsa and Cestone 2007). According to these authors, this reality is particularly true in countries and periods where political lobbying, social activism, and media campaigns have the power to promote or disgrace top executives of large corporations. Inefficient managers have then a special motive for committing themselves to a socially responsible behaviour that gains stakeholders' support.

Cepsa and Cestone (2007) suggest also that explicit stakeholder protection – whether enforced by courts and regulators, or by private monitoring institutions specialized in corporate social responsibility issues – can break this alliance, thus favouring control contestability and managerial turnover.

3. Link between entrenchment and performance: Literature review

The literature has highlighted the relationship between entrenchment and performance. Some studies consider that entrenchment affect negatively the performance. However, others precise that entrenchment enhances firm's value. We try to verify the sign of this relation for the specific case of quoted Tunisian firms. To achieve this goal, we select three entrenchment's attributes which are the ownership

structure, the financial policy and the structure of the board of directors. Hence, we exclude some entrenchment strategies, such as the investment in specific assets and anti-takeover strategies. In fact, the market for corporate control doesn't exist in Tunisian economy.

3.1 Ownership Structure And Entrenchment Effects: Theory And Previous Empirical Results

There is theoretical and empirical work on the existence of an impact of ownership structure on performance. We try to summarise the most important studies that have analysed this relation.

Mehran (1995) explains how the existence of large shareholders in the firm facilitates the control of managerial discretion, and thus lessens the need for equity-based compensation for managers in order to achieve a convergence between their interests and those of outside owners.

More recently, Farinha (2003) thinks that given their large shareholdings in the firm, entrenched managers may be tempted to offset the risk of non-diversification of their personal wealth through higher dividends.

Miguel et al (2004) find that insider ownership is related to performance in a non-linear way because of the managerial entrenchment that, contrary to the convergence of interest effect, leads to market valuation being negatively affected by some range of high ownership stakes. Similarly, the expropriation phenomenon that is likely to dominate the monitoring effect at high levels of ownership concentration explains why a highly concentrated ownership negatively influences corporate value.

Studying the interrelationship between managerial ownership and board structure, Lasfer (2006) concludes that high managerial ownership entrenches managers by allowing the CEO to create a board that is unlikely to monitor. Its results show a strong negative relationship between the level of managerial ownership and corporate governance factors (such as the split of the roles of CEO and the chairman, the proportion of non-executive directors). He also finds that companies with low managerial ownership are more likely to change their board structure which cast doubt on the effectiveness of the board as an internal corporate governance mechanism when managerial ownership is high.

3.2 Financial Policy And Entrenchment Effects: Theory And Previous Empirical Results

A wide literature in finance and in management have analysed the role of financial policy as a variable facilitating entrenchment. In fact, some studies try to answer to the following question: Does the financial policy, and in particular the debt policy constrain or facilitate entrenchment?

Corporate debt policy has been viewed as an internal control mechanism, which can use agency conflicts between management and shareholders, particularly the agency costs of free cash flow as suggested by Jensen (1986). In fact, he argues that managers with substantial amounts of free cash flow are likely to engage in non-optimal activities. Debt can be a disciplinary device that may be used to reduce the agency costs of free cash flow. Jensen and Meckling (1976) argue that managerial shareholding can reduce managerial incentive to consume perquisites, expropriate shareholder's wealth and to engage in other non-maximising behaviour and thereby helps in aligning the interests between management and shareholders.

Wang (2006) shows that dividend yield is negatively influenced by managerial entrenchment and leverage ratio. Furthermore, managerial agency conflicts vary with a firm's financial health. The interests of managers and shareholders become naturally aligned and shareholder-manager conflicts over risk choice and cash payout level disappear as a firm approaches bankruptcy. Specifically, entrenched managers choose leverage not only to reduce the likelihood of bankruptcy but also to avoid a threat from outside shareholders to terminate their contract. Managers will assume the minimum amount of debt necessary and choose the minimum dividend payout rate to prevent the outside shareholders from exercising their threat to fire.

According to the same author, when the entrenchment power reaches a certain level, managers are able to stop dividend payment without provoking shareholders' firing action. In other words, outside shareholders receive higher dividend if they are more effective in disciplining management.

Kumar (2006) examines the link between capital structure and shareholding pattern for a panel of more than 2000 publicly traded Indian corporate firms over the years 1994 to 2000. He finds that firms with weaker corporate governance mechanisms, dispersed shareholding pattern, in particular measured by the entrenchment effects of group affiliation, tend to have a higher debt level. Firms with higher foreign ownership or with low institutional ownership tend to have lower debt level. Studying the case of 135 non-financial quoted Spanish firms from 1990 to 1999, De Miguel et al (2005), demonstrate that entrenched managers encourage debt decreases in order to avoid its disciplinary role and to reduce risks, despite the negative consequences this decision may have on Spanish firms.

3.3 Board's Structure And Entrenchment Effects: Theory And Previous Empirical Results

An important measure of the degree of managerial entrenchment is the extent to which executive turnover is involuntary. By definition, non-entrenched managers are exposed to board and/or market-

imposed discipline. Thus, they are more susceptible to forced departure. Entrenched managers, in contrast, are less likely to leave involuntarily since they are less vulnerable to internal pressures.

Goyal and Park (2002) measure managerial entrenchment using the combination of chief executive and chairman duties. They report that vesting both positions in the same individual significantly reduces the probability of forced CEO turnover. Besides, Wilcox (2002) argues that staggered elections encourage board independence by reducing the threat that a director who refuses to succumb to management will not be renominated each year. Bebchuk and Cohen (2005) find that staggered boards of publicly US traded companies are associated with an economically meaningful reduction in firm value (as measured by Tobin's Q). They also provide suggestive evidence that staggered boards bring about, and not merely reflect, a reduced firm value. Finally, they show that the correlation with reduced firm value is stronger for staggered boards that are established in the corporate charter (which shareholders cannot amend) than for staggered boards established in the company's bylaws (which shareholders can amend).

Bates and al (2007) demonstrate that board classification is an anti-takeover device that facilitates managerial entrenchment.

In the following section, we will present our empirical design and methodology.

4. Empirical Design And Methodology

We will gauge the impact of entrenchment strategy on the performance of Tunisian quoted companies, and try to analyse which channel is privileged by managers to be entrenched. In fact, we consider three entrenchment pathways which are: the structure of ownership, the financial policy and the board's structure.

We begin our analysis by presenting our variables and hypothesis.

4.1 Data Selection And Hypothesis

We select all companies quoted on the Tunisian financial market over the period 2000 to 2006. Financial companies are excluded because of their specific characteristics. Other companies are also excluded because they become newly quoted on the Tunisian market.

We collect data on managerial ownership, board structure, financial policy and other control variables from companies' financial statements published on the site of Tunisian stock market (BVMT). The entrenchment variables were found by sending mails to directors in the corresponding firms. We asked them their age, the number of years passed in the firm and in the post of CEO. The discussion in the previous sections suggests the need to identify observable variables to test for the existence of an entrenchment strategy and the relationship between entrenchment and performance.

Table 1. Summary of variable definition

Variable name	Definition
Market-to-book MTB	Ratio between market capitalisation and total book value
Return On Assets ROA	Ratio between earnings before tax and interests and total assets
LNAGE	Logarithm of the age of CEO between 2000 to 2006
YEAR CEO	Number of years passed in occupying the post of CEO
YEAR FIRM	Number of years passed in the firm
BOARD SIZE	Number of directors sited in the board
BOARD IND	Number of non-executive directors who are outsiders with no business or personal relationship with the firm or any of its employee-directors.
CEO PROP	The percentage of equity ownership held by executive directors
INSTIT PROP	The proportion of shares owned by other companies.
FAM PROP	The proportion of shares owned by the controlling family.
DEBT	Ratio total debt over total asset
LN ASSET	Logarithm of total asset
FIRM AGE	2006 less the year the firm was founded

We will detail the different dependant and control variables and present our hypothesis.

4.1.1 Board's structure

Board's size. The literature has not defined the optimal board size. However, a number of studies argue that small boards operate more effectively than larger ones because of the high coordination costs and free rider problems associated with large boards. For example, Raheja (2003) develops a model where small boards will mitigate the agency conflicts between managers and shareholders. Consistent with the monitoring role of small boards, Yermack (1996) reports a negative relationship between firm value and board size.

Proportion of non-executive directors. Another aspect of corporate governance that may influence the level of managerial entrenchment relates to the composition

of the board. One argument here is that unless a board is independent, monitoring of management will be weak. Consistent with this conjecture, Rosenstein and Wyatt (1990) find a positive relationship between the percentage of non-executive directors on the board and corporate performance. However, there are studies that find exactly the opposite results. For example, the analysis by Franks et *al*. (2001) support the view that non-executive directors are usually characterized by a lack of information about the firm, do not bring the requisite skills to the job and, hence, prefer to play a less confrontational monitoring role.

H1: We expect that either board's size or its composition can be a strong tool for entrenchment. Thus, they will be negatively associated to performance.

4.1.2 Ownership structure

We try to analyse managerial ownership variable through shares owned by the CEO, by the controlled family, and other companies or institutions (We include also in the institutional ownership the shares owned by the state).

CEO ownership. According to the convergence of interests hypothesis, executive ownership helps align the interests of managers with those of shareholders. It is argued that executive ownership works as an incentive mechanism to prevent managers from expropriating wealth from outside shareholders. There is, however, evidence that the relationship between executive ownership and corporate performance is not necessarily linear and that the ultimate effect of executive ownership on performance is determined by a trade-off between the alignment and the entrenchment effects (Florackis, 2005 and Davies *et al.*, 2005).

Family ownership. According to Bozec and Laurin (2007), concentrated ownership structures can generate in the hands of large shareholders (mostly wealthy families) specific agency problems such as large shareholders expropriating wealth from minority shareholders. They add that firm performance is lower when large shareholders have both the incentives and the opportunity to expropriate minority shareholders.

We expect that large shareholders has (1) the opportunity to expropriate (high free cash flows in the firm) and (2) the incentive to expropriate (low cash flow rights).

H2: CEO ownership has an incentive role: The interests of managers and shareholders will be common, then the entrenchment strategy lose any sense. However, we expect that the possession by wealthy family of important shares help them to be entrenched which will affect negatively their performance.

4.1.3 Debt policy

The relation between debt structure and corporate governance is advantageous, not only to better understand whether or not firms that are vulnerable to expropriation issue more debt to have more resources to use for private interests, but also to shed lights on the other possible agency problems. These agency problems may arise between the firm's controlling shareholders and the debt providers and also between the debt suppliers and their minority shareholders. For example, whether the controlling shareholder of a firm and the firm's debt providers belong to the same business groups controlled by the same family. In this case, instead of performing the active monitoring and governance function, the debt suppliers could become the center of corrupt crony systems. In consequence, this would lead to an increase in the level of non-performing loans and hinder the proper functioning of the financial system.

It has been shown that entrenched managers prefer lower than optimal leverage (Broumen and *al.*, 2006); choose debt with longer maturity (Datta and *al.*, 2005); hold large amounts of cash (Harford and *al*., 2005); pay lower dividends (Hu and Kumar, 2004; and Khan, 2006); and overinvest (Pawlina and Renneboog, 2005).

H3: Debt policy constitutes an important tool for entrenchment.

We also include control variables, as suggested in the literature, to reduce specification bias.

4.1.4 Size of the firm

Firm size also has an ambiguous effect on the scope for managerial entrenchment. Jensen (1986) argues that larger companies are more likely to suffer from agency costs, which, in turn increases the desire for larger managerial ownership. However, because of the wealth constraint problem, managers cannot hold large stakes in large firms. In addition, large firms might enjoy economies of scale in monitoring by top management and by rating agencies, leading to a lower managerial ownership.

H4: An important firm size facilitates entrenchment.

4.2 Methodology

To test our research hypotheses, we use the following pooled cross-sectional time series model:

$$MTB = \alpha_0 + \alpha_1 AGECEO + \alpha_2 YEARCEO + \alpha_3 YEARFIRM + \alpha_4 CEOPROP + \alpha_5 INSTITPROP + \alpha_6 INSTITPROP_i + \alpha_7 FAMPROP_i + \alpha_8 CEOPROP_i + \alpha_9 DEBT_i + \alpha_{10} LNASSET_i + \alpha_{11} AGEFIRM_i + \varepsilon_i$$

Then, we test this equation below:

$$ROA = \alpha_0 + \alpha_1 AGECEO + \alpha_2 YEARCEO + \alpha_3 YEARFIRM + \alpha_4 CEOPROP + \alpha_5 INSTITPROP$$

$$+ \alpha_6 INSTITPROP_i + \alpha_7 FAMPROP_i + \alpha_8 CEOPROP_i + \alpha_9 DEBT_i + \alpha_{10} LNASSET_i + \alpha_{11} AGEFIRM_i + \varepsilon_i$$

Where

α = regression coefficients

i = index of ith firm

ε_i = error term

5. Empirical Results

5.1 Descriptive Statistics

The table 2 presents full-sample descriptive statistics.

The sample has an average MTB of 18.15% and an average of ROA of 12.19%. Panel A in Table 1 presents measures of entrenchment attributes. A Tunisian manager stays in average 15 years in the firm and occupies the post of CEO over 7 years.

Panel B in Table 1 presents descriptive statistics for dependant variables in our sample of Tunisian companies. The average number of directors in the board is 6 persons. The size of the board is about 9 directors.

The sample has an average of institutional ownership of 59%, family ownership of 21%. However, the CEO can possess in maximum 6% of the capital.

The sample has an average debt ratio of 50.21.

Panel C in Table 1 includes control variables: The total asset has an average of 10.98 with a standard deviation of 1.07. Whereas, average firm age for the sample is 29.85 years with a standard deviation of 18.48

Panel A of Table 3 presents the correlation coefficients between entrenchment attributes and MTB and the panel A of Table 3' indicate the correlation coefficients between entrenchment attributes and ROA.

We remark that MTB is negatively correlated at the 1% significance level with a coefficient of CEO AGE. Furthermore, MTB is also correlated at the 5% significance level with the number of years passed in the company. We think that new and young managers affect positively the value created for shareholders as they bring new ideas and new strategies to the firm.

The different measures of entrenchment (age, etc) are each negatively correlated to the corresponding measures of ROA. In fact, stakeholders also prefer young managers who can be able to innovate and to up-to-date strategies and structures.

The correlation matrix presented in Table 3 and 3' shows that shareholders are more sensitive than stakeholders to any entrenchment strategy. The entrenchment variables are significant with MTB and not with ROA.

Table 2. Descriptive statistics

Variables	MTB					ROA				
	Obs	Mean	Std.Dev.	Min	Max	Obs	Mean	Std.Dev.	Min	Max
MTB / ROA	147	0.181513	1.732635	.02	1.45	146	.1219178	.1593968	.01	1.29
Panel A:										
LNAGE	147	3.97415	.1350943	3.66	4.21	147	3.97415	.1350943	3.66	4.21
YEARCEO	147	7.571429	5.929956	0	30	147	7.571429	5.929956	0	30
YEARFIRM	147	15.19048	6.638754	0	31	147	15.19048	6.638754	0	31
Panel B:	147									
BOARDSIZE	147	9.619048	1.79166	5	12	147	9.619048	1.79166	5	12
BOARDIND	147	6.190476	2.203153	2	10	147	6.190476	2.203153	2	10
INSTITPROP	147	.5901361	.2401569	.15	.93	147	.5901361	.2401569	.15	.93
FAMPROP	147	.2135374	.3026952	0	.85	147	.2135374	.3026952	0	.85
CEOPROP	147	.088226	.1382103	0	.65	146	.088226	.1382103	0	.65
DEBT	147	.5021233	.2555514	.02	1.9	146	.5021233	.2555514	.02	1.9
Panel C:	147									
LNASSET	147	10.98789	1.072619	3.83	14.14	147	10.98789	1.072619	3.83	14.14
FIRMAGE	147	29.85714	18.48991	6	81	147	29.85714	18.48991	6	81

Table 3. Correlation matrix

Variable	MTB											
	MTB	LNAGE	YEARCEO	YEARFIRM	BOARS	BOARIN	INSTIP	CEOP	FAMP	DEBT	LNA	FIRMA
MTB	1.0000											
Panel A:												
LNAGE	**-0.0079**	1.0000										
YEARCEO	0.1321	0.4101	1.0000									
YEARFIR	**-0.0121**	0.0337	0.4473	1.0000								
Panel B:												
BOARS	0.1316	-0.1624	0.0308	-0.0694	1.0000							
BOARIND	0.1893	-0.1458	0.2230	0.2518	0.6269	1.0000						
INSTITP	0.3508	-0.0684	-0.1024	-0.0165	0.0791	0.3359	1.0000					
CEOPROP	-0.2392	-0.0595	0.00541	-0.2821	-0.0373	-0.3516	-0.8846	1.0000				
FAMPROP	-0.0231	-0.1560	-0.1423	-0.1826	0.1573	0.0441	-0.4280	0.5091	1.0000			
DEBT	0.0810	0.0328	-0.0180	-0.3654	0.1126	0.0515	-0.1866	0.0659	0.3029	1.0000		
Panel C:												
LNASSET	0.1060	0.1285	-0.1650	-0.3373	0.2675	0.2090	0.2496	-0.170	-0.126	0.3541	1.000	
FIRMAGE	0.5901	-0.1280	-0.0344	-0.0209	0.2448	0.4271	0.4931	-0.263	-0.444	-0.013	0.396	1.000

Table 3. Correlation matrix

Variable	ROA											
	ROA	LNAGE	YEARCEO	YEARFIRM	BOARS	BOARIN	INSTIP	CEOP	FAMP	DEBT	LNA	FIRMA
ROA	1.0000											
Panel A:												
LNAGE	-0.4383	1.0000										
YEARCEO	-0.1522	0.4119	1.0000									
YEARFIR	-0.1084	0.3334	0.4510	1.0000								
Panel B:												
BOARS	0.2040	-0.1640	0.0355	-0.0727	1.0000							
BOARIND	0.1943	-0.1501	0.2363	0.2487	0.6247	1.0000						
INSTITP	0.2519	-0.0715	-0.0944	-0.0229	0.0688	0.3193	1.0000					
CEOPROP	-0.0337	-0.1566	-0.1405	-0.1843	0.1551	0.0390	-0.4388	1.0000				
FAMPROP	-0.1806	-0.0577	0.0442	-0.2795	-0.0247	-0.3331	-0.8817	-0.544	1.0000			
DEBT	-0.1398	0.0337	-0.0214	-0.3640	0.1171	0.0611	-0.1807	0.0679	0.2984	1.0000		
Panel C:												
LNASSET	-0.0707	0.1282	-0.1639	-0.3386	0.2666	0.2079	0.2489	-0.171	-0.124	0.3560	1.000	
FIRMAGE	0.0707	-0.1296	-0.0296	-0.0243	0.2403	0.4210	0.4881	-0.267	-0.438	-0.009	0.3958	1.000

5.2 The Entrenchment Pathways And The Impact On Performance

Considering the table below which summaries the regression results:

Table 4. Regression results

Variables	MTB	ROA
LNAGE	1.119528	-0.453333
	(0.276)	**(0.000)*** **
YEARCEO	0.318833	0.0002453
	(0.172)	(0.923)
YEARFIRM	0.032875	-0.0031516
	(0.215)	(0.272)
BOARDSIZE	0.1443551	-0.0168633
	0.073*	**(0.053)*** **
BOARDIND	-0.184282	0.0215887
	(0.022) **	**(0.014)** **
INSTITPROP	4.705693	0.1230309
	(0.000)* **	**(0.014)** **
FAMPROP	2.898664	-0.008492
	(0.004)* **	(0.936)
Variables	MTB	ROA
CEOPROP	3.621579	2.352890
	(0.568)	(0.357)
DEBT	1.351101	-0.088492
	(0.006)* **	(0.119)
LNASSET	-0.4468714	-0.002598
	(0.001)* **	(0.856)
AGEFIRM	0.0643739	-0.0013182
	(0.000)* **	**(0.090)***

P-values are given in parentheses ***; **; * represent significance at the 1%; 5% and 10% level respectively.

We confirm the results founded by (Florackis and Ozkan 2007) who demonstrate that internal corporate governance mechanisms, such as ownership and board structures play an important role in determining the extent of managerial entrenchment. Their empirical analysis suggests that higher managerial entrenchment leads to greater agency costs. They add that short-term debt and dividend payments work as effective corporate governance devices in reducing the costs of manager-shareholder agency conflict.

5.2.1 First Pathway: Entrenchment Through The Board Of Directors And Performance

The size and the independence of the boars seem to be a strong pathway for Tunisian managers to be entrenched. For example, the board size variable is significant at a level of 1% and has a negative impact on ROA (-0.016).

Similarly, the board independence is a significant variable at a level of 5% (0.022) and has a negative impact on performance measured by MTB (-0.18).

We confirm then **H1**, in fact, tunisian managers use board members to increase their own interests. They establish good relationship with board members to be preserved form any threat. So, we join Yeh and Woidtke (2005) who suggest that there is poor governance when the board is dominated by members who are affiliated with the controlling family but good governance when the board is dominated by members who are not affiliated with the controlling family. We confirm that the independence of the board matter in concentrated ownership firms. Hence, the board structure is an important indicator of whether the controlling shareholder is committed to good corporate governance or entrenched.

This case is particularly true in Tunisia. In fact, board directors are usually members of the same family or of another wealthy family. It exist a network composed by rich Tunisian families who dominate the majority of the board of directors.

In this case, controlling shareholders may select board members that are less likely to monitor and more likely to support their decisions in order to entrench themselves further when the entrenchment effects of excess control outweigh the positive incentive effects of cash flow ownership. In this situation, the net personal benefit of expropriation is greater than the net personal benefit of shareholder wealth maximization.

These results suggest that controlling shareholders do wield influence over board member selection. In particular, boards that are closely linked to controlling families are associated with strong, negative entrenchment effects, and firms with these board structures are valued less by investors.

5.2.2 Second Pathway: Entrenchment Through Ownership Structure And Performance

We confirm that the presence of institutions (companies and State) and controlling families in the capital of Tunisian companies facilitate the entrenchment strategy. The institutional property and the family property are significant variables at a level of 1% and have a positive impact on MTB and on ROA.

Hence, we infirm **H2** since the link between ownership structure of institutional and controlling family- even if it constitutes a strong pathway of entrenchment- and performance is positive.

We confirm the hypothesis underlined by Bozec and Laurin 2007. In fact, when ownership is concentrated in the hands of a dominant shareholder, typical governance mechanisms, such as the board of director or the market for corporate control, may not be effective. Firms are exposed to an entrenchment problem that is a situation where the dominant shareholders have the power to pursuit of their own interests rather than the interests of all shareholders.

For these firms, the agency costs do not result from the traditional conflict between outside shareholders and managers (Type I agency costs, as per Villalonga and Amit, 2006). Instead, the costs are caused by a conflict between large shareholders, who control the firm's assets, and minority shareholders, who provide financing but run the risk of expropriation (Type II agency costs, as per Villalonga and Amit, 2006).

In entrenched companies, top management positions are often assigned to a member of the controlling family rather than to the most capable manager (Caselli and Gennaioli, 2003)

Analysing the CEO ownership, we find that the ownership of executive directors –when he isn't a member of the controlling family is very small (less than 3%). We assume that the inclusion of this variable is not going to be determinant in the analysis of the entrenchment strategy in Tunisia.

5.2.3 Third Pathway: Entrenchment Through Debt Policy And Performance

The regression results show that entrenched managers adopt a higher debt policy. In fact,

Debt can facilitate entrenchment, particularly in the countries where institutions are weak and appear to be ineffective (Bunkanwanicha and al, 2008). This is particularly true for Tunisian companies. In fact, this variable is significant at a level of 1% (0.006) and has a negative impact on ROA (-0.088).

Consequently, we confirm **H3** and agree with Kumar (2006) who show that firms with weaker corporate governance mechanisms tend to have a higher debt level. However, firms with higher foreign ownership or with low institutional ownership tend to have lower debt level, which is not the case in Tunisia.

6. Conclusion

This paper investigates empirically whether substantial protection from removal enhances or reduces the value of firms. This question has been much debated, and both defenders and opponents of management insulation have identified many ways, some positive and some negative, in which such insulation could affect value. Putting this long-standing question to an empirical test, we find that controlling family and concentrated ownership encourage entrenchment strategy by choosing directors in the board who are not necessarily the most independent, by investing in order to maximise firm size and by choosing an executive manager who can serve exclusively their interests.

The results in this paper suggest that controlling shareholders entrench themselves further by selecting both board members that are more likely to make decisions favoring controlling shareholders and those that are less likely to monitor when divergence is higher. Moreover, the resulting increase in board affiliation is associated with negative valuation in family-controlled firms. In sum, our results are consistent with larger agency conflicts and weaker corporate governance existing when the majority of directors and all of the supervisors belong to the controlling family.

Our analysis leaves future work for some questions about the relationship between entrenchment and compensation strategy. Moreover, it will be interesting to study the duality in the functions of CEO and chairman in Tunisian boards and analyse the network composed by controlling families who sits in the majority of Tunisian boards.

References

1. Bates, T.W., Becher, D.A., and Lemmon, M.L. (2007) Board classification and managerial entrenchment: Evidence from the market for corporate control, Journal of Financial Economics, forthcoming.
2. Bebchuk, L.A. and Cohen, A. (2005), The costs of entrenched boards, Journal of Financial Economics, 78, 409-433.
3. Berger, P., Ofek, E. and Yermack, D. (1997) Managerial entrenchment and capital structure decisions, The Journal of Finance, 52, 1411-1438.
4. Bozec, Y. and Laurin, C. (2007) Large shareholder entrenchment and performance: Empirical evidence from Canada, Journal of Business Finance and Accounting, forthcoming.
5. Broumen, D., De Jong, A. and Koedijk, K. (2006) Capital structure policies in Europe : Survey evidence, Journal of Banking and Finance, 30, 1409-1442.

6. Bunkanwanicha, P., Gupta, G. and Rokhim, R. (2008) Debt and entrenchment: Evidence from Thailand and Indonesia, European Journal of Operational Research, 185, 1578-1595;
7. Cepsa, G. and Cestone, G. (2007) Corporate social responsibility and managerial entrenchment, Journal of Economics and Management Strategy, 16, 741-771.
8. Chaves, R. and Sajardo-Moreno, A. (2004) Social economy managers: Between values and entrenchment, Annals of Public and Cooperative Economics, 75, 139-161.
9. Datta, S. Iskandar,-Datta, N. and Raman, K. (2005) Managerial stock ownership and the maturity structure of corporate debt, Journal of Finance, 60, 2333-2350.
10. Davies, J.R., Hillier, D. and Mc Colgan, P. (2005) Ownership structure, managerial behaviour and corporate value, Journal of Corporate Finance, 11, 645-660.
11. De Miguel, A., Pindado, J. and De la Torre, C. (2005) How do entrenchment and expropriation phenomena affect control mechanisms, Corporate Governance: An international Review, 13, 505-516.
12. Farinha, J. (2003) Dividend policy, corporate governance and the managerial entrenchment hypothesis: An empirical analysis, Journal of Business Finance and Accounting, 30, 1173-1209.
13. Florackis, C. (2005) Internal corporate governance mechanisms and corporate finance: Evidence for UK firms, Applied Financial Economic Letters, 11, 211-216.
14. Florackis, C. and Ozkan, A. (2007) The impact of managerial entrenchment on agency costs: An empirical investigation using UK panel data, European Financial Management,
15. Franks, J.R., Mayer, C. and Renneboog, L. (2001) Who disciplines bad managers in poorly performing companies?, Journal of Financial Intermediation, 10, 209-248.
16. Gadhoum, Y. (1999) Potential effects of managers' entrenchment and shareholdings on competitiveness, European Journal of Operational Research, 118, 332-349.
17. Gedajlovic, E. and Shapiro, D. (1998) Management and ownership effects. Evidence from five countries, Strategic Management Journal, 19, 533-553.
18. Goyal, V.K. and Park, C.W. (2002) Board leadership structure and CEO turnover, Journal of Corporate Finance, 8, 49-66.
19. Harford, J., Mansi, S. and Maxwell, W. (2005) Corporate governance and firm cash holdings, Working paper, University of Washington.
20. Hu, A. and Kumar, P. (2004) Managerial entrenchment and payout policy, Journal of Financial and Quantitative Analysis, 39, 759-790.
21. Jensen, M. (1986) Agency costs of free cash flow, corporate finance, and takeovers, American Economic Review, 76, 323-329.
22. Jensen, M.C. and Meckling, W.H. (1976) Theory of the firm: Managerial behaviour, agency costs and the ownership structure, Journal of Financial Economics, 3, 305-360.
23. Khan, T. (2006) Corporate dividends and ownership structure: evidence form UK panel data, Economic Journal, 116, 172-189.
24. Kumar J. (2006) Debt vs Equity: Role of corporate governance, Working Paper, Xavier Institute of Management, India.
25. Lasfer, M.A. (2006) The interrelationship between ownership structure and board structure, Journal of Business Finance and Accounting, 33 (7) & (8), September, October, 1006-1033.
26. Mehran, H. (1995) Executive compensation structure, ownership and firm performance, Journal of Financial Economics, 38, 163-184.
27. Miguel, A., Pindado, J. and de la Torre, C. (2004) Ownership structure and firm value : New evidence from the Spanish case, Strategic Management Journal, 25, 1199-1207.
28. Morck, R, Shleifer, A. and Vishny, R. (1988) Management ownership and market valuation, Journal of Financial Economics, 20, 293-315.
29. Pagano, M. and Volpin, P. (2005) Managers, workers and corporate control, Journal of Finance, 60 (2), 841-868.
30. Paquerot, M. (1996) L'enracinement des dirigeants et ses effets, Revue Française de Gestion, Nov-Dec, 212-225.
31. Pawlina, G. and Renneboog, L. (2005) Is investment-cash flow sensitivity caused by agency costs or asymmetric information? Evidence form the UK, European Financial Management, 11, 483-513.
32. Raheja, C. (2003) The interaction of insiders and outsiders in monitoring : A theory of corporate boards, Working paper, Vanderbit University.
33. Rosenstein, S. and Wyatt, J.C. (1990) Outside directors, board effectiveness and shareholder wealth, Journal of Financial Economics, 26, 175-191.
34. Shleifer, A., Vishny, R. (1989) Management entrenchment: The case of manager-specific investments, Journal of Financial Economics, 25, 123-139.
35. Villalonga, B. and Amit, R. (2006) How do family ownership, control and management affect firm value, Journal of Financial Economics, 80, 385-417.
36. Wang, H. (2006) Managerial entrenchment, dividend policy and capital structure, working paper, Faculty of Management, Mc Gill University.
37. Wilcox, J.C. (2002) Two cheers for staggered boards, Corporate Governance Advisor, 10, 1-5.
38. Yeh, Y.H. and Woidtke, T. (2005) Commitment or entrenchment?: Controlling shareholders and board composition, Journal of Banking and Finance, 29, 1857-1885.
39. Yermack, D. (1996) Higher market valuation of companies with a small board of directors, Journal of Financial Economics, 40, 185-211.