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Institutional impact on the expropriation of private benefits of control in North Africa

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ABSTRACT

This paper examines the effectiveness of six institutional quality measures, namely corruption control, effective government, political stability, regulatory quality, rule of law and voice and accountability, in inhibiting self-rewarding behaviour of boards in terms of their compensation as well as in influencing the likelihood of disclosure of individual executive salaries in IPO listings prospectuses. Using a unique and comprehensive dataset of 78 hand-collected IPO firms from across North Africa from 2000 to 2012 I find substantial evidence that government effectiveness and corruption control are important in inhibiting director self-reward and expropriation while political stability is more associated with increased likelihood of transparency in reporting of salaries. In addition firms from poor informational environments are more likely to initiate enhanced self-governance and transparency so as to overcome institutional deficiencies.

1. Introduction

The recent uprisings and political upheavals across the North African and Middle Eastern region, collectively referred to as the Arab Spring (BBC news, 2011) have focussed worldwide attention on institutions at a state-level on the process of economic and social stagnation and societal change. While there has been a considerable amount of media interest on topics related

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to excessive salaries, compensation packages and performance related bonuses of wealthy corporate elites during the recent financial crisis, board level remuneration excesses have long been a topic of interest in developing world with alleged corporate corruption amounting to as much as US$ 148 billion a year stifling industrial and economic growth across Africa (BBC news, 2006). However much of the research literature regarding this topic is concentrated on single country studies, and primarily OECD nations such as US, UK, Germany and Japan (for example, see Conyon, 1997; Cosh and Hughes, 1997; Conyon and Peck, 1998; Shen, 2003), and focussed on either CEO or executive compensation. However the dominance of these measures largely overshadows a broader aggregate board remuneration level that takes into account of firms falling within extended business or family networks, common to much of developing world (Claessens et al., 1999, 2000). Equally there is considerable variation in institutional quality across much of the developing world with this being reflected across North Africa and with particular relevance in wake of Arab Spring (Transparency International website, 2011). Consequently I am motivated to study the impact of institutional quality on aggregate board remuneration using six well established World Bank governance institutional quality measures, corruption control, government effectiveness, political stability and absence from terrorism, regulatory control, rule of law and democratic voice and accountability (World Bank Governance, 2012).

Firms undergoing initial primary offerings (IPOs) provide a unique opportunity to study the agency implications arising from the diversification of ownership to minority outsider shareholders for the first time in the focal firm's lifecycle (Fama, 1980; Jensen and Meckling, 1976). As such agency theory in its broadest sense is associated with the alignment of motivational differences (pecuniary and non-pecuniary) between various incumbent insider management (agents) and minority outsider owners (principals). Consequently its prescriptions tend to focus on the incentive alignment of insider agents with external principals through executive compensation packages, as well as monitoring of insiders through the optimal structure of boards of directors. This latter monitoring role infers a separation of roles of CEO and chairman as well as the proportion of nonexecutive directors and their degree of independence from dominant insider groups, such as the CEO. However the study of board remuneration in a multi-country setting underscores the importance of the role of institutions that act to regulate human behaviour and influence decision-making. Institutional theory seeks to establish the "rules of the game" through which all social and economic behaviour across a society is shaped. As such institutions have a fundamentally important role in shaping incentive alignment and in facilitating and supporting the role of monitoring, which are central tenets of agency theory. Consequently I adopt a combination of institutional and agency theories to elaborate on the role of these perspectives in shaping optimal incentive alignment and in curbing excessive self-reward or expropriation at board level.

I use two measures of aggregate board compensation, the fixed base salary disclosed in IPO listings filings, and a total remuneration measure that takes into account the initial base salary as well as income derived from individual equity holdings in firm and additional stated perks. This is based on a unique and comprehensive hand-collected sample of 78 IPO firms from across North Africa that listed between 2000 and 2012. I use the six well-established World Bank governance measures, namely corruption control, government effectiveness, political stability and absence from violence, regulatory quality, rule of law and voice and accountability, as a proxy of institutional quality. I find that government effectiveness, defined as independence of civil service from political pressure alongside its credibility and effectiveness in designing and executing policy, is closely associated with reigning in excessive self-rewarding behaviour of boards. In addition enhanced corruption control measures are associated with more conservative board's base salary. A surprising finding is enhanced rule of law is related to increases in board compensation. In terms of disclosure of individual executive salaries (a measure of informational transparency and protection of informational property rights) and I find that political stability is closely associated with enhanced disclosure. However a further unexpected finding is that lower voice and accountability is associated with increased likelihood of disclosure inferring firms in poor quality informational environments are more likely to adopt international best practice transparency measures to counter for state-level institutional deficiencies.

I proceed as follows. In next section I outline theoretical concepts while Section 3 outlines justification of hypotheses. Section 4 discusses data and nuances of north African business environment while Section 5 discusses empirical methods. Section 6 discusses results and final section concludes.