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Complex ownership structures, corporate governance and firm performance: The French context.

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ABSTRACT

This study seeks to understand the leading role played by the blockholders and their true governance mechanism, in the French context, characterised by complex ownership structures. We focus on the role that second-tier shareholders can play in the optimal governance of companies and in their capacity to solve both principal/agent and principal/principal agency conflicts. Using a sample of 2118 observations between 2000 and 2009, we find that second-tier shareholders exercise effective additional monitoring when power is contestable but increase principal/principal agency costs in the presence of a controlling owner. We also show that shareholder homogeneity reduces agency conflicts. Our results demonstrate that the level of control contestability is essential in the understanding of governance mechanisms. Such contestability is to be found simultaneously at institutional level, at the level of the balance of power between blockholders, and according to the nature of the shareholders. Thus, the usual agency theory conclusions are debateable when the legal framework offers little protection of minority shareholders, and when ownership structure is complex and heterogeneous in nature. The study of corporate governance must therefore encompass a twofold analytical perspective, namely, an institutional and a socio-organisational one. The analysis and findings could be particularly useful in assessing corporate governance in the context of several European countries with a similar self-dealing legal environment to the French one, including Italy and Greece.

1. Introduction

The role of ownership structure in resolving agency costs arising from the separation of ownership and control within firms has been the focus of extensive literature for many years. Analyses initially focused on principal/agent agency conflicts between shareholders and managers (Jensen and Meckling, 1976). It is taken for granted that large shareholders internalise the costs of monitoring managers' actions due to their considerable cash flow rights (Shleifer and Vishny, 1986; La Porta et al., 1999). Ownership concentration in the hands of the main shareholder is thus expected to foster the alignment of the managers' interests with those of the firm (Demsetz, 1983; Shleifer and Vishny, 1986; Denis et al., 1997). Many studies also suggest that certain types of shareholders are more apt at taking on this monitoring role than others, but without drawing firm conclusions as to which would take pre-eminence. The analysis framework then spread to principal/principal agency conflicts between majority and minority shareholders due to the potential for collusion between the main shareholder and

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the manager (Denis and McConnell, 2003; Holderness, 2003) or the appropriation of private control benefits by the main shareholder to the detriment of the minority shareholders (La Porta et al., 1998) and the firm's interests. Finally, institutional mechanisms are acknowledged to be an important part of corporate governance (Zattoni and Van Ees, 2012). Legislators have long been concerned about protecting companies' interests by limiting the potential for managers or majority shareholders to use their position or influence to engage in tunnelling, related-party transactions or any other act prejudicial to the interests of the minority shareholders. The regulations governing self-dealing therefore impose a protective legal framework that defines the methods and terms of execution of transactions involving conflicts of interest (ex ante private enforcement), giving minority shareholders the means to control the transactions effected (ex post private enforcement) and enabling offenders to be held civilly or criminally liable. In order to avoid any instances of improper use of minority powers that could paralyse a company's management, a minimum voting rights threshold is generally required for most ex post private enforcement methods to be exercised. This strengthens the minority shareholders' power to challenge self-dealing.

In this study, we focus on the role that second-tier shareholders[1] can play in the optimal governance of companies and in their capacity to solve both principal/agent and principal/principal agency conflicts. Bennedsen and Wolfenzon (2000) and Bloch and Hege (2001) thus consider that second-tier shareholders contribute to the enhanced control of managers, alongside the principal shareholder. Conversely, Zwiebel (1995) and Kahn and Winton (1998) believe that large, non-majority shareholders do not offer added control benefits and could actually be a source of additional costs. We support the idea that second-tier shareholders may, under certain circumstances, constitute an efficient mechanism for monitoring not only managers but also majority shareholders. In our view, the effectiveness of this control depends simultaneously on the division of power between shareholders, the similarity between the controlling shareholders, and the legal prerogatives granted to minorities to exercise their rights with regard to the management of the company. Consequently, the influence of minority shareholders is twofold. When a company's capital is concentrated in the hands of a majority shareholder, it is possible that other blockholders offer no added benefit in terms of control due to their relatively low level of influence (Zwiebel, 1995). Conversely, the legal framework in France gives certain shareholders, albeit minority ones, the possibility to block certain decisions if they disagree with a strategy or believe it is contrary to their interests. In the case of conflicts of interest, minority shareholders can therefore prevent proposed projects from being implemented. The greater the protection afforded by the law to minority interests, the greater the dissension costs arising from second-tier shareholders. On the other hand, the sharing of power leads to better dialogue between shareholders, simultaneously fostering control over the manager and more harmonious management of eventual conflicts of interest. Lastly, we support the hypothesis that the convergence of interests of shareholders of the same nature decreases the probability of conflicts arising between shareholders. The effectiveness of the challenging power of second-tier shareholders is therefore dependent on their proximity to the principal shareholder.

In this paper, we empirically test the impact of second-tier shareholders' control over a sample of French companies. Ownership in French companies is typically highly concentrated (Faccio and Lang, 2002), generating not only traditional principal/agent conflicts but also fierce principal/principal agency conflicts (Ginglinger and Lher, 2006). Moreover, La Porta et al. (1999) and Ginglinger (2002) stress that, with regard to the French market, there is little active market for corporate control, reinforcing the role of large shareholders as a governance mechanism. Lastly, the French 'complain and explain' type of legal framework is specific in that its ex ante private enforcement affords few constraints (Djankov et al., 2008), fostering costly ex post control by blockholders. Our results confirm that the primary shareholder constitutes an effective mechanism for monitoring managers and aligning interests. The firm's value is thus increasingly dependent on the principal shareholder's equity up to a certain threshold; when control can no longer be challenged, there are no additional control benefits to an increase in her ownership. Secondly, the presence of other blockholders is not sufficient in itself to guarantee additional control over the managers or the principal shareholder. Indeed, the monitoring activity of blockholders is less pronounced when they are of the same kind as the principal shareholder. Conversely, when they are of a different type, second-tier shareholders play their controlling role to the full. Our results therefore support the principle of the use of different control methods depending on how much influence the second-tier shareholders have. When power cannot be challenged, ex post private enforcement is the only recourse available to minority shareholders. This leads to high control costs that reduce the firm's value, to the detriment of the rest. Conversely, when challenging power is an option, ex ante private enforcement can be a valuable and inexpensive means of resolving principal/principal agency conflicts.

To our knowledge, no corporate governance scholars have conducted a simultaneous analysis of the impact of ownership concentration, similarity between shareholders and the institutional context to date. Current corporate governance studies focus not only on the governance environment (Aguilera and Jackson, 2003), but also on the characteristics of the organisations (Love, 2010) or the overlapping between governance mechanisms (Zattoni and Van Ees, 2012). Our study also follows this line and contributes to the literature on several fronts. First, we take a comprehensive approach to agency conflicts, not only between shareholders and managers (principal/agent), but also between majority and minority shareholders (principal/principal). Second, we adopt an analysis framework which encompasses corporate governance on three distinct fronts. To our knowledge, we are the first to demonstrate that the monitoring role of large minority shareholders is simultaneously contingent on the regulatory context, the balance of power and the similarity between the controlling shareholders. Third,

[1] We will be using the terms ̆second-tier shareholders ̈or ̇large minority shareholders ̈interchangeably to designate the large shareholders who come after the principal shareholder in terms of cash flow rights.