

An Empirical Analysis of Employee Ownership, Performance and Governance

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ABSTRACT

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The impact of establishing governance mechanisms on performance in the presence of employee ownership is equivocal and not yet conclusive. This contribution aims to provide evidence, empirically, whether the governance mechanisms having a positive impact on performance and whether this relationship is conditioned by the existence of employee ownership of companies. Our empirical approach, conducted on a sample of 108 French companies listed on the stock exchange at the index 120 and focused on the discriminating analysis technique, certifies that the proxies used for measuring governance mechanisms contribute significantly and positively to the performance of companies while the contribution of employee ownership is proved to be suitable to ensure the company's performance only if it manages to establish beforehand a good governance system.

KEYWORDS: *employee ownership – performance – governance - discriminating analysis - well classified.*

Introduction

If the issue of the link between performance and employee ownership is theoretically confirmed in most analyses and empirical works on different samples of companies [Ginglinger et al, (2011); Hollandts and Guedri, (2008); Trébucq,(2004); kruse et al, (2010); kim and paige, (2011); Freeman et al, (2011) and others], the preponderant role of governance mechanisms in the improvement of company performance cannot be concealed. As a matter of fact, the establishment of these mechanisms is considered not only as a means to make the management procedures effective - involving the company within a framework of transparency, and optimal and informational efficiency [Faleye et al, (2006); Ginglinger

(2013); Pendleton and Robinson, (2010); Pagano and Volpin, (2005); Bova et al, (2012) and others] - but can also positively impact the employee ownership practice.

This paper aims at blurring and empirically identifying the link between these three fundamental concepts namely Performance, Employee Ownership and Governance in order to see whether the governance mechanisms represent the determinants of company performance in the presence of employee ownership, and thus answer the two following questions:

- Are the governance mechanisms determinants and explanatory for the company Performance (direct positive effect)?

- Do the governance mechanisms induce the Performance in the presence of employee ownership, allowing us to generate an indirect positive effect between Governance and Employee Ownership?

In a first section, we will try to explain the objectives of this empirical study conducted on a sample of 108 French companies listed on the stock exchange, and to detail the approach adopted consisting in the application of discriminating analysis (1.), often used in the multi-variable analyses. A second section will be devoted to the presentation of variables used, and outlines the statistical and analytical interpretations of the results obtained (2.).

1. Objectives of the empirical study and approach adopted

After getting the sample set up and forming the two a priori groups (G1:Performing Companies; G2:non-performing Companies), referring to the following profitability indicators: the financial (ROE) and economic (ROA) profitability as well as the Market To Book (MTB) variable, our objective consists, at a first stage, in visualizing the evolution of these three indicators over the period from 2000 to 2012 so as to be capable of affirming whether the company will be classified in G1 or G2.

Therefore, on the basis of the study of evolution of these indicators, this analysis aims to predict a company belonging to one of these two groups:

Group 1: Performing Companies

Group 2:Non-Performing Companies

An uptrend of at least two performance indicators proves the performance of company. However, the decline or decrease of these rates over time testifies the vulnerability of the company to assure its performance.

Following this initial analysis, the sample decomposition in performing (G1) and non-

performing (G2) companies have resulted in the following:

Summary (composition of two a priori groups)

Companies	Number
Performing companies (G1)	58
Non- Performing companies (G2)	50

In order to find these two groups of companies, we apply the technique of discriminating analysis, using variables measuring employee ownership and governance measures. After identifying a certain number of variables whose discriminative power is satisfying, this technique refers to the use of one or several discriminating functions resulting from these variables.

Thus, thanks to the discriminating function composed of the variables of the employee ownership and the governance that will be generated, we are able to classify these companies correctly in the two groups formed a priori (finding a high percentage of well classified) and to predict a new company belonging, knowing its data of the employee ownership and governance.

The analysis conducted will allow us to determine the “percentage of well classified” in each of the groups targeted. In other words, owing to the discriminating analysis, the first group will identify the appropriate discriminating canonical function(s) and estimate their discriminating power in the sample used for determining the initial functions. The discriminating functions of the first group can then be applied to the data of the second group, considered therefore as validation sample. As a result, this method seeks to maximize intergroup variance for better discrimination.

2. Estimation and interpretations of results

2.1 Presentation of model variables

The matrix of data used will be (108 x 8=864: (108 companies* 8 variables) :

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Variables measuring employee ownership:

Percentages of shares held by employees in the capital (SHEQ)

Performance of dividends distributed (DPR)

Variables measuring mechanisms of governance:

Separation of ownership and control: the measurement retained for this variable is the following: binary variable taking value 1 when there is a separation of ownership and control, and 0 otherwise (SEPA) [Faccio and Lang, (2002), Bigelli and Mengoli, (2004), and Ben-Amar and André, (2006)].

Accumulated functions of chairman of the board and chief executive officer (CUMUL)

It is about a binary variable taking value 1 when the control shareholder does not combine the functions of chief executive officer and chairman of the board, and 0 otherwise.

Size of board of directors (number of directors) (TCA)

Jensen, (1993) considers that a large board of directors accentuates agency conflicts within it and leads the company to undergo communication costs and high coordination. According to Jensen, the optimal size of board consists of 7 to 8 members. Thus, the measurement retained for this variable is as follows: A dichotomous variable taking value 1 if the number of directors is less than or equal to 8 and 0 otherwise.

The control variables:

Company age (AZE): The age of firm has been often considered as a variable able to have a very significant effect on performance. In general, the variable age of the company is expressed as the logarithm of the number of years in practice [Brown et al, (2006), Ben Cheikh and Zarai, (2008)].

Company size (TAILLE): The size of company is also considered as a key variable in explaining performance. Used by many authors, this variable could have at the same time direct and indirect

effects on the said presupposed. Several measures have been retained to assess the size of company [Bahagat and Black, (2001), Andres et al, (2005), and Hergli, Bellalah and Abdennadher, (2007), using the “log (sales)” measure that we will retain.

Company indebtedness (ENDETT): The debt level of the firm expresses the debt burden supported by the company that may have an impact on the discipline of leaders [Andres et al, (2005); Peter et al, (2005); Hergli, Bellalah and Abdennadher, (2007)].

To take into account this debt effect on performance, we use the ratio of debt book value and total assets. This measure has been used by most authors who integrate the debt of company as variable in their models [André and Schiehl, (2004), Andres et al, (2005), Hergli, Bellalah and Abdennadher, (2007)].

2.2 Statistical analysis

The software used for the application of discriminating analysis is the (SPSS 15).

This table shows not only the total number of observations analyzed but also units excluded in the analysis. It gives a brief description of the processing of all observations for analysis.

Unweighted Observations		N	Percent
Valid		108	100,0
Excluded	Missing group codes or out of range	0	,0
	At least a missing discriminating variable	0	,0
	Missing group codes or out of range, and at least a missing discriminating variable	0	,0
	Total – excluded	0	,0
Total – observations		108	100,0

We get the following information:

- A number of 108 companies are targeted in the analysis, which corresponds exactly to the total number of individuals. These represent a percentage corresponding to 100%. Thus all the 108 units treated are valid, and so missing data have been reported.

The differences between the groups of targeted companies are obtained from the Statistical table of groups. It also shows intra-group statistics i.e., inside each group such as the average, the standard deviation of each variable in the model as well as the weight of individuals.

Therefore, the variance of averages in each group can be observed and interpreted, thereby judging the presence or absence of a wide variety. The diversity in group i relative to a given variable is measured by the coefficient of variation (Cv) that is calculated from the standard deviation (σ). We have : $Cv = \sigma / X \text{ moy}$.

For all coefficients of variation higher than 0,3, we can associate the corresponding variable with a variable through which there is a large diversity within companies concerning their good or poor level.

According to our results, we can retain that:

- In all these targeted groups, there is a large diversity within units observed. This is less important in group 1 than in group 2.
- The weight of individuals is, in this order, more important in groups 1 than in groups 2 with valid numbers that are respectively 58 individuals and 50 individuals.
- Whether weighted or not, these numbers are identical in each of these groups.

In many studies, the validation of an analysis has to be estimated in accordance with some indicators resulting from steps such as:

- **Equality tests of averages of groups,**
- **Matrices combined intra groups,**
- **The Box test of covariance matrices equality**

The equality tests of averages of groups:

This step allows testing if all different averages are equal or not so as to distinguish the characteristic variables having a discriminating power and those that do not have. Each of these characteristic variables chosen for the model establishment is tested.

This test is mainly based on a Fisher F, on an error of meaning and on the Lambda de Wilks.

- Equality tests of averages of groups:

	Lambda de Wilks	F	ddl1	ddl2	Meaning
CUMUL	,480	114,892	1	106	,000
SEPA	,211	125,31	1	106	,000
TAILLE	,368	102,41	1	106	,000
ENDETT	,573	78,983	1	106	,000
SHEQ	,317	101,5	1	106	,000
DPR	,990	1,053	1	106	,307
AEZ	,966	3,688	1	106	,057
TCA	,963	4,099	1	106	,045

We retain:

- **The Lambda de Wilks** is always inferior to 1 ($Lw < 1$), and when Lw tends towards the value zero (Lw tends towards 0), the corresponding value has a big influence in the model. Therefore, it becomes increasingly selectable in the model.

- **The Fisher** is associated with two degrees of freedom whose first degree of freedom (ddl1) is equal to $1(k-1$ or $2-1)$ and the second degree of freedom (ddl2) is equal to 106 ($N-k$ or $108-2$).

For any variable, the bigger the corresponding Fisher is, the more chances it has to be retained in the model.

The meaning "sig" is based on two assumptions:

Ho: $\text{sig} > 0,05$, the averages are identical in the different groups. In this case, for any independent

variable corresponding to this sig value, we retain that this has no discriminating power, so it will be excluded from the model.

H1: $\text{sig} < 0,05$, there is at least one average that differs from others. In this case, for any independent variable corresponding to this sig value, we retain that this has discriminating power, so it will be retained in the model.

According to the results found (table 2), we can affirm that:

- The variables (SEPA) and (CUMUL) used as proxies to measure the mechanisms of Governance are the most discriminating with a high F.
- The variable (SHEQ) is the sole measurement indicator, practice of employee ownership having a high F, and will consequently be retained in the remainder of the analysis.
- The variables (TAILLE) and (ENDETT) are the two most discriminating control variables, and they will be retained in the remainder of this modeling.
- Furthermore, the two variables (AEZ) and (TCA) will be eliminated due to their low value and invalidity of identifying the two groups of companies.

In the remainder of this modeling, only variables (SEPA), (CUMUL), (SHEQ), (TAILLE) and (ENDETT) will be retained to determine the most appropriate discriminating function.

The matrices combined intra-group

These matrices tell us about the existence of a matrix of correlation and covariance for the data set regardless of the group of belonging.

The goal is to know whether there is a significant link between the variables in order to avoid a phenomenon of redundancy.

Thereafter, when two characteristic variables are correlated (and the correlation exceeds 0,80), instead of taking both at the same time, we are

restricted to a single variable and we exclude the other from the model.

We retain these some following information:

- A correlation line-column whose value is equal to the unit (or 1) corresponds to intersection of a variable with itself. We find these unitary values of correlations at the level of the diagonal of this matrix.
- There isn't a phenomenon of redundancy between the variables used since the coefficient values of correlation between all variables are all inferior to 0.80.

The rest of the analysis will be conducted with the five variables, supposed to be the most discriminating and not representing multi collinearity problems.

Box test of covariance matrices equality

This test allows determining whether the matrices in the correlation are identical or not. When these latter are identical, we can say that variables retained do not allow developing a good model. On the other hand, we can conclude that these variables retained are able to promote the differentiation of groups of companies.

To interpret the Box Test of covariance matrices equality, we firstly deal with its principles, analyzing the table Determinants Log, and secondly with its results analyzed, this time, from the Results of test.

Determinants Log		
G	Rank	Determinant Log
1,00	5	-15,245
2,00	5	-13,050
Combined intra-groups	5	-14,125
The natural logarithms and ranks of determinants printed are those of covariance matrices of the group.		

The natural logarithms and ranks of determinants printed are those of covariance matrices of the

group. Each group is associated with a matrix characterized by its rank and its determinant. Therefore, we find all these correlation matrices having rank 5, after having eliminated the variables (AEZ, TCA, DPR), so (8-5) and their magnitude from their determinant vary in a descending manner from group 2 to group 1.

Test Result		
Mot Box		454,629
F	Approx	15,086
	Df1	28
	Df2	37380,981
	sig	000

Tests of null hypothesis of equal population Matrices

Tests of null hypothesis of equal population covariance matrices

The results of the test show that:

- The Box test is mainly based on decision rules. The latter is taken from the following two hypotheses:

H0: If sig <= 0,05, then it becomes possible to choose the variables retained so as to set up a model, which means there is at least a variable holding a discriminating power.

H1: If sig>0, 05, the variables retained have no discriminating power. In such a case, the analysis is invalid.

With the results we have, we have found sig = 0, 00, resulting in the choice of hypothesis H0: building a ranking model becomes possible as there is at least one characteristic variable having a key power. The assumption according to which there is equality is rejected.

- The M of Box obtained is equal to 454.629 (the M of Box has always to be the highest possible). This value can therefore be judged as high. Being given that M of Box is much related to the meaning sig (that has to tend towards value 0),

that is here equal to 0, 00, so we can say that the analysis is valid.

The discriminating power of axes is judged in general in accordance with own values, Lambda de Wilks test and structure matrix.

Consequently, the discriminating canonical functions can be determined from coefficients of discriminating canonical functions, allowing finding the best specification of the model wanted.

Own values

They define the axes that allow justifying the existence of discriminating functions. Determining own values is an analysis stage that allows counting the discriminating function to retain so as to get an overview of different assignments.

The objective then is to prepare the establishment of a model that allows facilitating the allocation of companies according to their group of belonging:

Own values				
Function	Own value	% of variance	%accrued	canonical correlation
1	3,805 ^a	100,0	100,0	,890

a. The 1 first discriminating canonical functions have been used for the analysis.

In reality, the closer the coefficient value of canonical correlation to the unit (value equal to 1) is, the stronger the link between a given discriminating function and the independent variables is.

Our results show that the function found has a correlation coefficient close to the unit (0,895) and a variance explained of 100%. This validates our choice of variables of the discriminating model in an excellent way.

The lambda de Wilks Test

The Lambda de Wilks Test is a test relying strongly on the prediction errors. It allows testing the discriminating function that forms the model.

Lambda de Wilks				
Test of function(s)	Lambda de Wilks	Khi-deux	Ddl	Meaning
1	,208	163,237	4	,000

The meaning of test “sig” determines the discriminating power of the function that is going to specify the model.

The decision is made in accordance with the following hypotheses:

The results of meaning levels of the function is sig = 0, 00. This value is below the threshold of 0, 05, which means that this function has a high discriminating power. As a result, the discriminating function that is going to be retained in the model is as follows:

Coefficients of discriminating canonical functions	
	Function
	1
ENDETT	-1,777
SEPA	5,051
SHEQ	2,25
TAILLE	-,079
CUMUL	-,288
(Constant)	-1,513
non –standardized coefficients	

Judgment of the model quality

To ensure the model quality retained, it is necessary to check the result of ranking of the two groups of companies formed a priori, and if we manage to regain their good ranking with the most discriminating variables retained.

The following table gives the percentage of well classified:

Results of ranking ^{a,c}					
	G	Assignment planned	classe(s)	Total	
Original	Number	1,00	55	3	58
		2,00	3	47	50
	%	1,00	94,8	5,2	100,0
		2,00	6,0	94,0	100,0
Validate d-cross ^b	Number	1,00	55	3	58
		2,00	3	47	50
	%	1,00	94,8	5,2	100,0
		2,00	6,0	94,0	100,0
a. 94,4% of original observations correctly classified.					
b. The cross validation is performed only for the observations of the analysis. In the cross validation, each observation is classified by the functions derived from all the other observations.					
c. 94,4% of validated-cross observations are correctly classified.					

The note (a) marks the model ranking power. So 94.4 % of original observations are correctly classified by the model. We can find this result by adding the numbers of observations that are at the diagonal from the upper part of the table of ranking results. The ratio of total numbers found divided by the total number of all companies gives the ranking power in percentage.

The total number on the diagonal from the top of the table is equal to 55+47= 102.

The number of all companies is equal to 108, hence the model ranking power is equal to 102/108=0, 94. This ratio converted to percentage gives 94.2%, which checks the result provided by the software SPSS 15.

According to the statistical theory, a model making a high ranking of 60% can be considered as acceptable. It is considered as good when it makes 75% of good ranking. However, when a model makes more than 75% of good ranking, it is considered as an excellent model. Since the model



obtained makes 94.4% of good ranking, we can consider it, therefore, as an excellent model.

2.3 Interpretation of results

The function discrimination retained is the following:

$$G(1.2) = -0.079 \text{ TAILLE} - 1.7 \text{ ENDETT} + 5.05 \text{ SEPA} - 0.28 \text{ CUMUL} + 2.25 \text{ SHEQ} - 1.5$$

The variable (SEPA), the most discriminating of the model significantly and positively contributes to the performance of companies even in the absence of employee ownership. This result supports the incentive effect thesis according to which the separation of ownership and control brings about the controlling shareholder, whose increasing voting rights accompanied by an increase in capital, to be more concerned with the performance of his company and to assume the monitoring activities.

A high control rate has lessened the expropriation risk of minority, and it is associated with a greater company upgrading.

This result meets the studies of Holmen and Holmen, (2004); of Faccio Stolin, (2006), and of Ben Ammar and André (2006), and supports the entrenchment effect thesis of the controlling shareholder which posits that the variable “sepa” acts negatively on the performance under the effect of rooting for the controlling shareholder, as it was emphasized by Boubaker and Labégorre, (2006); Bigelli and Mignoli, (2004), and Yen and André (2007), and under the effect of diversification transactions that create more agency conflicts and serve the extraction of private benefits of control [Cronqvist and Nilsson, (2003); Boubaker and Labégorre, (2006), and Thraya and Albouy, (2013)].

The positive effect of the variable (SEPA) on the performance can also be explained by the robustness and effectiveness of the legal

environment and the presence of extra-legal institution developed in France, our scope of investigation, that provides rigorous protection by preventing the phenomenon of “Tunneling”, materialized by a transfer of assets and profits of the company for the benefit of controlling shareholders. This result is consistent with the works of Dyck and Zingales, (2004); Djankov et al, (2008), and Srinidhi et al, (2009) who foresee that the development of financial markets of this country and activism of its employees enjoins the controlling shareholder, careful about his good social reputation, not to extract private benefits through harmful operations.

The variable (CUMUL) also has a very high discriminative power, but has a negative effect on company performance. This negative effect can be explained, according to the teachings of agency theory, by the fact that this combination of the functions of chief executive officer and chairman creates-on the one hand- a divergence framework that promotes interest conflicts, by giving the leader the right to exercise an influential role on the Board and to abuse his power, and strengthens-on the other hand-the dependence of directors on leaders, making the control exercised by the Board unsuccessful even ineffective, which is consistent with the works of Jensen, (1993); Kin et al, (2009); Tuggle et al, (2008) and Sarkar et al, (2009). The negative impact of the variable “CUMUL” on the performance can also be explained by the entrenchment of the controlling shareholders who, under the effect of holding a quota share of voting rights largely higher than their profit rights, benefit from the scope of this power for adventure in diversification operations that reduce the effectiveness of supervision exercised by the Board, which is consistent with the theoretical developments advocated in the framework of stewardship theory whose proponents plead for the thesis of combining the functions of chief executive officer and chairman

[Sridharan et al, (1997); Bhagat and Bolton, (2008)].

The control variable (ENDETT) is correlated negatively in terms of performance. This result can be explained by the fact that a heavily indebted company risks losing its financial autonomy and compromising its normal activities. For better performance, the company must diversify its funding methods, and ensure subsequently its credibility with funders and its capacity to honor its commitments to deadlines.

Moreover, the variable (TAILLE) is negatively related to performance. This result can be explained by interest conflicts that can emerge in the presence of a set of coalitions in a large company, being able to affect negatively labor relations and jeopardizing the managerial performance.

As a consequence, the Governance mechanisms allow identifying the belonging of companies in the two groups and they are a key to their level of performance. The variable (SHEQ) which is a measure of employee ownership contributes positively to company performance in a governance context, i.e., in the presence of governance variables [SEPA, CUMUL]. This result can be explained by the low equity of the employee shareholders of the companies of our sample (minority shareholders). Thus, at low level, employee ownership is considered as a mechanism of motivation and incitement that improves the company's performance. However, at significant level, employee ownership will be a destructive rooting lever thereof, which is consistent with the overall results and findings of empirical works in the context of the examination of the potential impact of the employee ownership on the performance.

This result can also be explained on the basis of the participation of employees in corporate governance. Indeed, the institutional participation to which employee shareholders can claim has a

role in some kind of internal governance of leaders and grows human capital investments of employees represented, which is consistent with the theoretical findings identified about this. As a matter of fact, this device can give the employee shareholders certain control rights, allowing them not only to protect their investments in specific human capital [Bompont and Marois, (2004); Royer et al, (2008)], but also to strengthen the governance in its four dimensions: shareholder, partnership, cognitive and behavioral.

Conclusion

Through the application of the discriminating analysis technique, we have tried to identify the variables measuring the most discriminating mechanisms of the governance and of employee ownership, capable of affecting the belonging of 108 French companies listed on the stock exchange, our starting sample. The discriminating analysis technique conducted has allowed us to regain the belonging of these companies to two groups formed through the selection of variables having a high discriminating power and to identify the most appropriate discrimination function. It is apparent from our empirical work that the proxies used to measure the governance mechanisms contribute considerably and positively to the performance of companies. Simultaneously, the practice of employee ownership allows regaining the belonging of companies to groups agreed upon, and represents a determinant to performance in the presence of good governance variables. Thus, the contribution of governance mechanisms onto the performance of companies is confirmed whereas that of the practice of the employee ownership is conditioned by the presence of good governance system. This leads us to conclude that the contribution of employee ownership is proved to be suitable to ensure the company's performance only if it manages to establish beforehand governance mechanisms based on transparency, division of leadership and control

tasks as well as consultation among various stakeholders.

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