



DIRECTORS' BOARD CONTROL AND DIVERSIFICATION DECISION IN TUNISIAN COMPANIES

Manel Gharbi

Ph.D. Student; Finance and Accounting Methods, University of Sfax, Sfax, Tunisia

Anis Jarboui

Professor; University of Sfax, Sfax, Tunisia

Abstract

The purpose of this paper is to identify the various indicators that are more likely to explain the corporate diversification decision. In addition, it examines the relationship between board composition and the diversification decision among the Tunisian firms. Our sample is composed of 111 Tunisian companies studied over the period ranging between 2011 and 2013. Our findings reveal that the percentages of outside directors have positive and non-significant relationship with the diversification decision. Also our results confirm that there is negative and non-significant association persisting between ownership concentration and diversification.

Keywords: Board of directors, diversification, executive, control block

1. INTRODUCTION

While a very large body of research examines different aspects of corporate governance and mechanisms' (Jeffrey *et al.*, 2015); (Gera *et al.*, 2014), little has been documented regarding the impact of governance mechanisms on the diversification decision (Anderson *et al.*, 2000) and (Larcker *et al.*, 2007). If we are interested in diversification decision, it is because the global financial crisis of 2008-2009 has led practitioners and researchers to question many widely-held beliefs about business and economics. One such belief relates to the value of corporate diversification. Corporate governance mechanisms seem to have a powerful link with the managers through their impact on firm decisions (Hambrick *et al.*, 2015) and (McNulty and Stewart, 2015). This study contributes to the literature by providing insights into the mechanisms and factors that are associated with diversification decision. In this regard, examination of governance mechanisms offers the potential for more insightful analysis of diversification decision. Hence, the objective of this study is to investigate the impact of governance mechanisms on the managers' diversification decision. This study includes the directors' board and the ownership structure. Through a study sample composed of 111 Tunisian companies studied over the period ranging between 2011 and 2013, we perform conditional logistic regression analyzes. Our results conceived to pave the way and inspire further horizon for potential theoretical and empirical research. We find a non-significant and positive association between outside directors and diversification decision. We also find that the ownership concentration (BLC) and diversification decision are negatively and significantly associated. The remainder of this study is organized as follows. Section 1, study context and research hypothesis, section 2, methodological aspects, section 3, results and discussion, and section 4, conclusion.

Corresponding author's
Name: Manel Gharbi
Email address: gharbimanel81@gmail.com

2. STUDY CONTEXT AND RESEARCH HYPOTHESIS

2.1. Theoretical framework

According to international studies on corporate governance, the administration Board is an essential and crucial governance mechanism. In addition to business and financial issues, boards of directors must deal with challenges and issues relating to corporate governance, corporate social responsibility, and corporate ethics. However, most studies dealing with this particular subject have predominantly been conducted with respect to major listed companies. The study of maps within entrepreneurial companies' remains is still in its infancy stage. Actually, the board's composition in terms of internal or external origin along with the independence of its directors stems usually from a willingly deliberate decision and is, therefore, an intentional and specific governance mechanism.

With referring to the recent research, two theories have been advanced to explain why some companies decide to separate the chairman and the Chief executive officer functions, as well as, adopting the dual structure leadership. Actually, they consist in the agency theory and the normal succession. One regarding the agency theory, it states that the board function is rather a disciplinary function. It helps especially to measure and control the major decisions taken by the managers (Hadiji *et al.*, 2010). Also, boards directors can influence the executives managers' performance along with determining their remuneration (Stevenot, 2005). Furthermore, the theory provides also that the dual leadership structure aims to control the agency costs.

2.2. Research hypotheses

In this regard, we consider it convenient and useful to be limited to formulating two major hypotheses: control through external directors and ownership concentration. The executive's incentive to diversify their business most often from several factors. Among the actors who are indirectly involved in intervening in this context, one could well cite council's Board (Jarbouli, 2008). Consequently, company control is usually determined through the power related to the ownership structure, separation of functions, small-size board as well as the presence of outside directors (Ellili, 2007).

In this context Fama and Jensen (1983), believe that the separation of the decision taking functions (initiation and implementation of investment projects) and decisions' control (investment ratification and monitoring) help well reduce agency costs and, therefore, improves business company performance. This denotes well that the highest level of the decision control structure (directors' board) should not be occupied simultaneously by the highest decision-taking level (the executive). Similarly, the authors state that the effective separation between decisions' management and control requires the separation between both responsible persons occupying these positions. In effect, the directors holding the position of board chairman represents the most crucially serious situation for shareholders. As they might well act against the shareholders' wealth. One holding the position of board chairman, the executive would certainly have a remarkable influence on the board functioning and simultaneously running operation especially on meetings conduct and remuneration fixing. He should never simultaneously hold the position of directors' board Chairman; otherwise, he would have tremendous power within the company and would likely well reduce the effectiveness of control mechanisms.

As far normal-succession theory, it implies that the separation between the executive and board chairman emerges as part of the normal process of succession applied to substitute dismissed executive / president (Jensen and Meckling, 1993). Concerning the new leader, he must go through a review check period, during which the directors assess his performance and determine whether they are ready or not to hold the board Chairman Position. In this regard Davidson *et al.* (1990) stress that, in such a case, the separation between the position of executive and board chairman would necessary lead to improving the company performance. Yet other authors have universally discovered that the joint responsibilities of executive and board chairman would likely help in improving performance. For them, firms with a single person holding both positions of CEO and directors' chairman tend to display effective performance (Rechner and Dalton, 1991) and (Pi

and Timme, 1993) and (Fosberg and Nelson, 1999). The latter favor the non-separation of functions option as the belief that it guarantee to maintain a better strategic vision. According to Brickley *et al.* (1997), the director holding the of Board Chairman position help well in enhancing and facilitating decision-making in companies with high growth opportunities or operating in high-tech activity sector. In fact, poor control by managers offers hems more freedom in their strategic choices (Jarboui, 2008). However, Controlled managing directors usually have a tendency to implement diversification policies (Amihud and Lev, 1981). If one is to assume that internal directors do actually detain knowledge and withhold information about the company (Baysinger and Hoskisson, 1989) and (Godard, 1997), it appears to be logical, then, that they would provide executives with a compensation system based on objective criteria, given the thorough knowledge, they enjoy regarding, the company and the executive, as already mentioned (his competence, qualification etc. ...). Besides, it also consists in a strategic control over the executive. Most often, such a control generates a strict discretion margin along with rather limited decision-making scope likely to eventually result in a handicap with regard to innovative investments, diversification etc. (Jarboui, 2008). Hence, the inside directors' dominance of the board council would certainly result in a greater enhancement for R & D and innovation as this involves long-uncharacterized strategy and vision. Nevertheless, executives discouragement to diversify the company would seem remarkably noticeable.

Indeed, the outside directors are usually those who are closely associated with financial control (Baysinger and Hoskisson, 1990) and (Godard, 1997). Consequently, the executive would turn one to be most at risk and, therefore, appeal to diversification as a mean whereby to reduce the risk to which he is exposed. So, the dominance of outside directors on the board would yield a greater incentive to diversify, as a convenient shield against risk (Godard, 1997). Within the same lineof, though, Markides (1995) has conducted a study in which he has proved that the dominance of outside directors in the board turns out to increase the risk for the executive and entices him to undertake unrelated diversification to reduce managerial risk. Actually, this independent over-diversification policy proves, most often, to be destructive of value. In this way one could well conclude that the more control is placed in the hands of outside directors, the more reduced levels of diversification would follow.

At this level, enough elements likely to help formulate the hypothesis concerning the directors' Board on the diversification, have been called, based on the advanced literature. Hence, the following assumptions could be put forward:

H1a: The presence of outside directors on the directors' board has a negative effect on the managers' diversificationdecision.

H1b: A positive relationship persists between the shareholders' control intensity and the executives' capacity to diversify.

3. METHODOLOGICAL ASPECTS

3.1. Research variables' measurement

In this respect, each set of variables will be dealt with separately namely the variables to explain, the explanatory variables as well as the control ones.

3.2. The variables to be explained (endogenous): The diversification decision

In so far as the present work is concerned, the diversification consists in a binary variable that takes the value 1 if diversification proves to be high and 0 if it is low. We have opted for calculating the diversification average as recorded during the three years (DIV (2011) + DIV (2012) + DIV (2013)) / 3; we have then proceeded with classifying the high and low qualifications by means of computing the reached values' median.

Yet: 0: be a low diversification And 1: a strong diversification.

3.2.1. The explanatory, exogenous variables

3.2.1.1. Ownership concentration

It consists in measuring the capital share held by the major shareholder. This measurement has also been applied by [Godard \(2005\)](#) with regard to the French context, as well as [Jarboui \(2008\)](#) regarding the Tunisian context.

3.2.1.2. Outside Directors

This variable is measured via the proportion of outside directors taking part on the board, the number of outside directors / the total number of directors.

3.2.2. Control variables

It is worth noting that the ownership structure and the directors' board, along with other factors, are not the only elements that help influence the diversification decision within the company. In fact, there exist other pertinent elements, such as leverage level, company size, financial structure and performance which jointly intermingle in determining the strategic choices particularly the firm's decision to diversify.

3.2.2.1. Leverage ratio

In this respect, [Taylor and Lowe \(1995\)](#), and [Mansi and Reeb \(2002\)](#) have documented observed that the most diversified companies appear to have the highest level of debt (at book value). As a matter of fact, the level of Debt could well control a number of factors. In a first place, it helps control managerial discretion which has made. ([Stiglitz, 1988](#)) states that the debt issuance increases the managers' voting power by rendering control of their activities implement. In a second place, as [Jensen \(1986\)](#) has declared managers often resort to issuing debt take signal of their ability to generate the cash flow necessary for paying interests and principal. Thus, debts are usually used to resolve conflicts prevailing between managers and shareholders and reduce managerial discretion along with lessening the consumption of benefits ([Ellili, 2007](#)). In addition, high debt levels would entice managers to diversify activities for the sake of minimizing risk ([Jarboui, 2008](#)). This variable is measured through total debt to total assets ratio.

LEV = Total debt / Total assets

3.2.2.2. Company Size

Company size could well stand as an explanatory factor for the choice of the investment nature, financing mode as well as performance. To note, the diversification level is positively associated with firm size ([Jensen & Murphy, 1990](#)). So, the greater the firm size is, the more complex the company turns out to be, and the more significant the managers' discretionary score is, the more diversified the firm would appear to be ([Jarboui, 2008](#)).

In fact, three measures could be determined with regard to this particular variable namely:

- The salaried personnel
- The sales' volume
- Total assets.

As far as our study case is concerned, this variable is measured via the decimal logarithm CA, as follow: Size = LOGCA

3.2.2.3. Performance

This variable is measured through net profit to equity ratio. ROE = Net profit / Equity

The following model is used to test the hypotheses:

A Multi-varied analysis will be undertaken through the following logistic regression, such as:

$$Div = a_0 + a_2 + a_1 ADEXT + a_3 BLC + a_4 LEV + a_5 SIZE + a_6 ROE + \epsilon$$

Where;

DIV: A binary variable that stands for diversification;

ADEXT: Outside directors; the number of outside directors / the total number of directors;

BLC: Ownership concentration, as measured by the proportion of capital held by the major shareholder;

LEV: Leverage or debt level, a variable measured by the ratio of total debt to total assets

SIZE: The CA decimal logarithm of sales, the denoting size

ROE: Performance as measured by net income / equity

The following table depicts the different variables relevant definition and measurement as a recapitulation, we consider it necessary to identify the various variables, along with their relevant descriptions and measurements as illustrated in the following table:

Table 1: Summary of operationalization of variables

Variables	Descriptions	Measurements
Endogens variables:		
DIV	Diversification	It consists in a binary variable that takes the value 1 if diversification proves to be high, and if it is low
Exogenous variables:		
BLC	Ownership concentration	This variable is measured through the capital share held by the major shareholder
ADEXT	Outside Directors	This variable is measured via the proportion of outside directors taking part in the board: the number of outside directors / the total number of directors.
Control variables:		
LEV	Leverage	This variable is measured through total debt to total assets ratio
SIZE	Company size	This variable is measured via the decimal logarithm CA
ROE	Performance	This variable is measured through Net profit to Equity ratio

3.3. Sample selection and data collection

3.3.1. Research instrument

Following the track undertaken by qualitative research works, the choice of sample size turns out to be also equally important with respect to quantitative studies. Yet, the selection criteria appear to exhibit a different nature, while the adequate sample size proves to be that which helps achieve the theoretical saturation. Given our particular research subject matter and study context, we have considered it useful to found our empirical study on a questionnaire survey, with the major objective being to test the research advanced hypotheses. On elaborating the questionnaire, a special care has been paid to combine two different objectives, namely:

- The questionnaire should help in accurately measuring the entirety of the theoretical model's variables.
- It should be clear enough and not too long for responders.

In addition, a special care has been made to develop a logically and coherently structured questionnaire.

3.3.2. Study sample description

Our initial sample consists of 186 listed and non-listed Tunisian companies. After removing the insurance and banking sectors' pertaining companies along with firms whose managers' access to respond to the questionnaires has been impossible and regarding which data necessary for conducting the study have been insufficient. Hence, our final sample reached turns out to consist of 111 Tunisian companies undertaking either industrial, service or commercial activities (see table below).

Table 2: Sample used in analyzers

Description	
Initial BVMT sample for 2011	55
Financial firms	-23
Other non-financial firms	113
Insufficient data to psychological characteristics	-27
Insufficient data to assets revaluation	-7
Final sample	111

3.3.3. Data sources

It is worth noting that ownership and diversification related data have sometimes been collected by proper means, based on annual reports, companies websites as well as the Tunisian stock exchange (TSE) relevant site BVMT, at other times, data have been gathered through managers' proper responses to the questionnaire. Other data stem from the directors' proper and direct responses to the questionnaire.

4. RESULTS AND DISCUSSION

The present section has as a major objective providing an initial empirical test helping to assess the board's supervisory role on managers in a bid to determine the Tunisian firms' strategic behavior along with providing a plausible consolidating answer to the question of a persistent link binding the existence of outside directors on these companies and the latter's diversification level.

4.1. Descriptive analysis

The sample firms' major characteristics are depicted in the following table:

Table 3: Descriptive statistics N = 111

Variables	Mean	Min	Median	Max	Std. dev.
BLC	66.541	50.000	64.430	81.820	21.795
ADEXT	13.629	0.000	0.000	26.670	22.966

As regards ownership structure, one could well notice that through the tables' depicted descriptive statistics it appears well to be variable. In fact, 66.54% of the subjects of our sample prove to have a majority shareholder holding 50%, or more, of company capital (BLC).

4.2. Correlation analysis

On analyzing the correlation matrix, one might well note that it clearly reveals that the explanatory variables turn out to be uncorrelated. Besides, a negative relationship appears to persist between the external Directors (ADEXT) and the ownership concentration (BLC). However, the matrix indicates highlights the prevalence of a positive relationship between the external Directors (ADEXT) and the control variables (LEV, SIZE, and ROE).

Moreover, a negative link appears to persist between ownership concentration (BLC) and both debt (LEV) and the firm size (SIZE) while a positive relationship appears to prevail with performance (ROE).

The aim of the analysis is to see if there is any multicollinearity problem among the variables and association among variables. According to [Tabachnick and Fidell \(2007\)](#), the problem exists if independent variables are highly correlated with each other with correlation values exceeding 90%. However, none of the variables found to be more than 0.5. The highest correlation is between external Directors (ADEXT) and the firm's performance (ROE) that is 0.870 which suggests that multicollinearity is not a serious problem that would jeopardize the regression results ([Tabachnick and Fidell, 2007](#)).

Table 4: Correlation coefficients of dependent and independent variables

	N=11	ADEXT	BLC	ENDET	LOGCA	ROE
ADEXT	Pearson Correlation Significance (bilateral)	1				
BLC	Pearson Correlation Significance (bilateral)	-0.123 0.200	1			
LEV	Pearson Correlation Significance (bilateral)	0.289** 0.002	-0.122 0.204	1		
SIZE	Pearson Correlation Significance (bilateral)	0.087 0.361	-0.323** 0.001	-0.262** 0.005	1	
ROE	Pearson Correlation Significance (bilateral)	0.016 0.870	0.071 0.461	-0.133 0.163	0.009 0.922	1

*: Correlation is significant at the 0.05 level (bilateral)

** : Correlation is significant at the 0.01 level (bilateral)

For the sake of finding an explanation justifying the association binding board control and diversification decision, we reckon it useful to introduce the outside directors' proposition on the board along with ownership concentration as explanatory variables for diversification. So, a logistic regression has been undertaken whose results appear in the table below (Table 5).

4.3. Multi-variant analysis

Table 5 shows the regression analysis for 111 companies in this study.

An examination of the table reveals well that they reached results appear to be significant exclusively ownership with respect to concentration (BLC) and performance (ROE).

The logistic regression reached results, relevant to model as figuring on Table 4 above seem to indicate well that the model adjustment X^2 has reached the value of 30.297 significance at the 1% level, $p = 0.000$. The Nagelkerke R^2 which is the equivalent of R^2 determination coefficient in the linear regression appears to be equal to 31.9%. This finding devotes well that, as far as the Tunisian context is concerned, diversification is in 31.9% explained by the presence of outside directors as well as ownership concentration, along with the variables' control. In addition, the "Hosmer and Lemeshow" test appears to indicate a non-significant X^2 with a rate of 10.027 ($p = 0, 263$). An examination of the statistical tests as appearing in the tables shows well that the ADEXT variable proves to have a positive and non-significant effect on the diversification decision. Indeed, the ADEXT variable regression coefficient appears to display a positive though non-significant t value at the threshold of 10% as compared to the dependent variable ($a = 0.006$, with p being greater than

10%). These results prove to be actually consistent with the hypothesis predictions stipulating that outside directors are negatively related to the diversification decision.

In fact, these attained results sound to corroborate those published by Godard (2005). Noteworthy, however, the BLC regression coefficient exhibits a negative and significant value at the level of 10%. In respect of the dependent variable (with $a = -0.036$ and $p = 0.002$ being inferior to 10%). These findings seem to be well consistent with the hypothesis predictions stating that the shareholders' exerted control proves to have a positive effect on the diversification decision. This result also highlights that a shift towards diversification strategy stands as a decreasing function of the controlling shareholders' capital percentage. So such a result seems to confirm well the model. A pertaining result such an effect might well have its explanation in the control exerted upon over the managers, for the outside directors are able to curb managerial discretion at the level of diversification.

Table 5: Results of the model's logistic regression

N=111	Endogens variable: diversification level DIV					
	Coefficient a	Std. dev.	Wald	Sig	R ² Nagelkerke	X ² Test
Constante	3.261	1.039	9.853	0.002	0.319	X ² =30.297 P=0.000
ADEXT	0.006	0.010	0.394	0.530		
BLC	-0.036	0.012	9.447	0.002		
LEV	-0.873	0.512	2.912	0.088		
SIZE	0.569	0.478	1.422	0.233		
ROE	-1.479	0.460	10.355	0.001		

DIV: a binary variable that takes the value 1 in the case of high diversification and in the case of low one. We have opted for calculating the diversification average as recorded during the three years $(DIV(2011) + DIV(2012) + DIV(2013)) / 3$; before proceeding with classifying the high and low qualifiable by means of computing the reached values' median.

ADEXT: External Directors, the number of outside directors / the total number of directors.

BLC: Ownership concentration as measured by share the major shareholder's capital proportion.

LEV: Debtedness, a variable measured by the ratio of total debt to total assets. A binary variable that takes the value 1 if the debt value is very high and 0 if it is low. We have chosen to the calculation of the average value recorded during the three years $(LEV(2011) + LEV(2012) + LEV(2013)) / 3$; we have then proceeded with classifying the high and low qualifications via computing the reached values' median.

SIZE: the CA decimal logarithm of sales, the size. A binary variable that takes the value 1 if the size is high and 0 if it is low. We have opted for calculating of the average size for the 3 years $(SIZE(2011) + SIZE(2012) + SIZE(2013)) / 3$; then, we have proceeded with classifying the high and low qualifications through computing the reached values' median.

ROE: performance as measured by net income / Equity. A binary variable that takes the value 1 if performance proves to be important, and 0 if it appears to be low. We have opted for calculating the average size recorded during the three years $(ROE(2011) + ROE(2012) + ROE(2013)) / 3$; then we have proceeded with classifying the high and low qualifications through computing the achieved values' median.

5. CONCLUSION

The present work has been focused on analyzing the diversification determinants of Tunisian companies within the context of governance theories. The empirical validation has concerned 111 industrial, service and commercial enterprises. Just like any research, the present study does involve some limitations. The Tunisian companies' diversification issue has been apprehended through a diversification score likely to help qualify the company with high or low diversification level based on such an approximate measure.

The observation period, the subject of study, concerns three successive years: 2011, 2012 and 2013. Still the above-mentioned limits should not belittle or reduce the relevance pertinence and importance of the study achieved results, studies which prove sometimes to disconfirm with a number of previously conducted studies.

A major finding recorded following application of multi-varied analyzes is that the existence of outside directors turns out to have a positive and non-significant relationship with companies diversification. Such results appear to be inconsistent with the hypothesis stipulating the outside directors' dominance over the board would help promote the diversification incentive as a means whereby to shield against risk.

Besides, it has also been concluded that ownership concentration level (presence of a control block BLC) proves to have a negative and significant relationship with business diversification. Such results do not seem to confirm with the hypothesis starting that a weakly diversified capital within heavily concentrated enterprises would likely help these companies to restrict diversification decisions (like risk situation). On the other hand, such a finding does not seem to corroborate the hypothesis stipulating that the leaders' participation in the capital does not seem to motivate them forwards taking on more risk.

From a theoretical and empirical perspective, our major though modest lies in the fact contribution that corporate governance mechanisms do not totally stand as neutral vis-à-vis the diversification decision. It is actually the verification of such a hypothesis within the Tunisian context which constitutes the fundamental contribution brought about by this modest study. In this way, the attained findings are intended to supplement a further enrichment to the area of diversification with respect to the Tunisian context.

Ultimately, the present study is also conceived to pave the way and inspire further horizon for potential theoretical and empirical research. Worth highlighting, in this respect, is that the governance mechanisms treated in this work do not constitute the exclusive element likely to help explain corporate diversification level. Indeed, other factors might also intervene to help explain this particular phenomenon such as managerial shareholding, the presence of institutional investors, family ownership structure etc... as factors likely to help affect the leaders' behavior with regard to the diversification decision issue. Furthermore, we tend to further carry out the execution, implementation of such a study by investigating the decision makers' behavior, particularly that of the leader. Actually, both of the latter's behavior and profile may help in remarkably influencing the company's strategy. More importantly, the psychological biases could well be introduced a field study implemented for the sake a more thorough understanding of the human behavior's impact.

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