

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

Spanish Journal of Finance and Accounting  
n° 115, April 2003  
pp. 256-289

## **CORPORATE CONTROL AND CAPITAL STRUCTURE CHOICE IN A FRENCH-CIVIL LAW COUNTRY<sup>1</sup>**

by

*Eduardo J. Menéndez-Alonso and Silvia Gómez-Ansón*

University of Oviedo, Spain

### **Address for correspondence:**

Silvia Gómez-Ansón  
Prof. Titular de Universidad  
Dpto. de Administración de Empresas y Contabilidad  
University of Oviedo  
Avda del Cristo s/n;  
Oviedo 33071  
Phone: 0034-85102825  
Fax: 0034-85103708

---

<sup>1</sup> The Spanish National Program of R&D (Grant BEC 2000-0980) and the Ramón Areces Foundation provided research support for this study. We thank participants at the 28<sup>th</sup> EARIE Conference and the 2001 IFAC Symposium on Modelling and Control of Economic Systems and two anonymous referees for their helpful comments.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY****ABSTRACT**

*This study analyses, using different methodologies, the relation between the firms' organisational structure and their capital structure choice in a civil law country, with closely held and medium size firms. Our findings suggest that entrenched CEOs tend to avoid the use of debt. Leverage levels are lower for firms with larger boards, small levels of managerial ownership and for firms lacking the presence of family groups. Our results also suggest that banks' presence, as shareholders, does not lead to higher debt levels. Exogenous shocks such as CEO's changes or takeovers do not appear to affect firms' total leverage.*

**KEYWORDS**

capital structure, corporate governance, ownership structure, managerial entrenchment, board of directors.

**JEL:** G3, G32

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY****1. INTRODUCTION**

Agency theory predicts that the mix between debt and equity may be influenced by managers' discretionary objectives that do not maximise shareholders wealth (Jensen y Meckling, 1976). Managers' desire to reduce firms' risk (Fama, 1980 and Amihud and Lev, 1981) or to retain jobs (Harris and Raviv, 1988; Stulz, 1988), as well as their dislike of performance pressures linked to fixed interest payments (Jensen, 1986) may influence capital structure decisions. Due to this monitoring role of debt, managers may avoid the use of this form of financing (Grossman and Hart, 1982; Stulz, 1990 and Hart and Moore, 1995). On the other hand, according to Harris and Raviv (1988) and Stulz (1988), managers may use debt to enhance their voting power and reduce takeover threats. For Novaes and Zingales (1995) firms' capital structure choice is influenced by managers' aim to maximize their job tenure.

The empirical evidence supports the link between agency theory and capital structure choice. Both Mehran (1992) and Berger *et al.* (1997) document that, for the U.S. market, entrenched CEOs, those presenting an opportunistic behaviour, seek to avoid debt and Berger *et al.* (1997) show that firms that experience shocks which reduce managerial security present significant leverage increases. Garvey and Hanka (1999) document leverage reductions for firms protected by "second-generation" state anti-takeover laws.

Our study aims to extend the set of empirical studies that analyse how management entrenchment affects capital structure choice. It adds to this literature in several ways. Firstly, it analyses jointly how a firm's governance structure and different economic shocks, i.e. takeovers and CEOs replacements, may affect firm's financing decisions. In this paper, we study not only the possible influence of managerial ownership, ownership concentration or the composition and size of the Board of Directors, on the firm's capital structure, but also

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

how the identity and characteristics of the major shareholders —banks and institutional investors or family groups— may affect the firm's financing decisions. Secondly, our study is not constrained to large firms and the relationship between the firm's corporate governance structure and its capital structure decisions is analysed in a different institutional environment. Most of the empirical literature linking managerial entrenchment to capital structure decisions refers to developed capital markets. Moreover, most studies that examine the role of banks as monitors refer mainly to the U.S. or Japan. The U.S., a common-law country, presents the highest legal protection for shareholders -an anti-director score of five over five- (La Porta *et al.*, 1998). Consequently, U.S. companies have better access to external markets and to debt financing (La Porta *et al.*, 1997). Japan, although a German-origin law country, also presents a high shareholders' legal protection –a score of four over five- and a high external and debt financing (La Porta *et al.*, 1997; 1998). The case of Spain may be interesting for different reasons. Spain represents an example of a French-civil law country, although protection for investors is relatively higher (a score of four over five according to La Porta *et al.*, 1998). Nevertheless, Spanish firms present a high ownership concentration and banks have traditionally played an important role both as shareholders and creditors of quoted companies. Besides, Spain lacks an active takeover market. Also, due to the characteristics of our database – a sample of companies listed in the Spanish Stock Exchange - the study is not restricted to large firms. This fact allows us to test if managerial entrenchment influences firms' capital structure for mid-sized firms. For these firms, considering the high degree of ownership concentration of Spanish firms, the agency problems that arise between shareholders and managers may differ from the ones that are usually present in large American firms.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

The results of the study reveal some new evidence. Similarly, to Berger et al. (1997) we find that entrenched CEOs tend to avoid debt financing. Leverage levels are lower for firms with larger boards and small levels of managerial ownership. We also find that, leverage levels are lower for firms lacking the presence of family groups and that the presence of other large shareholders, such as banks, does not lead to higher leverage. Our results also show that exogenous shocks, such as CEO changes or takeovers, do not affect Spanish firms' financing decisions. This last result suggests that these exogenous shocks may not influence significantly either firms' capital structure, or their corporate governance structure.

The paper is organised as follows: In Section 2 we discuss the models and empirical evidence linking managerial discretion to capital structure decisions. Section 3 describes the sample, the variables used to test the theoretical predictions, as well as the methodology employed. Section 4 examines the relation between managerial entrenchment and firms' leverage. A discussion of the results is presented in Section 5. Finally, Section 6 summarises and concludes the paper.

## **2. CORPORATE CONTROL AND THE FIRMS' CAPITAL STRUCTURE**

Agency theory predicts a link between capital structure decisions and conflicts of interests between shareholders and managers. Debt financing increases managers' share of equity and may, thus, mitigate conflicts of interests between managers and shareholders (Jensen and Meckling, 1976). Debt also reduces the level of free cash-flow by committing the firm to pay-out cash (Jensen, 1986). The models proposed by Grossman and Hart (1982), Stulz (1990) and Hart and Moore (1995) show that, as leverage reduces managerial discretion,

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

managers may choose debt levels that do not satisfy shareholders' desires. Thus, managers may under-lever.

Different empirical studies support the link between managerial discretion and capital structure choice. For Jung *et al.* (1996) firms without investment opportunities experience larger negative abnormal returns around equity issues. Arrondo and Gómez (2002) report a similar result for the Spanish market. The empirical evidence provided by Mehran (1992) and Berger *et al.* (1997) also supports managers choice to under-lever.

Nevertheless, from another perspective, we must point out that the models based on corporate control considerations emphasise the role of debt as an anti-takeover device, predicting that takeovers may induce managers to use higher debt ratios. Harris and Raviv (1988) and Stulz (1988) consider how a firm's capital structure choice may affect managers' control of voting rights and, consequently, the outcome of tender offers. For Novaes and Zingales (1995) managers aim to maximize their job tenure, which is threatened by bankruptcy and takeovers. Therefore, firm performance and the pressure of the market for corporate control determine managers' capital structure choice. Several authors also confirm this view of leverage as an anti-takeover device. Dann and DeAngelo (1988) document significant leverage increases for targets of hostile takeovers, and Denis (1990) reports increases in long-term debt by firms that remain independent after takeover contests. Similarly, Berger *et al.* (1997) document debt increases in leverage after unsuccessful tender offers, involuntary CEOs' replacements and the addition to the Board of a major shareholder.

In this study, we only consider the agency perspective and, therefore, propose the following hypothesis:

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

*H1: Entrenched managers will choose debt levels below the optimum (they will under-lever)*

Different corporate governance mechanisms may align directors' interests with those of shareholders and allow shareholders to monitor managers more closely. Among these mechanisms are those that refer to the firm's ownership structure (i.e. managerial ownership, ownership concentration and the identity of large shareholders) and to the characteristics of the Board of Directors.

According to Jensen and Meckling (1976) managerial ownership will align managers' interests with those of shareholders (alignment effect), and consequently, for firms presenting higher levels of managerial ownership higher debt levels should be expected. Berger et al. (1997) reports for the U.S. market this positive relation between managerial ownership and leverage. Nevertheless, a large managerial shareholding may allow managers to isolate themselves from other control devices, for example, from the Board of Directors (entrenchment effect). Accordingly, different studies report a non-monotonic relation between managerial ownership and firms' market value (Mork *et al.*, 1988; McConnell and Servaes, 1990; Hermalin and Weisbach, 1991; Barnhart et al., 1994; Fernández *et al.*, 1998). Consequently, and considering both the alignment and the entrenchment effect associated with managerial shareholdings, we propose the following hypotheses:

*H2a: Due to the alignment effect of managerial or internal shareholdings a positive relation should be expected between managerial ownership and firms' leverage.*

*H2b: The preponderance of the alignment and entrenchment effect, for different levels of managerial shareholdings, will derive in a non-monotonic relationship between managerial ownership and firm's leverage.*

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

The presence of large shareholders may also influence firm's leverage. Grossman and Hart (1980) show that monitoring and disciplining managers may be prohibitively expensive for small shareholders. Thus, monitoring will only be effective if a single party becomes large enough to internalise the costs of control. Consistent with this argument, different empirical studies take into account the influence of this variable on firm's value (McConnell and Servaes, 1990; Barclay and Holderness, 1991). In that which refers to leverage, Berger *et al.* (1997) document greater debt levels in the presence of significant blockholders. Consequently we propose the following hypothesis:

*H3: In the presence of a high ownership concentration firms will use more debt.*

Not all blockholders may have the same incentives to monitor. Shleifer and Vishny (1986) suggest that banks and institutional investors do not monitor managers' decisions as would be expected. Nevertheless, empirical studies in countries where banks play an important role, both as creditors and shareholders, show that banks' ownership may be beneficial for firms. For example, in the German market, Cable (1985) finds that banks' ownership increases shareholders' wealth. Gorton and Schmidt (1996) document similar results. For the Spanish market, Zoido (1998) reports increases in firms' market values attributable to banks' shareholdings. García-Marco and Ocaña (1999) show that, for firms with a close relationship to banks, investment's decisions are more optimal than for those firms where banks do not exercise control over firms' shareholdings. Therefore, we propose the following hypothesis:

*H4: Banks and institutional investors' ownership will lead to higher leverage levels.*

The presence of family groups may also influence managerial entrenchment. On the one hand, family groups may reduce managerial entrenchment due to their special links to the

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

firm, specially when founders are still alive (Morck et. al, 1988). Nevertheless, family groups may control the firm and select the Board's directors and, thus, entrench themselves above their voting power (Barnhart et al., 1994). In this sense, the empirical evidence reveals that founders may be specially valuable at the beginning of their entrepreneur's life (Morck et al., 1988), while for example Hermalin and Weisbach (1991) do not find any significant relationship between family groups and firm value. Considering the first argument, we propose the following hypothesis:

*H5: The presence of family groups among Board's directors leads to higher leverage.*

The composition of the board and its size are two characteristics that may affect the monitoring role exercised by the Board of Directors. In Spain, the Olivencia Code<sup>i</sup> recommends the presence of three types of directors in the Board: Non-executive directors representing large shareholders, non-executive independent directors and executive directors. Among the Board, the proportion of non-executive directors representing large shareholders and non-executive independent directors should reflect the proportion of large investor shareholdings and be of free-float. It also recommends the establishment of specialized committees composed exclusively by non-executive directors (auditing, remuneration or appointment committees). According to the Spanish Supervisory Agency (2001), Spanish companies are reluctant to adopt this last recommendation (only 45% of the firms declare to establish specialized committees composed exclusively by non-executive directors. Furthermore, in more than 60% of the Spanish firms the Board Chairman or the Vice-Chairman come from the controlling family (Faccio and Lang, 2001).

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

In the financial literature outside directors have been considered to monitor managers' decisions (Fama and Jensen, 1983). Weisbach (1988) finds that the removal of CEOs, caused by poor performance, is more likely to occur in outsider dominated Boards. Byrd and Hickman (1992) report that abnormal returns are significantly higher in bidding firms with outsider dominated Boards<sup>ii</sup>. For Berger et al. (1997) debt relates positively to the proportion of outside directors. Thus, we propose the following hypothesis:

*H6: Firms with a greater proportion of inside directors seating on the Board of Directors will present lower leverage.*

Board size may also influence the effectiveness of the Board's decisions intended to discipline managers. A higher number of directors may provide wider criticism of a manager's actions, but it may also slow down the Board's decision making and increase its politeness and courtesy, lowering, therefore, its level of criticism towards top manager's policies (Lipton and Lorsch, 1992; Jensen, 1993). Empirical findings document a significant negative relationship between a firm's board size and both its value and its debt level (Yermack, 1996, Eisenberg *et al.*, 1998, and Berger *et al.*, 1997). Considering these arguments we propose the following hypothesis:

*H7: Firms with larger boards will present lower leverage.*

Besides these corporate governance characteristics, different economic shocks may also influence the managerial discretion and the firm's financing decisions. Denis and Saris (1999) document that changes in the firms' ownership and board structure are associated to CEOs' changes, corporate control events and firms' prior performance. Accordingly, Berger

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

*et al.* (1997) document leverage increases after shocks that affect governance structures. Thus, we hypothesize:

*H8: After economic shocks, i.e. takeovers or CEOs changes, firms will restructure its capital structure and present higher leverage levels.*

### 3. METHODOLOGY AND SAMPLE DESCRIPTION

#### 3.1. Methodology

In order to analyse how corporate governance structure influences capital structure choice different methodologies are employed: OLS estimates with year effects; OLS estimates with industry and year effects; and “within” estimates (fixed firm effects) that control for the potential effect of unobserved firm heterogeneity. The use of a panel data approach avoids potential misspecifications in the presence of unobserved heterogeneity. That means that if some of the unobserved determinants of leverage are also determinants of the explanatory variables of the model, these variables might spuriously appear to be a determinant of firms’ debt levels. Panel data methodology avoids these distortions caused by possible correlations between unobserved firm characteristics and the set of individual variables (Hausman and Taylor, 1981).

In our model, we assume that leverage ( $Y_{it}$ ) depends on factors such as corporate governance and other firms’ characteristics. We assume that these variables are partly measured by  $X_{it}$ , but also partly unobserved and included in  $u_{it}$ , where  $u_{it}$  represents unobservable heterogeneity. We assume that the function is linear and that  $u_{it}=u_i$  because

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

when applying the Hausman's test, the results reject the hypothesis of the existence of correlation between the regressors and the individual unobservable firm effects. Thus, the unobserved heterogeneity should be treated as a "firm fixed-effect" and therefore time-invariant. The model can consequently be represented as follows:

$$Y_{it} = \mathbf{b}_1 X_{it} + \mathbf{g}u_i + \mathbf{e}_{it}$$

where  $\mathbf{e}_{it}$  is the independent measurement error and  $i = 1, \dots, N$ , being  $N$  the number of firms and  $t$ , the year of the observation.

### 3.2. - *Sample selection*

The database used in our study is composed of all firms listed in Madrid Stock Exchange during the period 1991-1997. We exclude financial firms due to their differential aspects regarding corporate governance structure and leverage. The selection rule requires each company to be quoted at least four years over the period 1991-1997, and that the different variables employed in the study present coherent signs. The final sample after applying these filters consists of 92 firms over eight years, 563 observations (see TABLE 1).

Accounting data was collected from the annual reports and from the Comisión Nacional del Mercado de Valores (C.N.M.V.- Spanish Supervisory Agency) databases. Stock ownership data was obtained from the Spanish Supervisory Agency's data tapes and from the directory "Spain: The Shareholder's Directory". Stock prices were collected from the Madrid Stock Exchange's data-tapes. Data referring to the composition and the size of the Board of Directors was obtained from the Spanish Supervisory Agency's tapes. This data was compared with the data contained in the firms' annual reports. Directors' personal data referring to their present and past jobs, and their family ties with other relevant members of

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

the company, were obtained from the following Directories: Who's Who in Spain, Duns 50,000 and Dicodi.

TABLE 1. Sample industry and annual classification

The sample consists of 92 non-financial firms listed on the Madrid Stock Exchange during the period 1991-1997. The number of observations amounts to 563 observations.

<b>Panel A: Sample industry classification</b>		
<i>Industry (SIC Codes)</i>	<i>Number of observations</i>	<i>Percentage of observations</i>
15	99	17.58%
16	18	3.2%
17	21	3.73%
20	64	11.37%
26	38	6.75%
28	25	4.44%
32	64	11.37%
33	31	5.51%
37	25	4.44%
47	28	4.97%
49	80	14.21%
65	25	4.44%
67	45	7.99%
Total	563	100.00%
<b>Panel B: Sample annual distribution</b>		
<i>Year</i>	<i>Number of observations</i>	<i>Percentage of observations</i>
1991	77	13.68%
1992	81	14.39%
1993	88	15.63%
1994	86	15.28%
1995	85	15.10%
1996	74	13.14%
1997	72	12.79%
Total	563	100.00%

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY****3.3. Variables selection**

TABLE 2 presents the list of dependent and explanatory variables used in the study. The dependent variable, leverage, is defined as the book value of debt divided by total assets (LEV). This variable is defined at the end of each fiscal year.

To analyse the influence of managerial entrenchment on firm's leverage, we include as explanatory variables: ownership variables (managerial ownership, ownership concentration and banks and institutional investors ownership), and variables that describe the characteristics of the Board of Directors (the proportion of executive directors and board size).

In order to measure the effect of managerial ownership (MANOWN) on firms' leverage, we include as explanatory variable the ownership held by the firms' top executive officers and their families. Considering, the non-monotonic relation between managerial ownership and firms' market value reported in several studies (Mork *et al.*,1988), we include in the analysis a quadratic term named MANOWN2. We control for the possible influence of ownership concentration on firms' leverage by including in the analysis variable OWNCON, defined as the fraction of shares held by the largest shareholder at the end of each fiscal year<sup>iii</sup>. In order to consider the influence of different types of blockholders we define variables INSTOWN and BANKSOWN that represent the ownership held by institutional investors and banks at the end of each fiscal year. The possible effect of family groups on firms' leverage is included in the analysis by defining a dummy that takes value one if there are two or more members of the same family seated on the Board of Directors of a firm (DFAM).

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

We consider the composition of the board and its size in order to take into account the influence of the Board of Directors' characteristics on firms' leverage. The Board composition and the degree of non-independence between the Board and the managerial team are measured through the variable representing the proportion of inside directors (BINT). Board size (BDSIZE) is defined as the logarithm of the number of directors sitting on each company's Board at the annual meeting as stated in each firm's annual report.

Finally, we include in the analysis dummy variables that represent shocks that may affect top managers' security and therefore, firms' leverage. These shocks are the following: (a) if a non-routinely CEO's replacement takes place during the year under consideration (DNEWCEO); and (b) if the firm has been the target of a takeover during the same period of time (DACQ). We also consider the differential characteristics of firms that have recently gone public by including a dummy variable representing if the firm has gone public during the year under consideration (DIPO).

In addition to the proposed explanatory variables we control for different factors that may also affect a firm's leverage. Therefore, in the study we include the following variables: a) market to book value of common equity (ME/BE); b) firm size (SIZE), defined as the logarithm of the firm total assets; c) the ratio of fixed assets over total assets (FASSETS) and d) the firm's risk (RISK), defined as the firm's annual change in earnings. We also control for time period or industry (SIC2) effects by including dummy variables. Due to the possible endogeneity of the regressors, all explanatory variables, except RISK, are defined one year lagged.

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

TABLE 2. Description of variables

Variables	Description
<i>Dependent variables</i>	
LEV	Book value of total debt divided by total assets
<b>Corporate governance explanatory variables</b>	
MANOWN	Percentage of shares held by the firm's top executives and their families
MANOWN2	Quadratic of the percentage of shares held by the firm's top executives and their families
OWNCON	Percentage of shares held by the largest shareholder
BANKSOWN	Percentage of shares owned by banks
INSTOWN	Percentage of shares held by institutional investors
<b>BINT</b>	Proportion of executive directors, those who are or have been executives of the company
BDSIZE	Logarithm of the firm's number of directors
<b>DFAM</b>	Dummy variable that takes value 1 if two or more members of the same family are directors of the company
<b>DNEWCEO</b>	Dummy variable that takes value 1 if the CEO of the company is replaced during the year before the period under consideration
<b>DACQ</b>	Dummy variable that takes value 1 if the firm is the target of a takeover during the year before the period under consideration
DIPO	Dummy variable that takes value 1 if the firm has gone public during the year before the period under consideration
<i>Control variables</i>	
ME/BE	Firm's market value over book value of equity
SIZE	Logarithm of the firm's total assets
FASSETS	Ratio of fixed assets to total assets
RISK	Firm's annual growth in earnings

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

### 3.4. Summary statistics

TABLE 3 presents the summary statistics of the dependent and explanatory variables. The total debt ratio (LEV) amounts to a mean value of 40.2%. Managerial ownership amounts to a mean value of 4.44%, a lower figure than the one documented by Morck *et al.* (1988) or Yermack (1996) for the U.S. market<sup>iv</sup>. The largest shareholder owns 34.5% of the firms' shares (mean value). This figure reveals the high ownership concentration of the sample's firms. The Spanish market is a thin, but in importance, increasing capital market dominated by a small number of companies. As reported by Crespí (1999), nearly 70% of effective market turnover is attributed to a small number of companies. Ownership structure in Spain, a civil-law country (La Porta *et al.*, 1997), is characterized by a high ownership concentration and important cross-shareholdings. While in the U.S., on average, the largest shareholder holds 3.6% of firms shares, and in the U.K. 14%, in Spain the largest shareholder holds, as a mean, 40% of firms' shares (Crespí, 1999)<sup>v</sup>.

Banks are significant large shareholders, holding, as a mean 13.4% of the firms' shares. Institutional ownership is close to zero. This is because during the period considered in the study, 1990-1997, institutional investors presence in the Spanish capital market was still almost insignificant. Whereas at the beginning of the decade institutional ownership amounted to around 1% of the shares quoted on the Madrid Stock Exchange, the percentage of shares owned by institutional investors at the end of 1999 amounted to 5.8% (Bolsa de Madrid, 2001).

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

Board size (BDSIZE) varies between 2 and 36 directors and presents a mean value of almost 10 directors. This figure is lower than the one reported for the U.S. market by Barnhart *et al.* (1994) and Yermack (1996), approximately twelve directors, and higher than the one observed for the U.K. by Franks *et al.* (1997), around 8 directors. Inside directors represent a mean percentage in Boards of 37.1%.

The proportion of observations, where family groups are present is fairly high. It amounts to 35.7%, while CEO's changes are only present in 14.4% of the observations. Acquisitions are rare (the percentage of observations for which the dummy variable DACQ equals one amounts only to 7.1%). This figure reveals that, in Spain, the take-over market is not very active (Fernández and Gómez-Ansón, 1999). Accordingly, the monitoring role of takeovers and their influence on the firms' corporate governance structure is not expected to be large. IPOs are also rare (1,1%).

Regarding the control variables, the ratio of market to book value of equity presents a mean value of 1.39 and the mean firm's total size amounts to 643.605 millions euros. The mean ratio of firms' fixed to total assets is 48.1% and the mean firms' annual growth in earnings is 10.7%.

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

TABLE 3. Summary statistics

The sample consists of 92 non-financial companies listed on the Madrid Stock Exchange during the period 1991-1997. The number of observations amounts to 563 observations. LEV denotes firm debt level. MANOWN is the percentage of shares held by the firm's top executives and their families. OWNCON is defined as the percentage of shares held by the largest shareholder. BANKSOWN and INSTOWN are defined, respectively, as the percentage of shares held by banks and institutional investors. Dummy variables DFAM, DNEWCEO, DACQ and DIPO proxy, respectively, family group's presence in the firm, if the, during the year before the period under consideration, the CEO is replaced, if the firm has been taken over or if the firm has gone public. BINT denotes the proportion of internal or executive directors and BOARDSIZE the number of directors. ME/BE is defined as the firm's market to book value of common equity, and TOTALSIZE as the firm's total assets (in euros). FASSETS is the ratio of the firm's fixed assets to total assets and RISK denotes the firm's annual growth in earnings. All variables except LEV and RISK are defined one year lagged.

Variables	Mean	Minimum	25 <sup>th</sup> percentile	Median	75 <sup>th</sup> percentile	Maximum	Standard deviation
<b>Dependent variables</b>							
LEV	0.402	0.533E-02	0.219	0.389	0.569	0.913	379.415
<b>Corporate governance variables</b>							
MANOWN	0.444E-01	0.000	0.100E-04	0.181E-02	0.311E-01	0.612	379.279
OWNCON	0.345	0.000	0.146	0.295	0.512	0.992	379.393
BANKSOWN	0.134	0.000	0.000	0.471E-01	0.160	0.913	379.314
INSTOWN	0.336E-02	0.000	0.000	0.000	0.000	0.167	0.202E-01
	0.371	0.000	0.231	0.333	0.500	1.000	379.403
	10.634	2	7	10	13	36	383.336
<b>Control variables</b>							
ME/BE	1.390	0.483E-01	0.674	1.077	1.623	21.231	379.793
TOTALSIZE	643.605	3.354	63.960	207.559	619.042	10,217.206	1,318.914
FASSETS	0.481	0.309E-02	0.244	0.492	0.717	1.254	379.445
RISK	0.107	-17.528	-0.412	-0.122E-02	0.263	80.800	379.326
<b>Other corporate related variables</b>		<b>Percentage/(number or observations)</b>					
	DFAM	35.7% (201)					
	DCEO	14.4% (81)					
	DACQ	7.1% (40)					
	DIPO	1.1% (6)					

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

The correlation matrix presented in TABLE 4 shows that ownership and boards' characteristics are strongly interdependent. The variable MANOWN is positively related to the proportion of inside directors (BINT) and the presence of family groups, (DFAM) and negatively related to the ownership held both by the largest shareholder (OWNCON) and by banks (BANKSOWN)<sup>vi</sup>. Furthermore, the proportion of inside directors (BINT) is negatively correlated with board size (BDSIZE) and positively with the presence of family groups (DFAM). Thus, firms where family groups are present show higher managerial ownership and a higher percentage of inside directors. Other factors such as firm size (SIZE), the ratio of market to book value of common equity (ME/BE) or the ratio of fixed to total assets (FASSETS) are also correlated to most of the corporate governance variables. Larger firms show lower levels of managerial ownership, and a lower proportion of inside directors, whilst Boards are larger for large firms. These correlations are consistent with interdependence among ownership and board characteristics, but also that other factors, such as the firm's size or its market value are correlated with ownership structure and board composition. Denis and Sarin (1999) report similar results for the U.S. market.

**CORPORATE CONTROL AND CAPITAL STRUCTURE  
CHOICE IN A FRENCH-CIVIL LAW COUNTRY**

TABLE 4. Correlation matrix for the dependent and explanatory variables

The sample consists of 92 non-financial companies listed on the Madrid Stock Exchange during the period 1991-1997. The number of observations amounts to 563 observations. LEV denotes firm debt level. MANOWN is the percentage of shares held by the firm's top executives and their families. OWNCON is defined as the percentage of shares held by the largest shareholder. BANKSOWN and INSTOWN are defined, respectively, as the percentage of shares held by banks and institutional investors. Dummy variables DFAM, DNEWCEO, DACQ and DIPO proxy, respectively, family group's presence in the firm, if the, during the year before the period under consideration, the CEO is replaced, if the firm has been taken over or if the firm has gone public. BINT denotes the proportion of internal or executive directors and BDSIZE the logarithm of the number of directors. ME/BE is defined as the ratio of firm market to book value of common equity, and SIZE as the logarithm of the firm's total assets (in euros). FASSETS is the ratio of the firm's fixed assets to total assets and RISK denotes the firm's annual growth in earnings. All variables except LEV and RISK are defined one year lagged.

Variables	LEV	MANOWN	OWNCON	BANKSOWN	INSTOWN			ME/BE	FASSETS	SIZE				
MANOWN	0.054 (0.204)													
OWNCON	0.007 (0.871)	-0.332 (0.000)**												
BANKSOWN	-0.071 (0.092)	-0.118 (0.005)**	-0.069 (0.101)											
INSTOWN	-0.196 (0.000)**	0.071 (0.091)	-0.005 (0.913)	0.104 (0.014)**										
	0.049 (0.249)	0.324 (0.000)**	-0.011 (0.796)	-0.101 (0.016)	-0.058 (0.169)									
	0.003 (0.950)	-0.034 (0.416)	-0.057 (0.175)	0.074 (0.081)	0.158 (0.000)**	-0.277 (0.000)**								
DFAM	0.080 (0.059)	0.429 (0.000)**	-0.193 (0.000)**	-0.184 (0.000)**	0.060 (0.158)	0.488 (0.000)**	0.022 (0.601)							
DNEWCEO	0.038 (0.363)	-0.073 (0.083)	0.130 (0.002)**	0.025 (0.552)	-0.026 (0.540)	-0.027 (0.520)	-0.13 (0.762)	-0.094 (0.025)						
DACQ	0.000 (0.996)	-0.025 (0.554)	0.120 (0.004)	0.000 (0.998)	-0.009 (0.829)	-0.010 (0.808)	0.036 (0.390)	-0.033 (0.436)	0.320 (0.000)**					
DIPO	0.123 (0.004)**	0.060 (0.157)	-0.062 (0.141)	-0.067 (0.113)	-0.017 (-0.058)	0.078 (0.065)	-0.084 (0.047)*	0.031 (0.463)	0.007 (0.873)	0.039 (0.360)				
ME/BE	-0.054 (0.204)	-0.007 (0.860)	-0.002 (0.957)	0.084 (0.046)*	-0.044 (0.293)	0.006 (0.879)	-0.086 (0.042)*	0.044 (0.298)	0.036 (0.398)	0.045 (0.288)	-0.002 (0.966)			
FASSETS	-0.028 (0.504)	-0.102 (0.015)*	0.044 (0.301)	0.261 (0.000)**	0.139 (0.001)**	-0.224 (0.000)**	0.306 (0.000)**	-0.017 (0.689)	-0.032 (0.443)	-0.013 (0.064)	-0.078 (0.064)	-0.021 (0.618)		
SIZE	0.201 (0.000)**	-0.244 (0.000)**	0.263 (0.000)**	0.078 (0.066)	-0.077 (0.068)	-0.176 (0.000)**	0.457 (0.000)**	-0.148 (0.000)**	0.036 (0.398)	0.062 (0.141)	0.019 (0.660)	0.041 (0.328)	0.247 (0.000)**	
RISK	-0.081 (0.054)	-0.078 (0.063)	-0.020 (0.635)	0.001 (0.987)	0.008 (0.850)	-0.041 (0.335)	-0.011 (0.791)	-0.059 (0.161)	-0.064 (0.128)	-0.040 (0.349)	-0.002 (0.969)	0.044 (0.295)	0.014 (0.744)	-0.032 (0.448)

P-values are reported in parenthesis below

\* Statistically significant at a 5% level

\*\* Statistically significant at a 1% level.

#### 4. RESULTS

TABLE 5 reports the estimates of the relation between the firms' corporate governance characteristics and their total leverage. The results are reported using pooled data for all firm-years (first two columns), considering industry -SIC2- effects (columns three and four) and considering unobserved heterogeneity at firm level (columns five and six). Managerial ownership influence on firms' leverage is considered both with the linear and quadratic specification.

The results show that for some variables the estimated coefficients change significantly with the inclusion of industry and, especially, of fixed effects. For example, the coefficients of variables BDSIZE and FASSETS become significant, and so does the coefficient associated to banks' ownership for the fixed effect estimation. The coefficients of variable ME/BE or INSTOWN are not significant when considering fixed effects and, for variable ME/BE, the sign of the estimated coefficient changes.

Once unobservable heterogeneity is considered, the results suggest the existence of a non-linear relationship between managerial ownership and firm leverage. As proposed in H2b, the linear term (MANOWN) is negative and the quadratic term (MANOWN2) is positive. Confirming H7 which proposed that firms with larger boards will present lower leverage, we find that the relation between the logarithm of board size (BDSIZE) and total debt is negative. Furthermore, and not confirming H4 that stated the banks and institutional investors' ownership would lead to higher leverage levels, the results show a negative and statistically significant coefficient for variable BANKSOWN. Finally, control variables representing firms' size and the ratio of fixed to total assets also turn out to be significant.

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

Larger firms and firms with a higher ratio of fixed to total assets present, as should be expected, higher levels of total debt.

In summary, the results of TABLE 5 tend to confirm H1. They suggest that corporate governance structure and other observable firms' characteristics influence firms' debt levels and that entrenched managers will choose debt levels below the optimum. Other non-observable firm characteristics also determine firms' leverage. Therefore, the coefficients obtained using the panel data approach are more reliable than the ones obtained using pooled data.

TABLE 5. Determinants of leverage

The sample consists of 92 non-financial companies listed on the Madrid Stock Exchange during the period 1991-1997. The number of observations amounts to 563 observations. The dependent variable is firm debt level. MANOWN is the percentage of shares held by the firm's top executives and their families. MANOWN2 is the quadratic of MANOWN. BANKSOWN and INSTOWN are defined, respectively, as the percentage of shares held by banks and institutional investors. BINT denotes the proportion of internal or executive directors and BDSIZE the logarithm of the number of directors. ME/BE is defined as the ratio of firm market to book value of common equity, and SIZE as the logarithm of the firm's total assets (in euros). FASSETS is the ratio of the firm's fixed assets to total assets and RISK denotes the firm's annual growth in earnings. All variables except LEV and RISK are defined one year lagged. The results are reported using pooled data for all firm-years (first two columns), considering industry -SIC2- effects (columns three and four) and considering unobserved heterogeneity at the firm level (fixed effects, columns five and six).

VARIABLE	Expected relation	Pooled (OLS)		SIC 2 effects		Fixed effects	
MANOWN	Positive (linear)/ Negative (Non linear)	0.312 (3.419)***	0.212 (0.808)	0.318 (3.497)***	0.166 (0.744)	0.150 (1.579)	-0.518 (-2.651)**
MANOWN2	Positive		0.272 (0.416)		0.413 (0.655)		1.602 (3.899)***
BANKSOWN	Positive	-0.422E-01 (-0.969)	-0.435E-01 (-0.996)	0.262E-01 (0.573)	0.235E-01 (0.515)	-0.137 (-2.412)**	-0.156 (-2.769)***
INSTOWN	Positive	-1.788 (-7.588)***	-1.773 (-7.084)***	-1.613 (-5.099)***	-1.597 (-5.166)***	-2.119 (-1.267)	-2.242 (-1.360)
BINT	Negative	-0.974E-02 (-0.205)	-0.683E-02 (-0.141)	-0.142E-01 (-0.349)	-0.877E-02 (-0.212)	-0.128E-01 (-0.313)	-0.557E-02 (-0.138)
BDSIZE	Negative	-0.301E-01 (-1.292)	-0.277E-01 (-1.196)	-0.645E-01 (-3.366)***	-0.621E-01 (-3.239)***	-0.320E-01 (-1.920)*	-0.313E-01 (-1.908)*
ME/BE	Positive	-0.135E-01 (-1.968)**	-0.131E-01 (-1.915)*	-0.199E-02 (-0.313)	-0.185E-02 (-0.295)	0.180E-02 (0.469)	0.168E-02 (0.444)
FASSETS	Positive	-0.398E-01 (-1.140)	-0.388E-01 (-1.101)	0.110 (3.101)**	0.111 (3.130)**	0.752E-01 (2.169)**	0.996E-01 (2.868)***
SIZE	Positive	0.347E-01 (5.191)***	0.338E-01 (4.731)***	0.494E-01 (7.138)***	0.481E-01 (6.679)***	0.401E-01 (2.506)**	0.484E-01 (3.047)***
RISK	Negative	-0.398E-01 (-1.140)	-0.410E-02 (-2.289)**	-0.191E-02 (-1.082)	-0.189E-02 (-1.070)	0.822E-03 (0.817)	0.665E-03 (0.670)
Adjusted R <sup>2</sup> (%)		9.8	9.3	31.3	31.3	81.9	82.5
F		4.81***	4.38***	10.48***	10.15***	26.48***	27.17***

\*\*\* Significant at a 1% level \*\*Significant at a 5% level \*Significant at a 10% level

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

Denis and Sarin (1999) show that shocks, such as CEO changes or takeovers, significantly affect corporate governance structure. Some of these shocks, such as takeovers or CEO's changes, may also significantly affect firms' leverage. To take into account these factors, dummy variables representing different firms' events are included in the analysis. These events are the following: if the firms have experienced CEO's changes, takeovers or if the firm has gone public during the previous year. Also, the possible influence of the presence of family groups on firms' leverage is considered through a dummy variable. Finally, we also consider the possible influence of firms' ownership concentration on firm's debt.

The results reported in TABLE 6 suggest that exogenous shocks such as CEO's changes or takeovers do not affect total leverage. Thus, they reject the validity of H8. Neither does ownership concentration (H5). Although not shown, the non-significant influence of the above reported shocks on firms' leverage is also obtained when estimating the mean differences of the changes in the firms' total debt between firms that experience the shocks and firms that do not experience takeovers or CEOs' changes. The estimations presented in TABLE 6 also highlight the importance of family groups in the Spanish market. The results show a positive and significant relationship between firm's leverage and the presence of a family group as a large shareholder. This result confirms H5 which stated that in the presence of family groups firms would present higher leverage levels.

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

TABLE 6. Determinants of leverage (shocks considered)

The sample consists of 92 non-financial companies listed on the Madrid Stock Exchange during the period 1991-1997. The number of observations amounts to 563 observations. LEV denotes firm debt level. MANOWN is the percentage of shares held by the firm's top executives and their families. OWNCON is defined as the percentage of shares held by the largest shareholder. BANKSOWN and INSTOWN are defined, respectively, as the percentage of shares held by banks and institutional investors. Dummy variables DFAM, DNEWCEO, DACQ and DIPO proxy, respectively, family group's presence in the firm, if the, during the year before the period under consideration, the CEO is replaced, if the firm has been taken over or if the firm has gone public. BINT denotes the proportion of internal or executive directors and BDSIZE the logarithm of the number of directors. ME/BE is defined as the ratio of firm market to book value of common equity, and SIZE as the logarithm of the firm's total assets (in euros). FASSETS is the ratio of the firm's fixed assets to total assets and RISK denotes the firm's annual growth in earnings. All variables except LEV and RISK are defined one year lagged. The results are reported considering unobserved heterogeneity at the firm level (within estimates). Adjusted  $R^2$  is expressed in absolute values.

Variable	Expected relation	Regression 1	Regression 2	Regression 3	Regression 4	Regression 5
MANOWN	Negative	-0.549 (-2.805)**	-0.544 (-2.774)***	-0.546 (-2.772)***	-0.566 (-2.879)***	-0.446 (-2.217)
MANOWN2	Positive	1.644 (4.005)***	1.643 (4.000)***	1.600 (3.870)***	1.665 (4.048)***	1.498 (3.556)***
BDSIZE	Negative	-0.296E-01 (-1.807)*	-0.2994E-01 (-1.828)***	-0.289E-01 (-1.764)*	-0.266E-01 (-1.594)	-0.343E-01 (-2.076)**
BINT	Negative	-0.692E-02 (-0.172)	-0.682E-02 (-0.170)	-0.479E-02 (-0.119)	-0.883E-02 (-0.219)	-0.230E-01 (-0.570)
BANKSOWN	Positive	-0.159 (-2.815)***	-0.161 (-2.848)***	-0.161 (-2.854)***	-0.159 (-2.817)***	
INSTOWN	Positive	-2.264 (-1.377)	-2.312 (-1.404)	-2.267 (-1.379)	-2.253 (-1.370)	
DFAM	Positive	0.593E-01 (1.807)*	0.598E-01 (1.820)*	0.605E-01 (1.841)*	0.600E-01 (1.827)	
DNEWCEO	Positive		0.801E-02 (0.664)			
DACQU	Positive			-0.186E-01 (-1.120)		
DIPO					0.382E-01 (0.929)	
OWNCON	Positive					0.173E-02 (0.041)
ME/BE	Positive	0.162E-02 (0.428)	0.150E-02 (0.397)	0.211E-02 (0.555)	0.161E-02 (0.425)	0.213E-02 (0.558)
FASSETS	Positive	0.997E-01 (2.879)***	0.101 (2.912)**	0.957E-01 (2.751)***	0.979E-01 (2.820)***	0.912E-01 (2.611)***
SIZE	Positive	0.505E-01 (3.175)***	0.504E-01 (3.172)***	0.505E-01 (3.178)***	0.498E-01 (3.127)***	0.410E-01 (2.495)**
RISK	Negative	0.683E-03 (0.689)	0.709E-03 (0.715)	0.650E-03 (0.656)	0.678E-03 (0.685)	0.6166E-03 (0.615)
Adjusted $R^2$ (%)		82.5	82.5	82.6	82.5	82.2
F		27.07***	26.78***	26.83***	26.81***	26.90***

\*\*\* Significant at a 1% level

\*\* Significant at a 5% level

\* Significant at a 10% level

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY****5. DISCUSSION**

In this study we analyse the relationship between firm corporate governance structure and capital structure for the Spanish market. The results reveal the importance of the selection of the econometric methodology in order to study this complex relation. As it has been mentioned in the previous section, the sign and degree of statistical significance of the estimated coefficients of certain variables vary substantially when different econometric methods are applied. The explanatory power of the models rise significantly when considering industry effects (from 10% to 30%) and especially when considering fixed effects (to more than 80%)<sup>vii</sup>. These differences suggest that the unobserved firm characteristics are correlated with the observed characteristics, and therefore bias the estimated coefficients in the pooled regression. This evidence suggests the relevance of considering unobserved heterogeneity in estimating the relationship between corporate governance and capital structure decisions.

Our results also show the existence of a non-linear relationship between managerial ownership and firm leverage. This evidence supports the fact that, for large levels of managerial ownership, managers may have incentives to raise corporate value by increasing firms' debt. Nevertheless, these results may also be interpreted in support of Stulz's model (1988) that suggests that managers may increase leverage in order to consolidate their voting control. The fact that the positive relationship is observed for large levels of managerial ownership reinforces this conjecture. Furthermore, it is worth noting, that, although not shown in TABLES 5 and 6, when we use an additional variable that represents the interaction of managerial shareholdings and ownership concentration, the results show a negative and statistically significant coefficient, at a 1% level, for this variable. This evidence suggests that

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

managers, as large shareholders, induce firms to use less debt. By doing this, managers reduce their exposure to risk.

The negative relation between Board size and firm leverage suggests that the addition of directors lead to leverage reductions. Berger et al. (1997) for the U.S. market reports similar results. Nevertheless, for a different environment, we do not find any significant influence of the proportion of inside directors on firms' leverage.

Regarding bank ownership, the evidence found in this study contradicts the view that banks' ownership can be beneficial for firms as has been reported by different authors for the German market (Cable, 1985 and Gorton and Schmidt, 1996) and in the Spanish market (Zoido, 1998 and García-Marco and Ocaña, 1999). Possible explanations for this behaviour include the interest of banks in avoiding risk, or the existence of a substitution effect between bank's ownership and debt as monitoring devices. Institutional investors' presence does not seem to influence significant firm's leverage. The period considered in the study may explain this result. Institutional investors' presence in Spanish quoted companies is fairly low during the first part of the '90s decade.

In this study we also analyse the potential effect of some specific shocks on the firms' capital structure. In particular, we consider how CEO's changes, takeovers, and the specific characteristics of firms that have recently gone public may affect a firm's financing decisions.

The results show no significant influence of these events on capital structure decisions. This evidence contradicts prior findings for the U.S. market reported by Berger *et al.* (1997). These authors document debt increases in leverage after unsuccessful tender offers and involuntary CEOs' changes. The characteristics of the Spanish capital market may be the

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

cause of this anomalous behavior. Takeovers are usually friendly and therefore may not represent a strong disciplining device for CEOs.

Finally, we also found a positive relationship between firm leverage and the presence of a family group in the ownership structure of the firm. This evidence suggests that the presence of family groups seems to discipline managers leading to higher debt levels. Nevertheless, it should also be considered that family groups may present higher debt levels due to possible constraints for equity offerings in the capital markets. The asymmetry of information for these firms may be higher due to their smaller size. Also, family groups will be reluctant to issue equity to outsiders due to their interest in maintaining firm control.

In line with the disciplinary role developed by family groups additional evidence has been found for the Spanish market. Galve Górriz and Salas Fumás (1996) found evidence of a higher efficiency in firms controlled by family groups with respect to firms with a presence of other groups of control such as banks or foreign firms, and also with respect to firms with a widely held ownership structure. However, other recent evidence suggests that the presence of a family group is more likely to increase agency costs as a result of manager entrenchment. Gómez-Mejía et al (2001) found that the disciplinary action in case of poor outcomes is weaker for executives with family ties than for managers without such family ties. Moreover, as a result of higher agency costs, it is also observed that CEO terminations have a more positive effect on organizational survival under family contracting than under non-family relation.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY****6. CONCLUSIONS**

Agency theory predicts that the mix between debt and equity may be influenced by managers' discretionary objectives. This link between agency theory and capital structure choice is supported by different studies that document, mainly for the U.S. market and for large firms, how entrenched CEOs seek to avoid the use of debt financing (Berger *et al.*, 1997; Garvey and Hanka, 1999).

We analyse, using different methodologies, the relation between managerial entrenchment and capital structure choice. The study deals with the analysis between a firm's corporate governance structure and its financing decisions including not only variables that have been considered in previous studies for Anglo-Saxon markets (i.e. managerial ownership, board composition or size), but also new variables not previously considered in the literature, such as the identity of large shareholders and the presence of family groups. Furthermore, our paper analyses this issue in a different environment, a civil law country, with closely and medium size firms. Our findings support the need to consider unobserved heterogeneity when studying the relationship between the firms' corporate governance structure and firms' leverage. Consistent with the evidence reported by Berger *et al.* (1997) for the U.S. market, the results support that in medium size firms entrenched CEOs tend to avoid the use of debt. Firms with larger boards, lower managerial ownership and lacking family groups show lower leverage. Nevertheless, we do not find that banks, as shareholders, exercise a pressure on CEOs regarding leverage levels. On the contrary, banks' ownership leads to lower leverage levels. Possible explanations for this behaviour include the interest of

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

banks in avoiding risk, or the existence of a substitution effect between bank's ownership and debt as monitoring devices.

When we examine the influence of events that may represent shocks that reduce CEOs' entrenchment, i.e. the replacement of a firm's CEO, or if firms have been the target of a takeover, we do not find that these events lead to significant leverage. The characteristics of the Spanish market may be the cause of this behaviour. Spanish firms are closely held and Spain lacks an active takeover market. We think that further research needs to be done to confirm this conjecture.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY****REFERENCES**

- AMIHUD, Y. AND LEV, B. (1981) 'Risk reduction as a managerial motive for conglomerate mergers', *Journal of Economics and Management Science*, 12 (2): 605-617.
- ARRONDO, R. AND GÓMEZ, S. (2002) 'A study of Spanish firms' security issue decision under asymmetric information and agency costs', *Applied Financial Economics*, forthcoming.
- BARCLAY, M.J. AND HOLDERNESS, C.G. (1991) 'Negotiated block trades and corporate control', *Journal of Finance*, 46 (3): 561-878.
- BARNHART, S.W.; MARR, M.W. AND ROSENSTEIN, S. (1994) 'Firm performance and board composition: Some new evidence', *Managerial and Decision Economics*, 15: 329-340.
- BERGER, P. G.; OFEK, E. AND YERMACK, D.L. (1997) 'Managerial entrenchment and capital structure decisions', *The Journal of Finance*, 52 (4): 1411-1438.
- BYRD, J.W. AND HICKMAN, K.A. (1992) 'Do outside directors monitor managers? Evidence from tender offers bids', *Journal of Financial Economics*, 32: 195-221.
- CABLE, J. (1985) 'Capital market information and industrial performance: the role of West German Banks', *The Economic Journal*, 95: 118-132.
- CRESPI, R. (1999) 'Corporate governance and performance: a review on Spanish research', in Barca F. and Becht, M. (eds.) *Ownership and control: A European Perspective*, European Corporate Governance Network.
- CRESPI, R. AND GARCÍA-CESTONA, M. (2001) 'Ownership and control of the Spanish listed firms', in Barca, F. and Becht, M. (eds) *Separation of ownership and control, 2001*, Oxford University Press.
- DANN, L.Y. AND DEANGELO, H. (1988) 'Corporate financial policy and corporate control. A study of defensive adjustments in asset and ownership structure', *Journal of Financial Economics*, 20 (1-2): 87-127.
- DENIS, D.J. (1990) 'Defensive changes in corporate payout: Share repurchases and special dividends', *Journal of Finance*, 45: 1433-1456.
- DENIS, D.J. AND SARIN, A. (1999) 'Ownership and board structures in publicly traded corporations', *Journal of Financial Economics*, 52: 187-223.
- EISENBERG, T.; SUNDGREN, S. AND WELLS, M.T. (1998) 'Larger board size and decreasing firm value in small firms', *Journal of Financial Economics*, 48: 35-54.
- FACCIO, M. AND LANG, L.H. (2001) The separation of ownership and control. An analysis of ultimate ownership in Western European corporations, Working Paper, Università Cattolica de Milano.
- FAMA, E.F. (1980) 'Agency problems and the theory of the firm', *Journal of Political Economy*, 88 (2): 288-307.
- FAMA, E. AND JENSEN, M.C. (1983) 'Separation of ownership and control', *Journal of Law and Economics*, 27: 301-325.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

- FERNÁNDEZ, A.I.; GÓMEZ-ANSÓN, S. AND FERNÁNDEZ-MÉNDEZ, C. (1998) 'El papel supervisor del consejo de administración sobre la actuación gerencial. Evidencia para el caso español', *Investigaciones Económicas*, 22: 501-516.
- FERNÁNDEZ, A.I. AND GÓMEZ-ANSÓN, S. (1999) 'Un estudio de las ofertas públicas de adquisición en el mercado de valores español', *Investigaciones Económicas*, 23: 471-495
- FRANKS, J.; MAYER, C. AND RENNERBORG, L. (1997) 'The role of large share stakes in poorly performing companies in the U.K.', Mimeo.
- GALVE GÓRRIZ, C. AND SALAS FUMÁS, V. (1996). 'Ownership structure and firm performance: Some empirical evidence from Spain', *Managerial and Decision Economics*, vol. 17 (6), pp. 575-586.
- GARCÍA-MARCO, T. AND OCAÑA, C. (1999) 'The effect of bank monitoring on the investment behavior of Spanish firms', *Journal of Banking and Finance*, 23: 1579-1603.
- GARVEY, G. T. AND HANKA, G. (1999) 'Capital structure and corporate control: The effect of antitakeover statutes on firm leverage', *Journal of Finance*, 54 (2): 519-546.
- GÓMEZ-MEJÍA, L. R.; NÚÑEZ-NICKEL, M.; GUTIÉRREZ, I. (2001). 'The role of family ties in agency contracts', *Academy of Management Journal*, vol. 44 (1), pp. 81-95.
- GORTON, G. AND SCHMIDT, F.A. (1996) 'Universal banking and the performance of German firms', NBER, Working Paper 5453.
- GROSSMAN, S. J. AND HART, O.D. (1980) 'Takeover bids, the free-rider problem, and the theory of the corporation', *The Bell Journal of Economics*, 11: 42-64.
- GROSSMAN, S.J. AND HART, O.D. (1982) 'Corporate financial structure and managerial incentives', in McCall, J.J. (ed.) *The Economics of Information and Uncertainty*, Chicago, University of Chicago Press.
- HARRIS M. AND RAVIV, A. (1988) 'Corporate control contests and capital structure', *Journal of Financial Economics*, 20 (1-2): 55-86.
- HART, O. AND MOORE, J. (1995) 'Debt and seniority: An analysis of the role of hard claims in constraining management', *American Economic Review*, 52: 567-585.
- HAUSMAN, J. A. AND TAYLOR, W.E. (1981) 'Panel data and unobservable individual effects'. *Econometrica*, 49 (6): 1377-1398.
- HERMALIN, B.E. AND WEISBACH, M.S. (1991) 'The effects of board composition and direct incentives on firm performance', *Financial Management*, 20 (4): 101-112.
- HIMMELBERG, C.P.; HUBBARD, R.G. AND PALIA, D. (1999) 'Understanding the determinants of managerial ownership and the link between ownership and performance', *Journal of Financial Economics*, 53: 353-384.
- JENSEN, M. AND MECKLING, W.H. (1976) 'Theory of the firm: managerial behaviour, agency costs and ownership structure', *Journal of Financial Economics*, 3: 305-360.
- JENSEN, M. C. (1986) 'Agency Costs of Free Cash Flow, Corporate finance, and takeovers'. *AEA Papers and Proceedings*, 76 (2): 323-329.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

- JENSEN, M. C. (1993) 'The modern industrial revolution, exit, and the failure of internal control systems', *The Journal of Finance*, 48 (3): 831-880.
- JUNG, K.; KIM, Y. AND STULZ, R. (1996) 'Timing, investment opportunities, managerial discretion, and the security issue decision', *Journal of Financial Economics*, 42: 159-185.
- LA PORTA, R.; LOPEZ-DE-SILANES, F.; SHLEIFER, A. AND VISHNY, R.W. (1997) 'Legal determinants of external finance', *The Journal of Finance*, 52 (3): 1131-1150.
- LA PORTA, R.; LOPEZ-DE-SILANES, F.; SHLEIFER, A. AND VISHNY, R.W. (1998) 'Law and finance', *Journal of Political Economy*, 106 (3): 1113-1155.
- LIPTON, M. AND LORSCH, J.W. (1992) 'A modest proposal for improved corporate governance' *Business Lawyer*, 48: 59-77
- MCCONNELL, J.J. AND SERVAES, H. (1990) 'Additional evidence on equity ownership and corporate value', *Journal of Financial Economics*, 27: 595-612.
- MEHRAN, H. (1992) 'Executive incentive plans, corporate control, and capital structure', *Journal of Financial and Quantitative Analysis*, 27 (4): 539-560.
- MORCK, R.; SHLEIFER, A. AND VISHNY, R.W. (1988) 'Management ownership and market valuation: an empirical analysis', *Journal of Financial Economics*, 20: 293-315.
- NOVAES, W. AND ZINGALES, L. (1995) 'Capital structure choice when managers are in control: entrenchment versus efficiency', NBER Working Paper 5384.
- SHLEIFER, A. AND VISHNY, R.W. (1986) 'Large shareholders and corporate control', *Journal of Political Economy*, 94 (3): 461-489.
- SPANISH SUPERVISORY AGENCY (C.N.M.V) (2001) *Análisis de los resultados del cuestionario sobre el Código de Buen Gobierno relativo al ejercicio 2.000*.
- STULZ, R.M. (1988) 'Managerial control of voting rights. Financing policies and the market for corporate control', *Journal of Financial Economics*, 20: 25-54.
- STULZ, R.M. (1990) 'Managerial discretion and optimal financing policies', *Journal of Financial Economics*, 26: 3-27.
- WEISBACH, M.S. (1988) 'Outside directors and CEO turnover', *Journal of Financial Economics*, 20: 431-460
- YERMACK, D. (1996) 'Higher market valuation of companies with a small board of directors', *Journal of Financial Economics*, 40: 185-211.
- ZOIDO, M.E. (1998) 'Un estudio de las participaciones accionariales de los bancos en las empresas españolas', *Investigaciones Económicas*, 22: 427-467.

---

**CORPORATE CONTROL AND CAPITAL  
STRUCTURE CHOICE IN A FRENCH-CIVIL LAW  
COUNTRY**

---

<sup>i</sup> Recently, in Spain, a new Code of Best Practice has been published: The Aldama Code. This new Code does not change substantially the recommendations regarding the composition of the Board of Directors.

<sup>ii</sup> Results for the Spanish market by Fernández *et al.* (1998) also support the positive effect of outside directors on firm value.

<sup>iii</sup> As alternative proxy variables for ownership concentration we include in the analysis the fraction of shares held by the three and five largest shareholders. The results did not vary.

<sup>iv</sup> Spain, as the U.S. and other occidental countries, has strict rules that oblige shareholders to disclose their holdings. Stockholdings above 5% have to be disclosed and any shareholder breaching a 25% threshold has to launch a takeover.

<sup>v</sup> Ownership structure has changed during the last years. The state participation has decreased considerably due to the privatization program undertaken by successive governments, there have been a large number of IPOs and foreign companies have become major shareholders (Crespí and García-Cestona, 2001).

<sup>vi</sup> A possible explanation for the negative relation between MANOWN and OWNCON is that when large shareholders are companies they are represented on the board by individuals and therefore their shareholdings are not included in MANOWN.

<sup>vii</sup> Himmelberg *et al.* (1999) report similar results when analysing the link between ownership structure and firms' performance.