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The Relation between Stock Repurchase and Ownership Structure in France

Rim El Houcine (Corresponding author)

Faculty of Science Economics and Management of Tunis, El Manar University, Tunisia

79 Route de la plage, 4011 Hammam Sousse- Tunisie

Tel : 216 58 350 993 E-mail: rimelhoucine@yahoo.fr

Adel Boubaker

Faculty of Science Economics and Management of Tunis, El Manar University, Tunisia

B.P 248 El Manar II 2092 TUNIS- Tunisie

Tel: 216 98 430 378 E-mail: adel.boubaker@fsegt.rnu.tn

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Abstract

The aim of this article is to study the relationship between the type of shareholders of French companies and their stock repurchase policy. According to the financial theory, the presence of institutional investors negatively influences the policy of purchasing the fact of preference of these investors over the reinvestment projects. The theoretical hypotheses of interest alignment and entrenchment have been used to justify the relationship between management stockholding and repurchasing policy. We have tested the validity of our hypotheses on a sample of 77 French companies during 2003-2008. The results have shown that the institutional investors affect negatively the repurchase, which can explain the priority of these latter for dividends compared to repurchasing and with holding the profit to invest it again. Moreover, we have found a positive relationship between the management stockholding and the repurchase, which has been explained by the power of entrenchment that can perform the repurchase by raising the stockholding percentage of managers who repurchase the stocks.

Keywords: Institutional investors, managerial ownership, Stock repurchases

1. Introduction

The stock repurchases have considerably grown in France since the law of July 2, 1998, which has highly relaxed the regulation of these operations. Thus, the initial French regulation as regards repurchasing stocks, defined by the law of July 24, 1966, entitles the stock repurchases exceptionally and according to a very strict and rigid procedure.

This law was significantly reformed on July 2, 1998. The new law relaxes the conditions in which the companies would be authorized to repurchase their own stocks. Because of the increasing resort of the companies to repurchases, studies are multiplied to examine the motives of these operations.

If the distributions policies allow limiting the agency conflicts, they should then be influenced by the stockholding structure (concentration and nature of stockholders), which is a decisive element of the agency conflicts.

Our study is considered on a sample of 77 French companies listed, during a six-year period from 2003 to 2008, so 462 observations.

This article is presented as follows. The second section underpins the literature. The third introduces the used sample and methodology. The results are shown in the fourth, and the last part concludes the work.

2. Literature

2.1. The institutional investors

Generally, the institutional stockholders (banks, insurance companies, pension funds) hold only minority interests (less than 10%) in the listed companies. Their role is however great as they are stockholders who define to a great degree the stock value of companies. They exert a big influence on the dynamics of the financial markets and within the companies.

The agency costs may become considerable in the case of a diffuse external stockholding due to the high costs of information and the heterogeneity of the interests of the external stockholders. The presence of the institutional investors can then have a direct effect on the agency costs resulting from separating between property and control. The manner with which the institutional investors influence the conduct of the managers is an empirical evidence since we can find the case of a passive policy (Porter, 1992) and the case of an active control from a certain category of investors (Bushee, 1998).

The consequences of the strong development of the institutional stockholding on the companies remain unknown to date.

Implicitly, the main question about the relationship between the presence of the institutional investors, the performance of the company and the policy of repurchasing emerges. These general questions require reviewing the knowledge’s we have about these stakeholders.

The holders of control blocks, like the institutional investors, can find an importance in taking on the surveillance activities, to the extent that they possess a considerable part of the stocks.

In this context, Shleifer and Vishny (1986) and Allen and al. (2000) suggested that these stockholders could not control the managers more than the scattered owners. They have a privileged position to access the company information and its competitors. Therefore, they can better assess the performances of the managers, by comparing them especially to those in the other companies of the same sector about whom they have information. Starting from the general description Jensen (1986), with a strict surveillance of the managers, the companies have to pay their flow of excess liquidity.

Jensen and Meckling (1976) showed that a possession of a high stock by the investors would be linked to a high level of distribution because of the surveillance functions exercised by these ones. (It is the role of the mechanism of controlling the managers and the majority stockholders which is brought out here.)

The repurchases have become a real means of distributing funds to the stockholders who can compete a "classic" payment of a dividend. So, Fama and French (2001) noted a significant fall in the percentage of companies distributing dividends, Grullon and Michalely (2000) observed for the first time in 1998 an amount of programs of repurchasing stocks higher than that of dividends.

Grullon and Michalely (2000) explained this behavior by the existence of different fiscal (The capital gains are generally taxed with a weaker tax rate than the dividends) conditions between these two distributions modes. The companies were accordingly attracted to the programs of repurchase more than having an important fiscal advantage pertaining to it. In a period characterized by different fiscal regimes, the results of Rau and Vermaelen (2000) on the English market proved this fiscal hypothesis. It is the tax system borne by the institutional investors (pension funds, organizations of investment,..) and not by the individual investors that determines the distribution policies of the companies.

Yet, another research trend predicts a negative relationship between the presence of an institutional investor and the policy of distribution. Indeed, given the importance bestowed by these investors upon whatever are projects and reinvestment; this stockholder type prefers holding the profits and reinvests them instead of distributing them.

2.2. The managerial property

Given that the investors often incorporate the managerial decisions concerning the choice of the company policies (debt policy, distribution policy) in assessing its future performance (De Angelo and al., 1996 et Benartzi and al.1997), a thought trend has recently focused on the study of the managerial property and distribution policy link.

Prime facie, a research trend showed that the Free Cash Flow (FCF) distribution payment decreases with the stockholding importance of managers, considering it a means of alignment of interests between agent and principal (Charlier and Du Boys, 2010).

Thus, the more the part owned by the manager is substantial, the more their objectives converge. So, the resort to the other disciplinary mechanisms including the payment of dividends or the repurchase of stocks has proved to be useless. It is the theory of alignment of interests (Jensen et Meckling, 1976). Actually, the more the number of stocks owned by the managers is large, the more these latter will be motivated to search for more profitable projects and the more their interests converge with those of the stockholders exercising a reduction in the costs which they bear to control the manager. Otherwise, when their right for the residual profit is weak, the managers may make profit from other sources in the company, which risks affecting its value (Ali, Chen et Radhakrishnan, 2007).

However, on introducing other variables, the recent studies have contradicted this idea leaning on the effect of setting which can dominate the managerial property and profit distribution relationship. It is the theory of entrenchment the managers (Collins and Wansley, 2003).

The model of managerial entrenchment stipulates that at a certain property level, the managers benefit by a control power that consolidate their position and they enter into a standpoint not to maximize the company value once the costs relating to a certain behavior are lower than the control benefits.

In the absence of complete contracts, the principal-agent problem comes out owning to the divergence of interests of the different stakeholders; the owners want to maximize the value of the company and the managers look for maximizing their own utility, which reduces the value of the company. This type of conflicts appears mainly in the big companies with diffuse stockholding where the managers do not hold any significant part of the capital. (Charreaux, 1997; Alexandre and Paquerot, 2000)

Separating the power and the property might offer the non-owner managers the scope of pursuing the specific objectives, most often non compatible with those of the stockholders (Burkart and al., 2003; Anderson and Reeb, 2003; Sharma, 2004; Charlier and Lambert, 2009).

This divergence of interests between the principal and the agent is particularly more considerable given the fact that the capital is scattered among several stockholders.

This way, the agency relationship is due to the fact that the principal (owner) think that the agent (manager) is better placed than him to control his property. The information asymmetry is then the origin of the conflicting relationship.

The information differential generates an opportunist behavior of the manager who acts against the interests of the other party. It follows a moral-risk phenomenon which occurs due to the fact that an agent has not learned how to realize his promises when his behavior is non-observable by the other party.

The agency theory provides a new interpretive framework to go though the distribution policy which will be a means for reducing the real or potential conflicts between the stockholders and the managers.

As put forward by Jensen and Meckling (1976), each group of individuals is supposed to maximize its utility function and consequently the conflicts might appear. Easterbrook (1984) and Jensen (1986) propose a partial solution to this problem. If the stockholders can minimize the liquidities under the control of the managers, these latter will not have the possibility to spend them on the projects with negative net present value (Sum of the updated future Free Cash Flows minus initial Investment).

For Easterbrook (1984), the fact of collecting the capital in the financial markets creates a behavioral discipline about the manager because of the surveillance activity generated by the investors. It is therefore necessary to intensify the access to the financial market while limiting the self-financing to control the conflicts between the managers and the external stockholders. The sole means to reach that is the regular distribution of profits.

For a given investment policy, the additional borrowings require implementing on audit and reviewing procedure in the company. Accordingly, the scattering of the capital weakens the power of controlling the stockholders, leaving the greater operation margins to the managers. More particularly, the managers are interested in giving up the payment of dividends that allow them to receive the payment in excessive kind, which is reflected by a drop in the company value. This drop entails a fall in the prices of which only the stockholders (as principals) suffer the consequences.

Using the repurchase programs can be linked to the will of the companies to declare their undervaluation at the stock market. Contrary to the rise in capital sanctioned by the negative abnormal profitabilities (Myers and Majluf, 1984 and Asquith et Mullins, 1986), the announcement of a repurchase program must correspond to good news for the investors. The American studies of Comment and Jarrel (1991) and of Grullon and Michalely (2000) present the abnormal profitabilities on announcing a program of repurchasing actions from 2 to 3%. This positive result exists in Europe, as well.

Nevertheless, launching a repurchase program is a low-costly signal because it is quite easy to get the consent of stockholders. The company managers do not commit themselves; they assume the possibility of buying the stocks on the stock market. From this standpoint, the repurchase program looks strongly like a free option from which the managers benefit when the stock price strays off the “real” value of the company. This option hypothesis was checked by Ikenberry and Vermaelen (1996). They showed that the effect of announcing a repurchase program depends on the volatility of the stock profitabilities and the number of concerned stocks. However, all the companies do not permanently have a program of purchasing active stocks. The option of repurchasing stocks is valuable only if the company has the funds to be invested in it and the managers are qualified to mark out the errors of the economic development on the market. Under these circumstances, the option is stimulated by the managers who really buy the stocks.

On the one hand, the risk of the company disappearance often urges the managers to diversify the activities of the company. On the other hand, such a strategy is confronted with the refusal of the stockholders who prefer a less costly diversification of their stock portfolio rather than an expansion of the activity field of the company. Consequently, the interest divergences form a source of potential conflicts between the managers and the stockholders.

3. Sample and methodology

We observe that there is little investigation into the relationship between the ownership structure and the company's policy of repurchasing its own stocks. A point of particular interest in this research is to study the effect of certain types of stockholders, either being the institutional investors or the managers.

3.1. Sample and data collection

The study is appraised on a sample of 77 listed French companies during six-year period from 2003 to 2008 that is to say therefore 462 observations.

For all the companies, we have collected the accounting data as well as the data concerning the profit distribution, the stockholding and the governance over six years, from 2003 to 2008. The accounting data or those concerning the dividends are extracted from the financial statements (statement of accounts and statements of results) and the activity reports published on the Internet sites of the concerned companies.

The data regarding the stockholding and the governance have been gathered from the annual reports of the companies. The data concerning the repurchase of stocks derive from the "information note relating to the programs of repurchasing stocks" and "the company's declaration of the purchases and the concerning the purchase and transfers of their own stocks", as well. These documents are published on the Internet site of the Authority of the Financial Market (AMF).

3.1.1. The stock repurchase

The data indicated at the declarations made by the companies concerning the purchase and transfers of their own stocks show that there exist many forms of effective repurchasing(repurchase, transfers, cancellation), and this is according to the motivations presented by the company.

In order to isolate the stock purchases resulting from a distribution decision, we have eliminated all the accomplished repurchases with the aim of providing the stock-option plans, controlling the price, or investing. So, we retain the notion of net repurchase: i-e, it is the number of repurchased stocks during the year, which is reduced by the sold stocks and the transferred ones.

This repurchase measure estimates the number of stocks which are cancelled or kept within the company, which corresponds neither to a coverage to stock-option plans, nor to an investment, and nor to a price control. In the case of a negative net repurchase, we have considered that the repurchases of the company were not carried out with a view to a distribution to the stockholders. The net repurchase has been considered as non-existent. Seeing that net repurchase is asymmetric, we have transformed this variable into Naperian logarithm. Even so the net repurchase variable can be zero, our measure is the naperian logarithm of the net repurchase+1.

3.1.2. The institutional property

It is the percentage of the institutional investors measured by the number of stocks held by the institutional investors over the total number of stocks.

Allen and al. (2000) suggest that these stockholders are more capable of controlling the managers than the other owners. They have a privileged position for acceding to the company data. So, they will be more influential concerning the financial decisions of the company, especially the policy of distribution in the form of repurchasing.

3.1.3. The property of the managers

It is represented by the percentage of the stocks held by the managers, the employees and the directors of the same company.

According to the theory of interests convergence (Jensen et Meckling, 1976), the possession of a part of the capital by the managers makes up an excellent encouragement to run the company in accordance with the interest of the stockholders. The more the part of the capital held by the managers is important, the more interest divergences between the stockholders and the managers will be low. Therefore, the resort to the repurchase policy as a controlling mechanism turns out to be useless.

3.2. Method of data analysis

To test our research hypotheses, we have used the linear declines that are robust against the heteroscedasticity problems or the residue normality in this case, the estimators got by the method of the ordinary least squares are unbiased. Furthermore, we have given attention to the problem of collinearity between explanatory variables.

Thanks to the study of the indexes of conditioning and the Variance Inflation Factor (VIF) of each variable, we can conclude that there is not any problem of collinearity in the declines.

The followings regressions equations were estimated to identify the determination of stock repurchases:

$$NETREP=\beta0+\beta1(INS)+\beta2(SIZE)+\beta3(DEBT)+\beta4(FCF)+\beta5(ROA)+\beta6(DIV)+uit \quad (1)$$

$$NETREP=\gamma0+\gamma1(MNG)+\gamma2(SIZE)+\gamma3(DEBT)+\gamma4(FCF)+\gamma5(ROA)+\gamma6(DIV)+uit \quad (2)$$

With:

NETREP: Net Repurchase; INS: Institutional; MNG: Managerial; SIZE: Firm size; DEBT: Leverage; FCF:Free Cash Flow; ROA: Return On Assets; DIV: Dividend

4. Empirical result and discussions

4.1. Descriptive statistics

The descriptive analysis enables us to have an idea on the used variables. It allows drawing some characteristics of our sample. Table 1 summarizes all the statistics of the variables. The mean of each variable is presented in the column titled Mean.

Table 1: Descriptive Statistics

	Mean	Minimum	Maximum	Median
NETREP	4.7414	0	16.982	0
INS	0.4024	0	1	0.376
MNG	0.046	0	0.541	0.002
SIZE	15.29	12.207	18.931	15.234
DEBT	0.262	0	0.9	0.256
FCF	0.209	-0.177	0.262	0.023
ROA	0.035	-0.209	0.377	0.033
DIV	0.268	0	1	0.262

In respect of the nature of the stockholders, we notice that the percentage of the stocks held by the institutional investors is the highest (40.24%). This result shows that these latter are the preferred stockholders of the French companies. These investors participate more and more in the stockholding of the French firms.

The fact that the French pension funds have not been enough developed up to now does not hinder an astounding growth of the other institutional investors.

4.2. Multi-varied analysis

Table 2 presents the results of the different linear regressions. They are satisfactory both on the econometric plan and on that the economic and financial interpretation. Most of the kept variables seem to highly affect the level of the net share repurchase.

Table 2: Regression results: Dependent Variable is Net Repurchase

	Model 1	Model 2
Constant	3.623217*** (0.007)	4.797531*** (0.001)
INS	-30.30471* (0.081)	
MNG		12.9117* (0.093)
SIZE	1.522636 (0.204)	1.624547 (0.170)
DEBT	-8.180071** (0.047)	-7.715953** (0.048)
FCF	-17.60112**	-15.76188**

	(0.019)	(0.036)
ROA	19.38075** (0.012)	16.30217** (0.029)
DIV	2.917162 (0.105)	3.019106* (0.080)
R^2	0.4066	0.4006
Number Of Observation	462	462

***, **,*, mean that the coefficients are statistically significant for the respective thresholds of 1%, 5%, and 10%.

4.2.1. The institutional property

The net repurchase drops with the presence of the institutional investors among the stockholders of the company. This relationship can be explained by the fact that these investors (investment funds, banks, insurance companies give a much greater importance to whatever is investment compared to profit distributions. So, they prefer holding the available cash flows and reinvest them rather than distribute them. However, this negative relationship can be explained by the preference of the institutional investors for the dividends compared with repurchases, which is for fiscal reasons (more taxed on the gains in capital).

Thus, as postulated by Maury and Pajuste (2002), they found a negative relationship between the repurchase and the property of the institutional investors. These authors affirm that the distribution ratio brings down when the control owner is an enterprise or a financial institution affiliated in a company group. According to these authors, it is possible that these companies rather prefer holding these funds in order to exploit them in group projects.

This result is opposite that of Grinstein and Michaley (2005), who found that the institutional investors would put up their property in the companies which would repurchase their stocks and would reduce their property in the companies which distributed the dividends, and so they would have a preference for the repurchases compared with the dividends. Also, in 2005 these authors showed that these investors would benefit from the opportunities which would arise in the company. A way of controlling the managers consists in distributing the available FCF in the form of repurchase so as to limit an aberrant use of the funds by the manager.

4.2.2. The managerial property

The payment of the FCF to the stockholders is an efficient mechanism helping in resolving the agency conflicts, whatever the form of this distribution including the repurchase of stocks is. Therefore, according to Jensen (1986) the FCF represents the cash flow (or discretionary funds) held by the managers after financing all the positive Current-Net-Value projects.

The managerial property can form an important mechanism of aligning the interests of the managers and those of the stockholders bringing about a reduction in the costs that they support to control the manager.

Besides, when their right for the residual profit is weak, the managers may make profit from other sources in the company, which risks affecting its value. When the managers do not hold all the capital, they will incite raising their deductions in the company from the time that they do not bear all the costs of their opportunism. In fact, the managers constitute the particular agent who can use the resources of the company to establish or increase their power as well as the different advantages they receive (freedom of action, job security, remuneration, payments in kind…)

Stiglitz and Edlin (1992) showed how the managers could use the information asymmetry with the different partners and the competing managing groups to dissuade these latter from applying for the direction of the company. The investment policy represents, in this respect, a conspicuous entrenchment tool for the managers.

The entrenchment strategy developed by the managers aim for increasing their discretionary space using all the means at their disposal, namely their human capital as well as the company assets, to neutralize the control systems and increase the dependence of all the company partners on the resources they control (specific human capital, information asymmetry…)

Therefore, the positive relationship observed for the managerial property can be explained by the fact that the repurchase makes up an additional means of entrenchment for the managers. This result is in agreement with that of Skjeltorp and Odegaard (2004).

Definitely, the managers who want to raise the proportions of their stockholdings in the companies they run must repurchase the stocks of these ones. The financial choices (in terms of dividend and indebtedness policy or stock repurchase) can represent a vector of managerial deep-rootedness. Indeed, the financial policies can enlarge the discretionary power of the manager.

4.2.3. The control variables

Our model includes often all the company characteristics as control variables. The results show that the net repurchase is positively linked to the performance of the company and its dividend policy. The coefficients of these variables are statistically significant. However, both the indebtedness and the FCF negatively influence the repurchase.

Actually, the indebtedness represents a control mechanism which is replaceable for the repurchase. While these two variables have the control mechanism of the agency costs linked to the FCFS, the companies using less indebtedness should, equally, repurchase more stocks.

The negative relationship between the repurchase and the FCF is in contradiction with the hypothesis of Jensen (1976) which specifies that a company having high FCFS has to raise these distributions in order to lighten the problem of abnormal use of the funds by the manager in the non-profitable investments. This let us suggest that the French stockholders do not use the repurchases as a means of controlling the funds made available to the manager and rather resort to using the disciplinary instruments else than the repurchase. In fact, a debt issue can be one of these instruments, which obliges the manager to allocate the FCFS as a priority to the repayment of the loan.

We observe also that the most successful companies repurchase more stocks. This positive relationship was spotted by Nohel and Tarhan (1998) who showed that the disciplinary power of the market would replace a mechanism of declining internal governance. Still, as suggested by Denis and Mc Connel (2003), the distribution policy could go towards improving the performance of the company by reducing the agency conflicts.

The positive relationship between repurchasing stocks and distributing dividends can be explained by the fact that these two policies are rather complementary than substitutable; i.e., the repurchase and the dividend coexist and do not substitute each other.

5. Conclusion

In this paper, we have tested the relationship between the stockholding of the institutional investors and the managers, and the policy of repurchasing the stocks. We have used the Ordinary-Least-Square method on a sample of 77 French companies during 6 years, from 2003 to 2008. The results have shown that property of the institutional investors negatively influence the repurchase of the stocks which can be explained by the preference of these latter to the dividends compared to the repurchases for fiscal reasons. However, we have found a positive relationship between the stockholding of the managers and the repurchase, and this has been accounted for by the entrenchment power which can be a factor for the repurchase by increasing the percentage of stockholding of the managers who repurchase the stocks.

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