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Corporate Governance and Market Volatility
"Tunisian Political Crisis, October 2011"

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Abstract:
In the context of political crises, the investor pessimistic sentiment increases, and the price changes in stock get amplified, which result some disorder in the financial markets and spectacular falls in share prices.
By analyzing the election period of the Tunisian Constituent Assembly in October 2011, we noticed that political tensions affect differently stock prices.
During the political crisis, some companies showed better resistance than others and have maintained an acceptable level of price volatility. The results show that this resilience is explained by the best practices of corporate governance codes as well as business performance.

Keywords: Corporate governance, Stock price volatility, Political crisis.

1.Introduction

The last decade will leave in the economic history several traces of important and frequent crises in the international financial system. In fact, speculative accidents which mark out the economic and financial history and, chiefly, the stock market crashes which periodically punctuate the financial markets on a global scale moving from the tulip bulbs in Holland, the bankruptcy of " South Sea Company " reaching the crisis of the " sub-prime "; which are, actually, examples of deviations leading mainly to speculative madness. Moreover, the excessive volatility manifested in the course is an additional evidence of dysfunctional financial markets. This sequence of exceptional increases followed by exceptional declines, during which, assets prices dramatically rise for no obvious reason, and then fall, leading to a collapse of the financial market. Several theorists have studied these events in an attempt to identify their causes.

Financial crises are often associated with political instability. In the two recent and dramatic episodes, Argentina in 2001 and Greece in 2009. Economic and financial difficulties were followed by massive popular uprisings that ultimately toppled governments. Despite awareness of these and other cases, our understanding of the links between the financial crisis and political crisis remains quite poor.

The impact of crises whether financial or political and the behavior of investors is generally unexpected and inevitable. Crises do not affect in the same way the prices of financial securities for the following two reasons: First, the financial crisis may have the potential to negatively influence corporate profitability; that is to say, it could lead to a decline in stock prices through a fundamental change in profitability, the crisis "subprime" is regarded as a typical example. However, the negative impact of political crisis on stock prices is not the same as financial crises. It could be based on other reasons, such as the psychological reaction of investors, Min Lee Chan et al (2010). In other words, a political crisis may lead to a pessimistic market sentiment, leading to a drop in stock prices due to investor behavior which is expressed by selling panic. A typical example was the stock market crash of Tunisia which was affected by a political crisis marked by the election of the Constituent Assembly in October 2011.

The political tensions caused by the election of the Constituent Assembly of Tunisia October 23, 2011, led to a drop of Tunindex . In this context of political disturbance, Tunindex dropped dramatically to 4,700 points 4550 after a period of two weeks prior to the election date. After a period of about two weeks before the elections, Tunindex rebounded to 4710 points. So if we look at the index movement around a month before the elections, we can see that the trend of the stock market index has a V-shaped. Furthermore, movements of stock prices for most companies have rebounded quickly for a short period just after the decline, while other companies have exposed a small V-shape (a small recovery after a slight decline). Although the stock index (Tunindex) rebounded at the level it was before the crisis.

Mitton (2002) and Beak et al (2004) found that a certain degree, the corporate governance is effective in terms of price maintenance of actions in case of a political crisis. However, the market risk is another important factor on which investors base their investment strategies. Therefore, the good practices of corporate governance could help to stabilize profitability on the one hand, and the level of stock prices on the other.

Several authors have focused on the mechanisms of governance as G.Charreaux (1997). He argues that the separation of ownership and the control of the company mark a new stage with a shareholding companies among a large number of shareholders who each have a low participation on the one hand, and on the other, the management of these companies by leaders who have only small shares in the capital of the companies they manage. However, a contract is established between shareholders and managers, giving them the power to manage the company. This contract marks the separation between owners and managers, and establishes a relationship between a principal and an agent, whereby the Jensen and Meckling agency concept (1976). The originality of this last theory in comparison with to other previous ones is that it no longer considers the firm as a separate entity, but as a legal fiction which serves as a resolution of an equilibrium process between the conflicting objectives of individuals within the context of a contractual relationship. The separation of duties between shareholders and managers is born to solve problems related to conflicts of interests and agency costs. The evaluation of companies in times of crisis also allows us to understand certain aspects of the business which are less evident during situations of financial and political crises, Kuppuswamy and Villalonga (2010) governance.

The objective of this research is to propose a conceptual framework for this type of phenomenon which allows us to understand the characteristics of the relationship between corporate governance and stock price volatility during periods of political crises on the one hand, and to analyze the nature of this relationship through an empirical study on the other hand, taking into account variables as the seniority of officers, the structure of the board, the proportion of the familiar leadership and market performance .

2. The Literature Review

2.1. The Usefulness of Corporate Governance

The theme of 'corporate governance' and its effect on the performance of companies have been treated by several authors during the last two decades, such as; Gérard Charreaux and Philpe Diserbière (1997), Rafael La Porta et al (2000) and Mitton (2002). Today, the field of theoretical development of this theme was expanded by several authors, such as, MLChan et al (2011), C.Liu et al (2012), M.Martin.Boyer et al (2012), Vincent.A et al (2012). There were many conflicting theories in terms of the effect of corporate governance mechanisms, particularly the ownership structure and the structure of the Board of Directors during the period of the global financial crisis "2007-2008".

Mongiardino and Plath (2010) show that despite the increased regulatory pressure induced by the credit crisis, risk governance in the big banks did not really improve. Base III agreements published in December 16, 2010 describe best practices in governance of banking risks and stress the need to have at least a committee dedicated to risk management where the majority of members must be independent. In addition, the manager should be a member of the board of the bank.

Indeed, Vincent.A et al (2012) demonstrated that the leader of the company and the committee responsible for risk management may have conflicting interests. Therefore, if the strategies scheduled by the Board of Directors have contributed to improving the financial profitability during the period before the financial crisis of 2007-2008, meaning that they were not convincing in the period of financial turmoil. These authors found that financial institutions whose governing boards have a committee member of risk management were more effective during the financial crisis of 2007.

When the crisis began and the expected performance decreases, investors begin to detect the weakness within the mechanisms of corporate governance. We can detect this behavior especially in countries where the rights of the minority shareholders are not well protected, Mitton (2002).

2.2. Ownership Structure

Capital structure plays an important role in corporate governance. The participation of leaders in the capital of the company converge the interests of consumers to those of shareholders based on share participation, Philip J.McKnight and Charlie Weir (2008). Jensen and Meckling (1976) show that the participation of managers on the boards provides an incentive for them to act like owners of the company. The higher the participation of managers is, the more the agency costs are lowered. While Singh and Davidson (2003) find weak evidence that high managerial ownership reduces the cost of agencies. Thus, the outer property is considered as a governance mechanism, namely, institutional investors, who represent a source of controlling management and reducing agency costs. Beltratti and Stulz (2011) argue that banks, with an important institutional ownership, have a higher level of risk during periods of financial crises.

Although all businesses have been affected by the crisis, however, David H. Erkens et al (2012) find that firms whose institutional ownership is   important,   had   low   stock   market   returns   during   the   sub-prime   crisis. According to Baek et al (2004), Korean firms whose institutional ownership is important experienced a dramatic decline in the value of their capital during the Asian crisis. The presence of controlling shareholders reduces conflicts of interest and agency costs; it improves participation in the creation of value for the company and monitoring officers. However, ownership of "block-holders" encourages the profitable strategies and improves the decision-making environment, which results an increased business performance McConnell and Servaes (1990).

2.3. The Structure of the Board of Directors
Several authors indicate that good practice governance codes depends on the skills of the members of the Board of Directors in management and structure of the board such as Gérard Philipe and Charreaux Desbières (1997). Thus, several papers present evidence and suggest that the effectiveness of the system of governance depends positively on the independent structure of the Board.David H. Erkens et al (2012) found that firms with more independent boards have experienced a dramatic drop in the prices of their shares during the financial crisis. Kashyap et al (2008) and Myers (1977) postulate that the negative relationship between stock returns and the independence of the board is explained by the pressure of independent directors on the heads of various departments and committees to mobilize equity during the crisis to ensure capital adequacy and reduce the risk of bankruptcy. Hermalin and Weisbach (2003) point out that there is no significant relationship between the composition of the board (such as board independence) and the financial and economic performance of firms.

2.4. Governance and Firm Performance
Fahlenbrach and Stulz (2011) studied the impact of managerial incentives on financial performance. They found that strong shareholder returns could lead to poor performance. Thus, during periods of crisis, he noted that the leaders do not limit their equity portfolios, which aggravated the financial situation of banks.
Beltratti and Stulz (2011) found that the banks which create more wealth for shareholders are more vulnerable to financial risks during periods of financial crises. This leads to conclude that the good governance practice code is unable to ensure the creation of wealth for shareholders. Beltratti and Stulz (2011) argue that companies whose boards help create wealth for the companies on the detriment of shareholders are mostly affected by the financial crisis of "2007-2008". Thus, firms with important institutional ownership are less efficient than those whose institutional presence is less performant. Indeed , previous studies have investigated how corporate governance structures affect the performance of stocks in the context of emerging markets during the Asian financial crisis of 1997-1998 as Baek et al (2004) , Mitton , (2002), Lins and Lemmon (2003) .
Kartick Gupta et al (2013) found that well-governed companies are no better than the poorly governed ones in terms of performance during the financial crisis of 2007-2008. This can be explained by the 'behavioral finance' approach, I-e, in a crisis, one could say that investors will quickly change their allocation of risky assets to safer assets. This redistribution results the rapid liquidation of securities without taking into consideration the quality of corporate governance. Thus, the benefits of good governance will not be reflected in a financial crisis. Chunyan.Liu et al (2012) found that public companies which rely on bank debt have experienced small declines in the performance of their actions during the crisis. While they exhibit poor performance during the period before the sub-prime crisis, this is explained by the state subsidy. Chunyan Liu et al (2012) argue that companies that use one of the offices of BIG- 4 for the audit work, saw a slight decrease in value during the period of global financial crisis. Similarly, they showed evidence that bank debt has a positive effect on business performance in times of crisis. These results contrast with the findings of Baek et al (2004), Kang and Stulz (2000) and Nogata et al (2011). K.Gupta et al (2013) have postulated that the statements and reports of the committees responsible for risk management and regulations which protect the minority shareholders affect the financial and market performance of financial institutions. That is to say that the leaders of companies have taken serious false decisions when they decided to distribute dividends at the expense of equity in a period considered sensitive (the period of the sub-prime crisis). While other authors as MLChan et al (2011) believe that the mechanisms of corporate governance positively affect the financial performance and the level of stock prices during periods of crises. Several factors have been at the origin of financial crises. We can reveal mainly the problems of delegation and different relations of agencies repelled by the inevitable agency theory initiated by Jensen and Meckling (1976).

3. Data and Research Methodology
The objective of our work is to examine the relationship between corporate governance and stock price volatility under the Tunisian political crisis in October 2011. This is to analyze the impact of some governance variables on the fluctuation of stock prices and to detect the degree of correlation between them. It should be noted in this connection that a previous study by Lee Min Chan et al (2010) analyzed the phenomenon of interaction between governance mechanisms and stock prices in the presidential elections in Taiwan (2002). They tried to identify factors that have contributed to the stabilization of certain market prices after a period of one month of the presidential elections. Indeed, the results of this study state that there is a positive relationship between the structure of the board, the proportion of independent directors, the presence of state-owned companies, belonging to one of the audit firms big4 in terms of control, the foreign participation and the market volatility . We will adopt the Min Lee Chan methodology et al (2010) to try to detect this relationship on the Tunisian market. In other words, it is to identify the variables of corporate governance that helped stabilize the market price after the elections of the Constituent Assembly of Tunisia in October (2011).

3.1. Presentation of Study Data
The financial data for the period between 2010 and 2011 was collected from fact sheets and published by the exchange of movable values in Tunis (BVMT) and the Financial Market Council (CMF). Those relating to corporate governance were also identified with flyers and reports from the activities of the companies published by the same counsel. The sample considered in this study consists of 32 non-financial corporations.

3.1.1. Definition of variables

3.1.1.1. The variables Explained
• VOL $= \dfrac{HP - LP}{\frac{HP - LP}{2}}$

VOL: is the range of fluctuation in the market price.
HP: the highest purchase closing price for one year of the date of the election.
LP: the lowest purchase price in a year before the date of the election.

3.1.1.2. The explanatory variables
• DUALIT: variable that indicates the nature of the structure of the board of directors (independent or dual). In case the CEO is himself, the president of the board.
State 0; if it is an independent structure
State 1; if the state is dual
• INDD: represents the proportion of external directors within the board. (The proportion of external directors includes all independent directors in the board).
• BIG4: variable Auditor, if the company has one of the BIG4's auditors.
        State 0; if the auditor is one of the BIG4
State 1; otherwise
• BUA: represents the presence of the bank or state enterprise within the sample.
• ETRG: Presents the annual proposal of foreign investments in the
 market capitalization of each company.
• PERF: Represents the market performance based on the financial profitability (ROA). It is the financial profitability of each company within the segment profitability.
                PERF = ROE - ROE sector

3.2. Model test
After introducing all the variables in our model and their actions, we can deduce our analysis that expresses the relationship between performance and governance model:
$$VOL_i = \alpha + \beta_1 (BIG4)_i + \beta_2 (DUALIT)_i + \beta_3 (PERF)_i + \beta_4 (INDD)_i + \beta_5 (BUA)_i + \beta_6 (ETRG)_i + \varepsilon_i$$
Or i = 1 ....32 means business.

4. Analysis and Discussion of Results

4.1. Descriptive and Comparative Statistical Analysis
    These two tables summarize the average, median, maximum and minimum value of each variable of the companies studied.

Variable of 2010	Average	Median	Variance	Minimum	Maximum
Volatility in equity prices (Vol)	0.412	0.387	0.293	-0.911	1.638
Control subjected to one of the BIG 4 firms	0.437	0	0.504	0	1
Structure of Board of Directors (Dualit)	0.468	0	0.507	0	1
Financial Performance ROE ROE-sect (Perf)	0.15373	0.10485	0.2464	-0.29940	0. 8363
Proportion of independent directors (INDD)	0.372	0.4	0.252	0	0.9
Presence of public enterprises (BUA)	0.187	0	0.396	0	1
Participation in the foreign market capitalization (Etrg)	0.099	0.019	0.158	0	0.592

Table 1: Descriptive statistics for the year 2010

Variables of 2011	Average	Median	Variance	Minimum	Maximum
Volatility in equity prices (Vol)	0.083	0.072	0.046	0.021	0.206
Control subjected to one of the BIG 4 firms	0.468	0	0.507	0	1
Structure of Board of Directors (Dualit)	0.437	0	0.504	0	1
Financial Performance ROE ROE-sect (Perf)	-0.002	0.001	0.144	-0.430	0.250
Proportion of independent directors (INDD)	-0.002	0.001	0.144	-0.430	0.250
Presence of public enterprises (BUA)	0.750	1	0.439	0	1
Participation in the foreign market capitalization (Etrg)	0.100	0.023	0.162	0	0.642

Table 2: Descriptive statistics for the year 2011

For the variable structure of the Board of Directors for companies whose structure is dual board, the majority of leaders hold office for a period not exceeding 4 years, with an average of 0.468, a median equal to zero for 2010. Whereas in 2011, it admits an average of 0.437, that is to say, the minority leaders shall hold office for a period exceeding four years. Most of them are under state control or a group of investors, with an average of 0.720. Thus, they are characterized by low foreign participation with average of 9.9 % in 2010 and 10% for 2011.
Variable Proportion of independent directors (INDD) varies between a minimum value of 0 and a maximum value of 0.9 and a median average 0.372 and a median of 0.4 for the year 2010. Whereas, in 2011, it varies between a minimum value of 0.120 and a maximum value 0.620 and 0.359 average and median 0.385.
As to the membership of one of the big4 audit firms in terms of control, the average value is 0.437 in 2010 and it increased to 0,468 in 2011. However, the presence of public enterprises (BUA) has averaged 18, 7% in 2010; however, it increased in 2011 and reached 75%.
Financial performance is expressed by the difference between the financial sector profitability less financial profitability (ROE - Segment ROE), it is presented as a percentage in 2010.The average company in our sample represents 15 373 in terms of performance and admits a median of 10 489% with a maximum of 83.63% and a minimum of 29,940%. However, it dropped to 2011 with an average of -0.002, a median of 0.001 to a maximum of 0.250 and a minimum equal to -0430. We observe a large variability of performance caused by the political crisis in January 2011.
Regarding the fluctuation of stock prices in 2010 or the volatility which is determined by the ratio between the difference from the highest price minus the lowest price in a month after October 24, 2011 (date of election of the Constituent Assembly) and the average of these two variables during the same period. The average volatility of firms is 0.412, and the median equal to 0.387, with a minimum of -0911 and a maximum of 1.638.
In 2011, the average volatility is 0.083, with a median of 0.072, with a minimum 0.021 and maximum of 0.206. We can see that the volatility of stock prices varies from one sector to another and from one society to another. This large variability in volatility between companies and sectors and especially in the period mentioned above is purely driven by political events. This political crisis affects businesses and levels of stock prices differently.
As for the fluctuation of stock prices, we can see that the levels of share prices of companies that are characterized by duality leaders which are more volatile than companies that recognize an independent governance structure with an average range of fluctuation of 0.082 against/versus 0.068.

4.2. The Regression Results Obtained in the Tunisian Context

4.2.1. Test Heteroscedasticity Errors
The heteroscedasticity test error allows us to test the stability of the error variances. Detection of this phenomenon is by using White test. Observing the probability associated with the statistic TR ^{2} in the White test table, we note that this probability is less than 0.05 (5%), which leads us to the acceptance of the non-null hypothesis (H1). This leads to the acceptance of the hypothesis of heteroscedasticity errors.

$$VOL: TR\ ^2 = 0.0084 < 0.05\ (5\%)$$

4.2.2. The Estimation Results
Both tests allow us to confirm that the basic assumptions of the method of ordinary least squares are violated, which leads us to process by the method of generalized least squares.

To check the assumptions, the results of different regressions for each dependent variable on the other independent variables are summarized in the following table:

Variable explained	VOL 2010	VOL 2011
BIG4	(1.123) 0.261	(0.461) 0.648
DUALIT	(2.135)** 0.042	(2.698)** 0.012
PERF	(0.017) 0.985	(-0.581) 0.566
INDD	(-1.700) 0.115	(-1.647)** 0.095
BUA	(-0.743) 0.463	(1.741)* 0.093
ETRG	(-1.886)* 0.071	(-2.086)** 0.047
DW	2.151	1.538
R²	0.274	0.423
R ² adjusted	0.100	0.285
Fisher	(1.578) 0.197	(3.063)** 0.021
N	32	32

Table 3: Results of regression

* Significant at 10%
** Significant at 5%
*** Significant at 1%
The values between parentheses represent the " T" of student.

The regression variables for the year 2010 shows that calculated F is less than F tabulated and the probability associated with the statistic "Fisher" is greater than the threshold of 5% risk (F prob = 0.197 > 0.05), therefore we accept H_0 , and we conclude that the model is generally not significant, it can be explained by the limited sample size . For cons , the second regression model volatility on different explanatory variables shows that F calculated is greater than F tabulated, then we can reject H0 and then we can confirm that the model is globally significant at as 5% (F prob = 0.021 < 0.05). The examination results of the two models allow us to confirm that the Durbin Watson is close to 2, so we can accept the hypothesis of absence of self-creation errors. We note that after the regression of fluctuations in stock prices on corporate governance variables, the coefficient associated with the variable BIG4 is not significant for the period 2010-2011. What we can notice is that the quality audit and management control has no effect on the volatility of stock prices. We note in this regard that the Tunisian financial market investors seem not to award interest on the notes and reports of the auditors or neglect the variable reputation affiliated with BIG4 companies.

We also note that the coefficient associated with the variable DUALIT is positive and significant at the 5% level when the explanatory variable is the fluctuation of stock prices, 2135 for the year 2010 versus 2698 in 2011. These results show that the duality of the leader positively influences the fluctuation of stock prices. That is to say that firms whose managers occupy a seat on their board, admit higher volatility during the political crisis over companies whose governance structure is independent. This relationship has its arguments through the managerial entrenchment and agency theories. The result converges to the agency theory, which argues that the existence of a duality reduces the quality control of the board; it also reinforces the entrenchment, Fama (1980) and Williamson (1983). Therefore, periods of policy throughout 2011 on, were characterized by a performance below the average of previous years. The coefficient associated with financial performance (PERF) is negative (-0,581) for 2011 versus a significant positive coefficient for 2010 'Student'. This result seems logical, since in times of financial or political crises, economic aggregates of a country deteriorate. Regarding the variable of the proportion of outside directors, we can notice that after our regression was negatively significant for the year 2011.The Coefficient 'Student ' brand (1647) versus (1700) for the year 2010. This means that the presence and the number of independent directors on the board of directors assigned to indirect market volatility during the period of the Tunisian revolution. In addition, the number of independent directors in relation to the size of the board is small; most decisions of the latter are perishable. Indeed, the independent directors always keep a normally neutral position in terms of advice on management from management of the firm. All this systematically affects results, forecasts, and the level of stock prices of companies. Our study has a selective and binary variable which divides our sample between private and public enterprises, this variable (BUA). Regression on this variable shows that the public or private companies played a key role in the first phase of the Tunisian political crisis in 2011. Estimation results show that the coefficient of 'Student ' for the variable ' BUA is positively significant with 1 .741 at the 10% level. Private companies are more sensitive to financial and political crises. This finding has already been proved by several authors. In Tunisia, the private companies were more sensitive against political interference. Regression on the variable ' BUA ' shows that stock prices of private companies are more volatile than those of public enterprises. We can forward a possible explanation that Tunisian investors, given the state support for public institutions,

give   more   confidence   to   these   companies.
However, the regression results on foreign participation in the capital of companies (ETRG) are negatively significant. The variable ' ETRG admits Student negative coefficients for 2010 and 2011, with (1886) and (2086). It may be noted that the accuracy of probability associated with Student statistic has become more important in 2011 with only 5% compared with 10 % in 2010. These results are quite logical since the crisis; foreign investors sell their equity holdings to preserve their wealth.

5.Conclusion

However, the results below show that if companies adopt an independent governance structure, they take into account the recommendations and ratings of professional audit firms and expertise, and they adopt standards in terms of appointment of independent directors, this could help to reduce some of the volatility of stock prices and excessive reaction of stock prices during periods of political crises. These results are considered to be related to investor confidence. We believe that our results confirm the importance of corporate governance in times of political crises, they could help investors and financial economists to better understand the behavior of stock prices during political crises. Our results suggest that investors should consider corporate governance when making investment decisions. Indeed, corporate governance, has not only a positive effect on the performance of financial assets, but also plays a role to stabilize stock prices during crises.

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