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The governance of Moroccan listed companies: understanding challenges and integrating behavioral aspects.

La gouvernance des entreprises marocaines cotées en bourse : compréhension des défis et intégration des aspects comportementaux.

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Summary:

This article aims to demonstrate the importance of behavioral approaches in developing a governance theory that addresses the shortcomings of classical theory. It highlights the limitations of the latter, as evidenced by the low explanatory levels observed in some studies, such as Larcker, Richardson, and Tuna (2004), which show that this approach explains only 9.1% of firms performance in the American context. Researchers like Jensen (2004) also question the effectiveness of traditional disciplinary mechanisms, such as financial markets, in the face of the behavioral biases of economic actors. An alternative explored, notably by Charreaux (2002 ,2003), consists of adopting a more complete approach to governance, considered conflicts between parties involved and the important role of skills in value creation. Jensen extracts insights from research conducted in various fields such as neuroscience, organizational learning, and behavioral economics, particularly the works of Thaler and Shefrin (1981). He identifies behavioral biases as a source of "self-agency costs," but these consequences remain underexplored in his work on corporate governance.

Thus, this article proposes to explore the implications of behavioral biases in governance theory, by revisiting their definition and role in the literature and then proposing a method to incorporate these elements into governance theory.

Keywords: governance, behavioral bias, firm performance, crises, financial scandal, agency theory, behavioral theory, governance mechanisms, board of directors, listed companies Casablanca Stock Exchange.

Introduction:

The concept of governance developed by Jensen and Meckling (1976) confirms the issues of conflicts between shareholders and executives. It emphasizes that financial scandals in the 2000s led to strengthened governance mechanisms, but these function imperfectly, with companies often settling for formal compliance rather than real adherence to governance principles. [1]

We aim to identify the governance mechanisms applied to publicly Moroccan publicly traded companies and explain their inefficiencies. Besides cultural and organizational factors, the authors argue that executives often perceive governance as aiming to avoid mistakes rather than actually creating value.

Nowadays, researchers are incorporating behavioral aspects, harnessing insights from Jensen's (1994) work on the pain avoidance model. This requires combining theoretical frameworks from behavioral finance with those of strategic and evolutionary economics to better understand executive decisions and their impact on value creation. We highlight the challenges of governance, present the shortcomings of traditional mechanisms, and propose integrating behavioral aspects to improve the effectiveness of governance practices in companies.[2]

In the following sections, we will explore and attempt to answer the question:

What are the effects of behavioral biases on the decision-making of executives in traded Moroccan companies?

To do so, we will structure our analysis into several key sections:

Firstly, we will delve into the institutional reforms prompted by financial scandals. The aftermath of major financial scandals, such as those involving Enron, Lehman Brothers, and Société Générale, exposed significant deficiencies in regulatory and oversight mechanisms. In response, a series of institutional reforms were implemented to enhance transparency, improve corporate governance, and protect investors. These reforms include stricter regulations on accounting practices, increased disclosure requirements, and the establishment of stronger regulatory authorities. For instance, the Sarbanes-Oxley Act in the United States introduced rigorous reporting and compliance requirements to restore investor confidence and prevent future financial malfeasance. Secondly, we will explore the sources of inefficiency in governance mechanisms in Morocco.

The effectiveness of governance mechanisms is often undermined by factors such as bureaucratic red tape, weak implementation of laws and regulations, and limited transparency, which can foster corruption. Corporate governance practices in Morocco may also be influenced by family-dominated business structures, potentially leading to conflicts of interest and suboptimal resource allocation. Addressing these inefficiencies is crucial for improving the overall governance framework and fostering a more conducive environment for business growth.

Subsequently, we will discuss the correlation between corporate governance and value creation. Effective corporate governance is integral to creating value for shareholders and stakeholders alike. Good governance practices contribute to better decision-making, enhanced risk management, and greater transparency, which can lead to improved financial performance and increased investor trust. Companies with robust governance frameworks are generally better positioned to seize opportunities and mitigate risks, which positively impacts their market value.

Additionally, we will address specific governance mechanisms and their role in value creation. Mechanisms such as independent boards of directors, audit committees, and performance-based executive compensation systems play a pivotal role in value creation. Independent boards can provide objective oversight and avoid conflicts of interest, audit committees ensure the integrity of financial statements, and performance-based compensation aligns executives' incentives with shareholder interests. These mechanisms collectively contribute to effective governance and, consequently, to the creation of long-term value.

This will lead us to examine the main streams of behavioral literature. Behavioral literature explores how cognitive biases and heuristics affect economic and financial decisions. Concepts such as risk aversion, overconfidence, and groupthink have been identified as factors influencing investor and managerial behavior. Understanding these behavioral tendencies is essential for recognizing how they impact decision-making processes and governance outcomes.

Finally, we will explore the integration of the behavioral dimension into governance. Incorporating behavioral insights into governance involves acknowledging and addressing cognitive biases and irrational behaviors that can affect decision-making. This may include implementing structured decision-making processes, providing training on cognitive biases for leaders, and fostering a culture of transparency and objectivity. By integrating behavioral insights, companies can enhance their governance practices, improve decision-making, and ultimately create more value.

1. Evolving theories of Corporate Governance

Agency Theory: Shareholder Perspective: Agency theory, popularized by Jensen and Meckling , is one of the most influential theories in corporate governance. This theory is based on the contractual relationship between owners (principals) and managers (agents),[3]
Fama and Jensen The primary issue highlighted by this theory is the potential conflict of interest, where managers may act in their own interest rather than in the interest of shareholders. Agency theory proposes governance mechanisms such as boards of directors, performance-based incentives, and external controls to align the interests of agents with those of the principals.[4]

Stakeholder Theory : Stakeholder theory, developed by Freeman, broadens the perspective of corporate governance by including not only shareholders but also other stakeholders such as employees, customers, suppliers, and the community, Mitchell, Agle, and Wood .This theory argues that companies must consider the interests of all stakeholders to ensure long-term success. It emphasizes corporate social responsibility and business ethics.[5]
Behavioral Governance Theory : Behavioral governance theory emerges as a response to the limitations of traditional agency and stakeholder theories, Tversky and Kahneman (1974),This approach integrates insights from psychology and behavioral economics to better understand how executives make decisions[6].
For example, cognitive biases such as overconfidence and temporal myopia can influence managerial decisions, potentially leading to suboptimal behaviors.[7]
This theory highlights the importance of corporate culture, individual values, and morality in governance.[8].

Recent research has deepened the study of overconfidence in executives, a cognitive bias where individuals overestimate their abilities or the accuracy of their information. Malmendier and Tate , were among the first to document the impact of overconfidence on CEO decision-making, showing that excessively confident CEOs tend to overinvest in internal projects and underestimate risks.[9]

More recent studies, such as those by Ben-David, Graham, and Harvey , have confirmed these findings, demonstrating that overconfidence can lead to imprudent investment decisions, thereby increasing the risk of corporate failure[10].

These studies underscore the importance of effective governance mechanisms to mitigate the negative effects of overconfidence.[11]

Another recent approach in corporate governance is adaptive governance theory, which proposes that governance structures should be flexible and capable of adapting to environmental and organizational changes. This theory, discussed by Aguilera, Judge, and Terjesen, suggests that companies must continuously evaluate and adjust their governance practices to remain competitive and meet stakeholder expectations.[12]

2. Institutional Reforms due to Financial Scandals

Recent financial scandals, such as Enron, Worldcom, and Parmalat, had a significant impact on investor confidence internationally.

In response to these events, authorities have been compelled to enact new regulations to restore this confidence. For example, the Sarbanes-Oxley Act (SOX) in the United States and the Financial Security Act (LSF) in France impose stricter internal control obligations. [13]

In Morocco, similar measures have been taken to enhance the financial transparency of listed companies. In addition to laws, several reports and recommendations, such as the Viénot , have sought to improve corporate governance by emphasizing the independence of directors and oversight of executive decisions. Codes of conduct have also been developed to promote best governance practices, reflecting an international trend observable since the Cadbury report in the UK. Institutional investors also play a crucial role in improving the financial transparency of companies by demanding greater ethics and better comparability of financial information. For example, their influence has led to the adoption of oversight committees by listed companies, even in Morocco, due to their increasing involvement in the capital of these companies.

In the last ten years, institutional and legal pressures have shifted corporate governance towards an accumulated role of directors, the development of oversight committees, and a separation of powers. Indeed, following pressures from institutional investors and minority shareholders, the status of independent director appeared in 2002 (Bouton report) to ensure greater independence of the board of directors, beyond the views of executives or majority shareholders. Recommendations and best practices mean that in general, the percentage of independent directors in the board of directors of a listed company is around one-third. The practice largely conforms to the recommendations of "good governance" codes in all major companies.

In addition to the independence of directors, the creation of oversight committees within the board of directors of Moroccan listed companies has also been subject to multiple pressures. The first Viénot report in 1995 introduces a recommendation regarding the establishment of oversight committees, more particularly audit, nomination, and remuneration committees. Since the publication of this report, the pressure exerted by Anglo-Saxon institutional investors on listed companies to align with "good governance" standards has accumulated, and the requirements have strengthened, particularly regarding the number of independent directors composing these committees. The establishment of these committees also responds to pressures from policies and public opinion following recent scandals related to excessive executive compensation and "manipulation" of accounts[14].

Executive compensation has also been subject to pressures, even controversy, from many shareholders, particularly at general meetings. Over the past decade, the share of stock-based compensation plans and stock options has accumulated considerably in executive compensation. In addition to the incentive nature of remuneration, executives who own shares in the company bear the consequences of decisions harmful to the company and benefit from those that increase its value. It follows that executives with a larger ownership stake would provide more effort, have longer investment horizons, and make better investment decisions. If executive share ownership is recognized as one of the most effective and direct methods to align the interests of executives with those of shareholders, opposition from many shareholders is developing, given the amounts involved. Boards of directors are therefore subject to increasing pressure from shareholders who want to ensure that there is an effective relationship between the granting of such remuneration schemes and the specific financial performance of the firm. Moreover, the disputes go far beyond shareholders and institutional investors to involve other parties such as employees and their unions, political circles, and the media. Similarly, in public opinion, stock options fuel criticism[15].

It is no longer just a question of addressing the link between remuneration and performance, but also of questioning the ethics of the remuneration system they are responsible for designing and managing. Regardless of their remuneration, executives have also seen their status evolve. In Morocco, the separation of the roles of Chairman and CEO was prohibited by law in the joint-stock company. But the explosion of the number of scandals in the 1990s due to many abuses of power by certain executives generated certain tensions at the origin of the NRE law in 2003. This law now introduces the possibility of separating the roles between Chairman and

CEO within Moroccan listed companies, and today more than 51% of companies in the SBF 120 have adopted this separation.[16]

According to the Deloitte study, a number of directors suggest that despite the more stringent framework, the new rules of corporate governance and the new culture lead to greater transparency. However, the adoption of "good governance practices" carries a real danger, the practice of "box-ticking": companies would be in a process of formal adherence to the principles of governance. Thus transparency would turn into appearance, and the information disseminated could only be a clever screen. Even if transparency is one of the requirements of effective corporate governance, executives would be skeptical about the idea that better governance creates value.[17]

3. The sources of inefficiencies in governance mechanisms in Morocco

The dysfunctions of corporate governance mechanisms in Morocco are diverse and stem from various factors. Some of the primary challenges include weak institutional and regulatory frameworks, where governance mechanisms are often treated as recommendations rather than legal obligations, potentially undermining incentives for sound governance practices[18] .

Conflicts of interest, especially prevalent in dominant public enterprises, pose significant hurdles to implementing good governance practices. Additionally, while there is widespread awareness of corporate governance, translating this knowledge into actionable strategies remains a challenge. Insufficient control mechanisms, such as external auditing and taxation, further exacerbate the situation by failing to effectively regulate accounting discrepancies [19]. The lack of separation of functions, particularly evident in companies where the roles of chairman and CEO are combined, can lead to conflicts of interest and biased decision-making [18].

Moreover, inadequate transparency and disclosure practices among Moroccan companies impede shareholders and authorities from effectively monitoring their operations. The absence of essential committees, such as remuneration and audit committees, also contributes to governance gaps. Addressing these challenges necessitates continual improvement of mechanisms and practices to ensure the effective and transparent management of companies in Morocco, A. Aajly and M. Tahrouch,.

The relationship between good corporate governance and value creation is a subject of much debate and discussion.

The connection between corporate governance and value creation has been widely debated. Numerous studies confirm the relationship between governance practices and corporate performance, either from a broad perspective or by examining specific governance mechanisms.

Gogler, Mueller, and Yurtuglu assert that a reliable governance system aligns the interests of managers and shareholders, thereby maximizing shareholder wealth. Campos, Newel, and Walson investigated the correlation between governance and firm value, finding that good governance practices are recognized by the market through higher valuations. Companies that invest in shareholder rights, information transparency, and board independence generate more trust among shareholders. [20]

Bai, Liu, Song, and Zang found that investors are willing to pay a premium for companies that adopt exemplary governance practices.[21]

Amir, in a study of 55 French firms from the SBF120, confirmed the significant role of governance mechanisms in value creation. The study highlighted that the proper functioning of the board of directors, linked to its structure and independence, as well as the existence of an audit committee, are crucial for firm performance. However, practices related to remuneration policy, ownership structure, and shareholder rights did not show a significant effect on firm performance, which is inconsistent with many governance codes and recommendations for value creation.[22]

The literature frequently discusses four specific governance mechanisms: board independence, board size, separation of chairman and CEO roles, and incentive-based remuneration.

Some studies, such as those by J. Rosenstein and S. Wyatt [23] J.W. Byrd and K.A. Hickman, [24] R. Morck and M. Nakamura, [25] and S.N. Kaplan and B.A. Minton, argue that the presence of independent directors improves company performance[26].

Other studies, conclude that increasing the percentage of independent directors has no significant impact on performance. A more recent study, conducted by scholars from Hong Kong and published in the Journal of Financial Economics in 2010, showed that the loss of an independent director can lead to a 0.85% average decrease in stock price, representing losses of $35 million for a market capitalization of $4 billion. Additionally, concerning Board Size, smaller boards of directors are often seen as more effective in overseeing management, although a very small board may lack diversity of expertise[27].

Also, regarding the Separation of Chairman and CEO Roles, studies show mixed results on whether separating these roles has a positive impact on performance. Additionally, Incentive-

Based Remuneration should provide close alignment of executive compensation with company performance to reduce costs associated with conflicts of interest[28].

In particular, the current economic and financial crisis highlights weaknesses in certain governance mechanisms in Morocco. Recent scandals involving the dismissal or negotiated departure of executives from listed companies have revealed that part of executive compensation is disconnected from their effectiveness.[29]

To address the inefficiencies of corporate governance mechanisms, several recommendations can be made. This includes strengthening legal frameworks to ensure governance mechanisms are seen as obligations rather than recommendations, ensuring the independence of audit and remuneration committees to avoid conflicts of interest, increasing transparency and disclosure in corporate management and communication to facilitate better oversight by shareholders and authorities, and promoting the separation of roles of chairman and CEO to reduce conflicts of interest and enhance fairness in decision-making. By addressing these challenges, corporate governance in Morocco can be continuously improved to ensure effective and transparent management of companies[18].

4. Behavioral literature: The integration of the behavioral dimension in governance:

Behavioral biases define deviations from an ideal norm of perfect rationality.

These biases often lead to irrational behaviors and negatively influence efficiency. In other words, behavioral deviate from an ideal norm where individuals would be perfectly rational, selfish, and capable of flawlessly implementing their decisions. This theoretical model would lead to optimal efficiency if transaction costs were zero and markets were perfect. Behavioral biases represent a source of inefficiency that needs to be corrected. Ulen distinguishes behavioral inefficiencies from environmental inefficiencies, such as information asymmetries and opportunism[30] .

Thaler (1996) classifies biases into three categories: Bounded rationality: judgment errors and deviations from utility maximization. Bounded willpower: behaviors contrary to long-term interests, such as difficulty quitting smoking. Bounded self-interest: fairness concerns in decisions. [31]

For that matter, the classification of Biases: Biases can be classified according to two criteria: **cognitive/emotional and individual/collective**. Cognitive and individual: Hindsight bias. Cognitive and collective: Cognitive conformity, such as belief in market efficiency despite anomalies. Emotional and individual: Overconfidence of executives. Emotional and collective: Collective panic, peer pressure. Other Areas of Behavioral Approaches We owe the existence of several types of biases. [6]

Besides, behavioral governance can be seen as a component of behavioral finance, but it can also benefit from contributions from other streams of behavioral literature. In addition to behavioral finance, three other streams are mobilized: behavioral economics, behavioral economic analysis of law, and strategic management. [32]

Moreover, the types of Biases Individual Biases: Anchoring, cognitive overload, cognitive dissonance, framing bias, heuristic, hindsight bias.

Collective Biases: Cascades, common beliefs, consensus, manipulation, mimicry, peer pressure, etc. Cognitive and Emotional Biases: Addiction, endowment effect, loss aversion, overconfidence, status quo bias, etc. Behavioral Finance Initially developed to explain anomalies in financial markets, behavioral finance has begun to integrate corporate finance. Pioneering models such as Lintner and Roll , introduce behavioral dimensions. [7]

Sheffrin and Baker et al. are crucial for understanding the integration of behavioral dimensions into corporate finance, notably by identifying internal behavioral costs (manager biases) and external costs (analyst and investor errors). Behavioral Economics seeks to better understand economic behaviors by integrating insights from cognitive and social psychology. [33]

Researchers like Rabin , Camerer et al., and Zak study economic decisions and cognitive biases. A promising area for governance is behavioral institutional economics, which explains certain institutions like Social Security through the prism of behavioral paternalism [34].

Behavioral Economic Analysis of Law This stream, developed by American jurists, aims to offer a better explanatory theory of law by integrating behavioral biases. Concepts like "asymmetric paternalism"

Camerer et al. are used to protect the most irrational individuals without harming the most rational ones. Reflection on governance includes recommendations to educate investors and regulate markets to correct evaluation errors[35].

Strategic Management Research in strategic management deals with the influence of cognitive biases on executive decisions. Authors like March and Simon, Hogarth , Schwenk, and Bazerman analyze errors made in mergers and acquisitions and the influence of boards of directors on executives' cognitive patterns.[36]

Biases and Governance The dominant vision in these streams is anti-bias, aiming to improve decision quality and create more value. However, some biases can have beneficial effects. [37].

The perspective of remediability Williamson, proposes that existing situations are effective unless a feasible alternative can bring a net gain. Some degree of irrationality can be beneficial in the real, ambiguous, and imperfectly knowable world, notably by encouraging risk-taking and innovation. [38]

In the traditional model, governance mechanisms are designed to reduce agency costs, that is, the costs associated with conflicts of interest between stakeholders. However, this model often overlooks the impact on value creation through cognitive pathways, notably the construction of investment opportunities.[39]

The behavioral dimension is generally perceived negatively in this context because it is associated with risks of suboptimal decision-making by executives, such as overestimating synergies in an acquisition project due to overconfidence. Additionally, traditional governance mechanisms can be compromised by the behavioral biases of directors, analysts, auditors, or investors.[40]

To enrich the analysis of governance systems, it is proposed to integrate behavioral biases from both an explanatory and normative perspective. On the explanatory level, this means recognizing that real governance systems aim to reduce not only traditional agency costs but also behavioral costs. On the normative level, this can lead to more paternalistic public intervention and measures aimed at correcting the cognitive biases of decision-makers.

From a partnership perspective, which considers the agency costs between different stakeholders in the company, the analysis of governance mechanisms must Consider the behavioral biases that influence these relationships. Governance mechanisms can then be evaluated based on their impact on agency costs and behavioral biases.

Finally, the integration of the behavioral dimension allows for the reinterpretation of the costs and gains of competencies, as well as the role of different governance mechanisms.

Conclusion:

The separation between ownership and control in joint-stock companies has given rise to the concept of governance, aimed at mitigating potential conflicts of interest between shareholders and executives. Despite governance mechanisms put in place to align interests and maximize shareholder wealth, recent financial scandals have revealed their partial effectiveness. In France, this inefficiency is attributed to various cultural, organizational, and environmental factors, as well as a primarily formal approach by executives towards governance. To improve governance, it is suggested to incorporate elements of behavioral finance, aiming to better understand and manage irrational behaviors of individuals in extreme situations.

Recent financial scandals such as Enron, WorldCom, Parmalat, and others have led to a widespread crisis of confidence in international markets. In response, legislators have enacted laws such as the Sarbanes-Oxley Act in the United States and the Financial Security Law in France, imposing new obligations regarding internal control and financial transparency. In addition to laws, reports like the Viénot report and initiatives from MEDEF have proposed recommendations to strengthen corporate governance, particularly in terms of executive compensation. Codes of conduct, such as the Cadbury Code in the UK and the Principles of Corporate Governance in France, have also been developed to promote best governance practices. Institutional investors have also played a role by demanding greater transparency and ethics. Overall, these initiatives aim to restore investor confidence and promote stronger and more responsible corporate governance.

Over the past ten years, institutional and legal pressures have led to significant evolution in corporate governance, marked by strengthening the role of directors, developing supervisory committees, and separating powers. These changes were motivated by the desire to restore investor confidence and address growing concerns about executive compensation and transparency practices. However, despite these advances, persistent challenges remain, including the risk of formal compliance rather than genuine adherence to governance principles, questioning the real effectiveness of these measures in creating value.

The challenges of corporate governance in Morocco and France highlight multiple shortcomings, ranging from institutional and regulatory weaknesses to conflicts of interest, lack of transparency, and control. To improve the situation, it is essential to strengthen regulatory frameworks, increase awareness and action, and promote a culture of transparency and accountability. The creation of supervisory and compensation committees can also help strengthen governance mechanisms. In sum, improving corporate governance is an ongoing process that requires the commitment and collaboration of all parties involved.

Recognizing behavioral biases and their impact on economic and strategic decisions is essential for understanding and improving corporate governance. By integrating insights from behavioral finance, behavioral economics, behavioral law and economics, and strategic management, governance practitioners can better understand the mechanisms leading to sometimes irrational decisions. Awareness of these biases allows for the implementation of correction and prevention mechanisms, contributing to more effective governance and value creation for all parties involved. Ultimately, the goal is to leverage the potential advantages of irrationality while mitigating its negative effects, to promote more informed and balanced decision-making.

In conclusion, integrating the behavioral dimension into the financial and cognitive governance of companies offers an enriching and necessary perspective. By recognizing behavioral biases and incorporating them into the analysis of governance mechanisms, it is possible to better understand the complex interactions that influence value creation and strategic decisions. This approach allows for more targeted interventions to correct biases and improve the overall effectiveness of governance systems.

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