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Effect of Managerial Ownership Concentrated on Firm Return and Value: Evidence from Iran Stock Market

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Abstract

The article aims to emphasize the importance of the Activity-Based Budgeting (ABB) implementation within This research examines the relationship between corporate governance and firm return and value which are two measures of firm performance. Absolutely, there are several measures for investigation the corporate governance but we picked up the ownership concentration as measure of it. In general, this paper tries to investigate ownership concentration and its effect on firm return and value in Iran Stock Market. An analysis has been made as evidence taking sample of listed non-financing firms from the Tehran Stock Exchange (TSE). Our sample consists of non-financial firms listed on Tehran stock exchange between 2007 and 2009. Our findings indicate that ownership concentration has a negative and significant relationship with firm's value.

Keywords: Corporate Governance, Ownership Concentration, Firm Return, Firm Value, TSE

Introduction

The object of this research is to explore the ownership concentration relation with firm return and value in TSE. The need for corporate governance arises from the potential conflicts of interest among participants (stakeholders) in the corporate structure. These conflicts of interest often referred to as agency problems, arise from two main sources. First, different goals and preferences and Second, the participants have imperfect information as to each other's actions, knowledge, and preferences. Berle and Means (1932) addressed these conflicts by examining the separation of corporate ownership from corporate management – commonly referred to as the separation of ownership mechanisms, provides executives with the ability to act in their own self-interest rather than in the interests of shareholders.

Playing the accountability to ensure the public as well as shareholders needs adequate supervision and more care to be taken. There are good mechanisms for doing supervision and care required in this issue. Among these mechanisms, design and implementation of corporate governance in firms, which attention from those days, others days became raising in the past two decade that corporate governance one of fundamental aspect of business. In early 1990's the countries like England, Canada and America the corporate governance for response to any problem

cause to lack of corporate board effectively has been presented. Basic principles of corporate governance in the UK with Cadbury report, Dey report in Canada and the Board rules on GM America was formed, which the most topics concentrated on shareholder rights and firm leadership. Then, this issue was evolving when modern view about right of all stakeholder and community has been introduced. Progress in corporate governance issue in points of global was completed in recently years. International organizations like the international corporate governance network, common wealth association for corporate governance, organization for economic co-operation and development (OECD) provide acceptable international standards in this case. Now in US and UK and other countries continued to strengthen its corporate governance system and make attention to shareholders and their relationships, accountability, improve board performance, audit committees, accounting systems and internal controls. In addition, accountants and auditors and other stage actors in capital market be aware about philosophy of existence and improve the corporate governance.

Literature Review

La Porta, Lopez-De-Silanes and Shleifer (1999) found that families or the state typically controls most large corporations in 27 wealthy economies, in 1995. Additionally, the power of the controlling shareholder exceeds his cash-flow rights, and dispersed ownership is more of an exception in countries with poor shareholder protection, which tend to have civil law tradition¹¹. Demsetz and Villalonga (2001) find no statistically significant relation between ownership structure and firm performance. Their finding is consistent with the view that diffuses ownership, while it may exacerbate some agency problems, also yields compensating advantages that generally offset such problems. Some researches investigate whether management ownership structures and large non-management block holders are related to firm value, the result of them refer that large non-management control rights block holdings (having more control rights) are positively related to firm value (Lins, 2002).

Christoph and Benjamin (2005) address the question whether there is any empirical relationship between corporate performance and insider ownership. His findings shows that a positive and significant relationship between corporate performance. Imam and Malik (2007) use all firms in Bangladesh to examines how corporate governance is practiced through ownership structure and how firm's performance as well as its dividend payout policy is influenced by different ownership pattern. They find the foreign holding has positive and significant relationship with firm performance as measured by firm's holding period returns and Tobin's Q, and the relationship is a monotonic one. They also find that firms with high institutional ownership and firms with concentrated ownership pay high and less dividend payout respectively. Leif and Nico (2009) they analyzed the relation between the ownership structure and the performance of the 70 largest companies on the German stock exchange. They used a limited sample but a long period of 16 years and ownership data collected in an elaborate procedure. Their results showed strong support for the argument that ownership structures are chosen in response to the characteristics of the firm and its environment. They found only partial support for a systematic relation between ownership structure and performance. Zhongfeng, Yuan and Lin (2010) found that there is no significant relationship between ownership concentration and executive compensation in state-owned enterprises (SOEs), while there is a U-shaped relationship in non-SOEs. The recent researches for exemplar Lanouar & Elmarzougui

(2011) found that a significant negative impact on firm performance as measured by a proxy for Tobin's Q in a simultaneous equation system.

Methodology of Research

Sample Selection

In this study the Statistical population is all listed firms which are in Tehran Stock Exchange during the period of 2007 to 2009 (three-year period).

We selected a sample contain 70 firms according to some conditions such as:

1. End of firm fiscal year should be at end of hegira year which matches with March.
2. The firm should not change on fiscal during years of desire (2007 to 2009).
3. This firm is active during research and its shares are traded and book value of equity is not negative in any year.
4. The financial information required for conducting the research in the period of 2007 to 2009 which is fully provided and by the firm that should not be a financial or investment one and be profitable.

Methodology and Variables

In this study we used the quasi-experimental research method for investigate the effect of corporate governance on firm performance. Variables used in this study included 3 groups of independent, dependent and control variables. Independent variables is ownership concentration and dependent variables which are the firm performance as first dependent variable divided into two which are firm value (Q Tobin) and firm return. The third group of variables is control variables which are firm size, listing age, leverage, and industry.

Research Models and Definition of Variable

In order to provide evidence for effects of ownership concentration on corporate performance and in this study we used multiple regression methods (backward method). For testing these relationships two models according Imam and Malik (2007) models have been estimated which as follows:

First model¹:

$$\text{Firm-value}_{it} = \alpha + \beta_1 \text{MOC}_{it} + \delta_1 \text{SIZE}_{it} + \delta_2 \text{LEVERAGE}_{it} + \delta_3 \text{LISTAGE}_{it} + \sum_{j=1}^{20} \gamma_j \text{INDUSTRY}_{ijt} + \varepsilon_{it} \quad (1)$$

In this model the relationship between ownership concentration and firm value and other control variables are used.

FIRM VALUE (Tobin's Q): Tobin's Q formula is applied to calculate firm's value. A proxy for Tobin Q is applied to find out firm's value. So the formula becomes as follows:

$$\text{Tobin's Q} = \frac{\text{Book Value of Debt} + \text{Market Value of Common Stock}}{\text{Total Asset}} \quad (2)$$

¹ β In all models refers to independent variables and δ in all models refers to control variables.

MOC: Here for the term concentration, we mean managerial ownership concentration. We have taken a dummy variable MOC as the value of one when share-holding percentage by the managers (board members) is the largest among all the equity holders and zero otherwise.

SIZE: Firm size is the natural logarithm of total assets of the firm.

LEVERAGE: Leverage is the ratio of long term and short term debt to total asset.

LISTAGE: Is the number of years that the firm was present on (TSE) being accepted until 29/March/2006.

INDUSTRY: type of industry, as a dummy variable which are in these research 20 industries.

Second Model:

$$\text{Firm-return}_{it} = \alpha + \beta_1 \text{CON}_{it} + \delta_1 \text{SIZE}_{it} + \delta_2 \text{LEVERAGE}_{it} + \delta_3 \text{LISTAGE}_{it} + \sum_{j=1}^{20} \gamma_j \text{INDUSTRY}_{ijt} + \epsilon_{it} \quad (3)$$

In this model the relationships between firm return and managerial ownership concentration and other control variables are used.

Firm Return: return is considered as a dependent variable. The return is calculated from period of 2007 to 2009. In this observation, not only cash dividend but also bonus dividend is adjusted to current years share price. The formula used here is as follows:

$$\text{FirmReturn} = \frac{\text{Scp}_{i2009} - \text{Scp}_{i2007} + \text{Div}_{i2007} + \text{Div}_{i2008} + \text{Div}_{i2009}}{\text{Scp}_{i2007}} \quad (4)$$

Where:

SCP= stock current price;

Div= dividend.

Test of Models Significant

Test of first model significant

In this section, we will check the effect of assumed variable on the firm value. Basic statistical assumption states that any one of the independent variables does not influence to the dependent variable changes. In contrast, the alternative statistical hypotheses are expressed, which there is at least an explanatory variable that effects the dependent variables changes. In other words, for the first model:

$$H_0 = a_1 = a_2 = a_3 \dots = a_{24} = 0$$

$$H_1 = a_i \neq 0 \quad \text{at least for an } i$$

According to the perceived values (F = 4/120, Sig=0/000) that the test statistics is located in rejection the H₀ region. So, at least there where one variable influencing on firm value, and there is not any reason to reject the entirely the first model significant. Coefficient of determination (R²= 0/692) also shows that about 69/2 percent of firm value changes are described by the regression model. Consequently, the first model and the final results are as follows:

Table 1. About the final step (17) for first model

<i>Dependent variable: firm value is proxy of firm performance</i>			
Level of significance	T statistic	Unstandardized Coefficients	Independent variable
0/000	3/959	4/749	Constant
0/014	-2/529	-0/691	Managerial Ownership Concentration(MOC)
0/003	-3/153	-0/016	Leverage
0/002	3/177	0/599	Medicine Industry (MEI)
0/000	5/034	1/845	Cement Industry (CI)
0/000	4/745	1/856	Metallic Ores Industry(MOI)
0/058	1/932	1/299	Machinery Industry (MAI)
0/000	4/214	2/632	Woodcraft Industry (WI)
0/055	-1/954	-0/425	Firm size
R ² = 0/640		Adjusted-R ² =0/592	F=13/339
*level of significance is %10			

$$\text{FirmValue}_{it} = 4.749 + 0.691 \text{ MOC} - 0.016 \text{ Leverage} + 0.599 \text{ MEI} + 1.845 \text{ CI} + 1.856 \text{ MOI} + 1.299 \text{ MAI} + 2.632 \text{ WI} - 0.425 \text{ Firm - Size}$$

Test of Second Model Significant

In this section, we will check the effect of assumed variable on the firm return. Basic statistical assumption states that any one of the independent variables does not influence to the dependent variable changes. In contrast, the alternative statistical hypotheses are expressed, which there is at least an explanatory variable that effects the dependent variables changes. In other words, for the second model:

$$H_0 = a_1 = a_2 = a_3 \dots = a_{24} = 0$$

$$H_1 = a_i \neq 0 \quad \text{at least for an } i$$

According to the perceived values (F = 1/192, Sig=0/299) that the test statistics is not located in rejection the H₀ region. Coefficient of determination (R²= 0/394) also shows that about 39/4 percent of firm return changes are described by the regression model. Consequently, the second model and the final results are as follows:

Table 2. About the final step (22) for second model

Dependent variable: firm return is proxy of firm performance			
Level of significance	T statistic	Unstandardized Coefficients	Independent variable
0/054	1/961	127/332	Constant
0/000	3/803	41/976	Medicine Industry (MI)
0/029	2/234	49/368	Metallic Ores Industry(MOI)
0/075	-1/810	-21/325	Firm Size
R ² = 0/222		Adjusted-R ² = 0/186	F= 6/169
*level of significance is %10			

$$\text{FirmValue}_{it} = 127.332 + 41.976 \text{ MI} + 49.369 \text{ MOI} + 21.325 \text{ Firm} - \text{Size}$$

Conclusions

This essay has examined the model of corporate governance and provides empirical evidence on the nature of corporate governance through ownership concentration in the context of Iran. Our investigations indicate that the effect of managerial ownership concentration on firm value is significant and negative. In other word, when ownership of executives or board directors are high the firm value will be less. The reason for this case could be that all firms in the sample that have a managerial ownership concentration are family firms, in the extra expression; ownership majority of this firm ownership is on hands of a family or a family group, which is being aligned regarding to this ownership group together, as they do not provide accurate and actual results to outsiders and also probably should attempt to manipulate information. Probably these problems arise from information asymmetry between manager owners and other stakeholders. This situation makes the manager owners be able to get further interests more than other stakeholders. In general, these shareholders having in hand the entire company and full control over the company's board can use firm's wealth to their advantage. For example, focus on short term benefit projects and investments that are may not concern to firm and the long-term benefits of shareholders.

There is significant and negative relationship between firm size and firm performance in way that when firm size increases its performance decreases too. Other findings of this study point out that an intensive relationship is between the type of industry and firm performance. In first model, it can be seen that if companies operate in the Medicine industry, cement industry, metal ores industry, machinery industry and woodcraft industry their value will be increased. In second model it can be seen that if companies operate in the medicine or metal ores industry their return increased.

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