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Effects of CG Practices on Firm's Performance: A Study of Stock Exchange Listed Companies

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ABSTRACT: *The present study is conducted in order to determine Relationship between Management Efficiency and Corporate Governance. The main purpose of the financial management is focused on maximizing the shareholder's wealth. The conflict of interest among shareholders and managers can lead to the abnormal behavior of the managers which is mostly directed toward their own interest not the institutional owners of the firm. This is finally effective on the management efficiency. In doing so, the findings reveal that institutional shareholders and non-executive members of the board are significantly related to the management efficiency. This relationship is not the same as the two other mechanisms of the corporate governance.*

Keywords: Corporate Governance, Institutional Shareholders, Non-Executive Members of the Board, Ownership Concentration, Management Efficiency

Corporate governance is the relationship of managers, board of directors, shareholders and stakeholders according to the definition of the Organization of Economic Cooperation and Development (OECD) in 2004. It is also intended to provide a framework between the predefined goals and the ways to achieve them. Corporate governance also helps the monitoring and determination of the goals. Corporate governance is an essential factor of the organizations. It is not only the required condition for the proper growth of the firm in the market, but also the most valuable item for the shareholders in order to keep up with the impartiality, accountability, disclosure and transparency of the different elements and parameters (Base, 2009). Corporate governance provides a structure by which the aims of the firm are defined. Additionally, this structure determines how to monitor the performance of the managers (- Al-Najjar, 2010). Corporate governance prohibits the secret destructive vocations and excessive risk acceptance. Corporate governance is also defined as a directive and controlled system which functions as the linkage of the firm‟s management (EUROPEAN COMMISSION, Brussels, 2011).

Appropriate corporate governance is a useful device for creating confidence and sincerity in a firm. It provides confidence in order to achieve the most possible value and the best interest for the shareholders, employees and stakeholders (Norwegian Corporate Governance Board, 2010). Management efficiency is the aim at which the corporate governance mechanisms mainly focus on. The independence of the board is expected to control over the value increasing activities. Non-executive members of the board are initially a measure of the board independence and secondly a measure for evaluating the firm's managers performance (Chalevas & Tzovas, 2010). Ownership structure is the fundamental base of the control and power over a firm which is the main reason of agency problem that finally influences on the firm‟s performance in the situation of market inefficiency and intrinsic deficiencies of the contracts (Al Farooque, 2007). Thus, the present paper aims to examine the relationship of selected mechanisms of the corporate governance and management efficiency which is measured, designed and implemented through financial performance measures.

Theoretical Background

There are numerous theoretical backgrounds for the description and analysis of the corporate governance and they are derived from special scientific perspectives concentrated on the corporate governance title. Agency theory is one of the famous theories in this regard. Agency problem was first introduced by Ross in 1973 and Jensen and Mcling. They considered the managers as the agents and the shareholders as the owners of the firms. There is no monitoring and control possibility in the firms with the dispersion shareholders and that's why the managers look forward their interests. Position stability assumption of the managers is one of the main hypotheses in this field. This was introduced by Demsetz in 1983 and was more investigated by the other researchers. According to this hypothesis, the competitiveness in the labor market of the managers and the incentive of keeping the position and achieving higher and better positions leads managers protect their interests. Fama and Jensen (1983) evaluated board structure as one of the most important processes in measuring the management performance. Lim et al. (2007) and Fama (1980) argued that non-executive members of the board lead to the improvement of the board efficiency. Some other researches also supported this declaration. Weisbach (1988) showed that the presence of non-executive members of the board can mitigate the possibility of discharge of top executive managers as a result of their weak performance. Valenti et al. (2011) indicated that there is a positive relationship between non-executive members of the board and firm‟s performance. Ajinkya et al (2005) and Karamonou and Vafeas (2005) also confirmed the same result.

In contrast, there are some different results achieved by some other researchers which are in contradicting with the concepts of the agency theory. Klein (1998) and Chalevas & Tzovas (2010) found no significant relationship between the presence level of non-executive members of the board and performance level of the firm. Efficient monitoring hypothesis is also considered in this field. According to this assumption, institutional shareholders who are out of the firm can monitor the managers with a lower cost and to a higher degree than other shareholders. This is because of the facilities, expertise and experiences they possess. Thus, the positive relationship between institutional shareholders and firm's performance is expected. It seems that ownership concentration can also lead to a better performance of the managers which is the result of power concentration and firm's penetration in some specific shareholders. This relationship is enriched as the ownership is concentrated on the institutional shareholders.

The prior findings revealed that the level of monitor and control executed by the institutional shareholders might constraint the opportunistic behaviors of the managers (McConnell & Servaes, 1990). A survey conducted by Pushner (1993) in Japan showed that dispersion of ownership has a positive influence on the firm's performance. This study aimed to investigate the influence of ownership composite on the sample performance of the non-manufacturing companies in Japan. The findings also showed that increasing the ownership share of institutional shareholders might lead to a better performance and higher return of the firms. Yammeesri & Sudhir (2001) found that institutional shareholders and firm‟s return are positively related. This relationship also holds true for the ownership concentration and firm‟s performance. Chen and Yur-Austin (2007) found that the external institutional shareholders have more influence on mitigating the agency costs. Alfarouq et al (2007) asserted that there is no relationship between ownership structure and the performance of the firms in Bangladesh.Ben Ali (2009) revealed that institutional shareholders of America in France decline the agency costs. C. G. Holderness and Sheehan (1988), R. Muraly and Welch (1989) and D. J. Denis, and. Denis (1994) argued there is no relationship between institutional shareholders and their yields.

According to the above statements, it can be concluded that considering the corporate governance mechanisms can affect management efficiency. Four measures are selected in this study to investigate the hypotheses. Institutional shareholders‟ ownership is one of the measures used because of the adequate experience, expertise and facilities they possess. Ownership concentration is the other measure which is regarded because of the considerable influence on the firm and the board of directors. On the other hand, board ownership and the ratio of non-executive members of the board are applied because of the executive power in the firm and the monitoring effect over the board member, respectively. Hence, the main hypothesis is developed as follows: There is a significant relationship between corporate governance and management efficiency. Management efficiency is measured by two financial rations including return on owner's equity (ROE) and return on assets (ROA). The main hypothesis is examined through two secondary hypotheses.

Research Background

McConnell & Servaes (1990) found that increasing the institutional shareholders can increase the performance of the firm. Hermalin and Weisbach (1991) found no significant relationship between the level of non-executive members of the board and the firm's performance. Dalton et al (1998) and Klein (1998) also confirmed their conclusions. Weig & Lehmann (1999) investigated the effect of corporate governance mechanisms on the profitability of the German firms. Their findings revealed that there is a negative relationship between ownership concentration and firm‟s performance. Black and Bernard (2001) documented the strong relationship between institutional shareholders and their yields by using time series and regressions. J. Dlugosz et al (2004) also supported their findings. Tong and Ning (2004) referred to the negative relationship between institutional shareholders and firm‟s performance. Kapopoulos & Lazaretou (2006) investigated the Greece firms and revealed that the more concentrated the ownership structure, the most positive effect on profitability and the performance of the firms. Lee (2008) tried to find the effect of ownership structure on the financial performance of the Korean firms. Ownership concentration and shareholders‟ nature were the two measures used as the proxies of the ownership structure. Their findings showed that the performance of the firms will improve by the increase in the ownership concentration, while this effect is not important in the field of institutional ownership. The U form relationship between ownership concentration and firm's performance was also confirmed. This means that the firm's performance reaches the top level when the ownership concentration is in an average level. Chalevas & Tzovas(2010) examined 176 listed firms in Athena which had accepted the corporate governance mechanisms.

They aimed to find the effect of corporate governance rules after and before the implantation. They discovered no increase in the stock returns after the implementation of the corporate governance rules. Alnajjar (2010) examined the effect of institutional shareholders on the Japanese firms and found that they are in a negative significant relationship with the firm's performance. Garcia et al (2011) concluded that ownership concentration influenced on the firm‟s value in Madrid, but this is in an inverse relationship with a higher level of ownership concentration. Valenti et al (2011) selected 90American firms as the sample and found that the negative changes on the firm's performance significantly influence on the reduction of the number of board members and also the number of non-executive members of the board.

Statistical Population and Sampling

Tehran listed firms are selected as the sample for a five year period covering 2006 to 2010. The statistical sample is chosen among the firms of the specified industries according to a filtering criterion. The selected firms should be qualified in terms of the following metrics:

1. They should have been listed on Tehran Stock Exchange from 2006.
2. The end of the fiscal year should have been consistent with the calendar year.
3. There should be no change in the fiscal year during the period.
4. There should be no transaction cease for more than six months.
5. The firms should not be classified as financial intermediaries or banks.
6. The required data should be available.

7. There should be no loss reported in their financial statements.
Finally, 265 firm-years observations were examined as the final sample.

Independent Variable

3 Managerial share ownership (**MANOWN**)
This variable is calculated by dividing the shares held by executive and non-executive members to the total issued shares.
4 Institutional Investor Ownership (INSOWN)
Bushee (1998) defined the institutional investors as the large investors such as banks, insurance companies, investment firms and pension institutes. In the present study, this variable is calculated by summing the shares held by the institutional investors and total issued stocks.
5 Non-Executive Directors of the board Ratio (**NED**)
Non-executive directors are the part time members who are not of executive responsibility. This ratio is calculated by dividing the non-executive directors to the total directors.
6 Ownership Concentration (**OWNCON**)
Herfindal-Hirschman index is the proxy used to calculate the ownership concentration. This index is an economic proxy for measuring the exclusivity level of the market. Hence, the share percentage of any shareholder is squared and summed together. The result is between 0 and 1 and the closer number of 1 is more concentrated: OWNCON= Σ (of ownership percentage)

Dependent Variables

7 Return on Owner's Equity (**ROE**)
This is resulted from the division of net income to the total equity of owners.
8 Return on Assets (**ROA**)
This is the number calculated by dividing the net income to the total assets.

Control Variables

9 Firm Size (**Size**)

Table1. The Summary of the Variables

Variable Title	The Position in the Model	Ind.	Source
The ownership percentage of the Board	Independent	MANOWN	*Valenti et al (2011)*
The ownership percentage of the Institutional Shareholders	Independent	INSOWN	*Pushner (1993), Chalevas and Tzovas (2010)*
Non-Executive Directors	Independent	NED	*Valenti et al (2011), Lin et al (2010)*
Ownership Concentration	Independent	OWNCON	Lee (2008), Garcia (2011)
Return on Owner's Equity	Dependent	ROE	*D. J. Denis and Denis (1994),Chalevas and Tzovas (2010)*
Return on Assets	Dependent	ROA	M. *Bowen et al (2008)*
Firm Size	Control	Size	Gonenc (2005), Alnajjar (2010)
Book Value of the Tangible Fixed Assets to total Assets	Control	PPE	M. *Bowen et al (2008), Chalevas and Tzovas (2010)*

This variable is the natural logarithm of the total assets.
10 Book Value of the Tangible Fixed Assets (Property, Plant, and Equipment) to total Assets (**PPE**).This is the ratio calculated by dividing the book value of the tangible fixed assets to the total assets. The summary findings are presented in table 1.

Research Methodology

The present study is an applied research and is classified as a descriptive correlation study. The required information about the literature review are collected through literature review; while the data needed for the analysis come from the financial statements of listed firms. The data are entered in Excel software and the research variables are calculated. Finally, the relationships between the variables are measured in terms of correlation and multivariate regressions. Other tests related to the data are presented in different tables. The Pearson correlation coefficient is applied to investigate the correlation of independent variables in a pairwise form

Data Analysis

The descriptive and inferential statistics are used to analyze the collected data. e summarized in table 2.

Table 2 Descriptive Statistics of the Research Variables

Table 2. Descriptive Statistics of the Research Variables

Kurtosis	Skewness	Std. Deviation	Median	Mean	Number	Variable
6/82	2/82	19/16	0	6/99	265	MANOWN
2/48	-1/7	2/11	80	74/63	265	INSOWN
57/02	7/59	1/05	60	61/52	265	NED
0/321	0/845	21/17	29/8	31/62	265	OWNCON
1/75	0/843	1/87	34/88	36/23	265	ROE
5/51	1/69	1/087	13/30	15/51	265	ROA
1/83	2/1	1/7	21/68	24/43	265	PPE
0/94	0/50	1/24	13/44	13/43	265	SIZE

The descriptive proxies (central tendency and dispersion) are summarized in table 2. According over, all the variables are significantly different from the normal distribution except for the Size. The variables are normalized before the research. This is because it is assumed that the research variables are normally distributed in estimating the parameters of the model

Hypotheses Testing

Estimation Period: 2006-2010				
$ROE_{it} = b_0 + b_1\ INSOWN_{it} + b_2\ MANOWN + b_3\ NED + b_4\ OWNCON + b_5 Size_{it} + b_6\ P.P.E_{it} + \varepsilon_{it}$				
Cross-section fixed (dummy variables)				
R^2	0/880299	F	26/1199	
Adj. R^2	0/846597	(Prob)	0	
Durbin-Watson	2/047903			
Explanatory Variable	Coefficient	t-statistics	Prob.	Sig.
Intercept	128/8	6/7258	0	99%
OWNCON	**7/505**	**0/9332**	**0/3518**	-
MANOWN	**-16/3**	**-0/378**	**0/7056**	-
INSOWN	**-0/276**	**-2/83.2**	**0/0051**	**%99**
NED	**-2/91**	**-0/781**	**0/4351**	-
Ppe	-12/9	-2/53	0/0119	%95
SIZE	-5/06	-4/27	0	%99

It is believed that the regression model is significant at 99 percent. The findings related to the Durbin-Watson statistics demonstrate that the data are proportionately independent. According to the independent variable coefficient, one unit variation in the variables of OWNCON, MANOWN, NED leads to 7.50, -0.16, -0.27 and -0.209 variation, respectively. It is concluded that institutional ownership is the only mechanism which is inversely related to the return on owner's equity. It means that increasing the ownership of institutional shareholders causes a reduction in the return on owner's equity. The findings also reveal that there is an inverse relationship between ROE and the two other variables including the ratio of book value of the tangible fixed assets to the total assets and firm size. **Testing the hypothesis 2** Table 4 shows the results of the second hypothesis.

Table 4 the findings about the effect of corporate governance mechanisms on ROA

Estimation Period: 2006-2010				
$ROA_{it} = b_0 + b_1\ INSOWN_{it} + b_2\ MANOWN + b_3\ NED + b_4\ OWNCON + b_5 Size_{it} + b_6\ P.P.E_{it} + \varepsilon_{it}$				
Cross-section fixed (dummy variables)				
R^2	0/957222	F	79/08921	
Adj. R^2	0/945119	(Prob)	0	
Durbin-Watson	1/844076			
Explanatory Variable	Coefficient	t-statistics	Prob.	Sig.
Intercept	106/7	12/250	0	99%
OWNCON	**-2/01**	**-0/5536**	**0/5804**	-
MANOWN	**-0/56**	**-0/04815**	**0/9616**	-
INSOWN	**-0/10**	**-3/2037**	**0/0016**	**99%**
NED	**1/739**	**2/9520**	**0/0035**	**99%**
ppe	-6/47	-3/5719	0/0004	99%
SIZE	-6/12	-9/66888	0	99%

As table above shows, the regression model is significant at 99 percent. One unit variation in OWNCON, MANOWN, INSOWN and NED finally leads to -2.015, -0.56, -0.104 and 1.73 variations, respectively. Finally, it demonstrates that only institutional shareholders ownership and non-executive directors are related to ROA. Their directions are different, although. Institutional shareholders are inversely and non-executive directors are directly related to ROA. In other words, increasing the ownership of institutional shareholders causes a reduction in ROA; while increasing the ratio of non-executive directors can cause an increase in the return of assets.

Conclusion and Remarks

Corporate governance is the topic widely discussed in today's scientific journals. Most of the researches in this field have concentrated on the monitoring role of the board in terms of protecting their interests and shareholder benefits in the process of making decisions and implementing organizational decisions. The present study aims at investigating the influence of corporate governance mechanisms on the performance of the firms performing in the industry of an emerging economy like Iran. The findings reveal that the presence of institutional shareholders in the firm might have a negative influence on the efficiency and performance of the management. This finding is consistent with the findings of Tong and Ning (2004) and Al-Najar (2010). This is also in a complete contradiction with the efficient monitoring and the expected role of the institutional shareholders. The results of Pushner (1993), Black and Bernard, (2001) and Yammeesri and Sudhir (2001) are completely inconsistent with the findings of the study.

Generally, institutional shareholder possess facilities, expertise and experience in a firm but they might not interfere in the decisions related to the firm. This is because of some reasons as follows:- Interference in the firm‟s decisions can be interpreted as a bad news for the market which finally affects share‟s value.- Interference in some organizations especially those with diversified portfolios is a time consuming and expensive process.Keasey et al (2005) argue that the cultural organizations and those dependent on the government do not have enough incentives for the interference not only because of the lack of accountability but also the essential expertise required for investment. The lack of the expert members in the board can lead to a decrease in the efficiency of the board. Additionally, it is a motivation for the short-term vision about the investments. Finally, institutional shareholder is a challenging concept by considering the less efficiency and manager‟s performance. The findings assert that there is no relationship between ownership concentration and firm‟s performance. This is inconsistent with the findings of the Pushner (1993), Weig & Lehmann (1999). The findings of Yammeesri and Sudhir (2001), Kapopoulos & Lazaretou (2006) and Lee (2008) also don‟t support their conclusions. Increasing the number of non-executive directors on a board is another approach proposed by the present study which is focused on increasing the management efficiency and firm‟s performance. Ajinkya et al (2005), Karamanou and Vafeas (2005) and Valenti et al (2011) are consistent with the results of this study. This conclusion is consistent with the existing philosophy of non-executive directors on the board of directors as the monitoring leverage over the managers.

Further Suggestions

1. It seems that non-executive members of the board are considered as one of the main mechanisms of the corporate governance which finally influence on the efficiency of the firms. The shareholders are suggested to emphasize on the selection of non-executive members at the time of assigning the board of directors.
2. Institutional shareholders are offered to struggle more to perform their monitoring role. This is because of the fact that the negative relationship between institutional shareholders and management efficiency is confirmed.
3. Investors are suggested to pay a special attention to corporate governance mechanisms and control variables influencing on the performance. This should be executed in decision making about the investment opportunities along with the other factors.

The other opportunities surrounding the future studies include the following:

- The role of institutional shareholders on the firm‟s yields in different industries might be examined separately.
- Other mechanisms such as CEO duality also exist in the corporate governance and it is offered those mechanisms to be investigated with the consideration of management efficiency.

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