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Investigating the Effect of Corporate Sovereignty Mechanisms on the Stock Returns of Listed Companies of Tehran Stock Exchange

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Abstract: Facilitating domestic and foreign investment and the expected stock returns of shareholders are issues that are typically important for all stakeholders of the company. The alignment of the interests of stakeholders and managers of companies can be achieved by reducing the problems of the agency. The decrease of these problems increases the shareholder's interest in trading on the capital markets and results in the increase of stock liquidity and expected return of shareholders. This study aims to explore some of the corporate governance mechanisms on the stock returns of listed companies in Tehran Stock Exchange. The explored governance mechanisms of the study included non-executive members of the board of directors, the duality of responsibility of the managing director, ownership of institutional shareholders and audit quality. To this end, 93 companies were chosen through the systematic elimination from 2007-2014 which were analyzed using panel data regression analysis. The results of the study indicated that institutional ownership and auditor specialization in industry had an effect on the stock return. In addition, independence of the board of directors, managing director responsibilities and the size of audit institution had no effect on the stock return.

Key words: Audit quality, institutional ownership, managing director duality of responsibility, non-executive members of the board of directors, stock return

INTRODUCTION

Managing the affairs of companies is a critical component for profitability and growth through the acquisition of allotment efficiency so that the lowest expendable budget for more efficient investment projects can be more advantageous for all stakeholders of the company compared to other investment options. Typically, the investment projects that could earn greater returns compared to other investment costs represent the interests of shareholders and other stakeholders through managing the corporate.

Lack of monitoring the performance of managers spoils the interests of shareholders. In addition, managers tend to maintain and increase their personal interests in the absence of inadequate monitoring on managing the corporate. Moreover, assigning unlimited authority to managers to decide about fundamental affairs has a remarkable role in terms of their potential abuses and creating agency costs.

The correct application of corporate governance mechanisms in an environment with a healthy financial infrastructure can be a stimulus for the benefit of shareholders as the owners of companies and other stakeholders because shareholders are trying to ensure about the return of capital and good returns. On the other hand, managers are trying to control the interest fluctuation and show the safe margin and the financial health of the company by using obscene tricks such as smoothing the interest in order to maintain the current liability and receive the reward of being a manager and reach their personal goals. In this case, it is clear that the interests of shareholders (employers) and managers (agents) will not be consistent. A control system such as corporate governance will reduce the capacity of managers to manage interest, though infrastructures such as the efficiency of capital markets and information content are of utmost importance to provide mechanisms of corporate governance. If operational efficiency, data efficiency and allotment efficiency in financial and capital markets are effectively implemented, its impact can clearly be seen in the improvement of economic situation. Financial resources are allocated in the best and optimal way in these markets and increase the liquidity of assets in order to reduce the cost of transactions at the minimum possible level, therefore without reducing quality, the cost

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will be reduced. In this situation, the companies which are member will desirably provide investment. However, it is difficult to achieve information content because corporate managers are reluctant to disclose information within their company (Samimi and Paitakhti, 2015). If it is possible to reliably apply the market mechanisms and shareholders ability in the efficient markets to control and watch manager's behavior and their decisions, it is possible to expect good returns and the solicited returns of the shareholders. In addition, it is possible to satisfy the expectations of other stakeholders to an acceptable level. But this requires the establishment of a system of control and governance by monitoring the implementation of corporate governance policies of organizations and the listed companies of Tehran Stock Exchange.

This study is an attempt to answer the following question by considering the ownership structure of Iranian companies and the economic, political and social conditions and regulations of listed companiesof Tehran Stock Exchange; what is the effect of corporate governance mechanisms on the stock returns of listed companiesof Tehran Stock Exchange?

Objectives and the need for research: The purpose of corporate governance system is to ensure the non-occurrence of opportunistic behavior which can be achieved by reducing agency problemsand potential asymmetric information between managers and different stakeholders such as shareholders, creditors, etc.The reduction of these problems increases the willingness of investors to trade in these markets and increases liquidity in the stock market.

Regarding the importance of the study, it can be stated that the existence of suitable corporate governance systems is effective in gaining the trust of investors and encouraging them to invest. With the growing increase of the dominant view on the effect of corporate governance mechanisms in reducing agency costs and reducing conflicts of interest between different groups with interests in companies, this study aims to explore the effects of corporate governance mechanisms, both within organization and outside the organization, on the effectiveness of these mechanisms on the company's stock return. It is obvious that the correct implementation of the principles of corporate governance system improves the performance of companies. Since corporate governance mechanisms reduce agency costs and increase the company's value, it can be expected that the implementation of corporate governance mechanisms through the creation of a suitable regulatory framework leads to the creation of value which results in the enhancement of the stock returns and company's value.

Literature review: The results of the study of indicated that there was a direct significant relationship between the value of the company and the strategic level of companies. This means that companies which have a higher strategic level have more tendencies toward enlargement and growing faster. In contrast, there was an inverse correlationbetween corporate strategy and the expected stock return (Drobetz *et al*., 2004).

The findings of the study of about samples of United States companies confirm that the companies that allocate fewer rights to shareholders have lesser value and stock returns. Moreover, democrats companies (good strategic level) had better performance than dictator companies (Gompers *et al*., 2003).

In a study about exploring the effect of some corporate sovereignty mechanisms and profitability of the companies concluded that desirable corporate sovereignty leads to the more profitability of companies which results in the increase of stock price and the paid dividend to shareholders (Brown and Caylor, 2004).

Explored the relationship between corporate sovereignty as well as investment function and structure in Bangladesh Stock Exchange. They concluded that increase in the proportion of non-executive members affects the value of the company. When the executive members and non-executive members wereanalyzed separately, only the proportion of non-executive members affected the value of the company (Imam and Malik, 2007).

Investigated the relationship between corporate strategy and return of shareholders. They explored two criteria of corporate strategy (institutional ownership andthe composition of the boardof directors) and its relationship with shareholder returns and found that in companies with weak strategy, each 1$ change in cash will result in changes about 0/42-0/88$ of shareholders return whilethis amount is doubled in companies with good strategy (Dittmar and Mahrt, 2007).

Explored the relationship between characteristics of the board of directors and performance of listed companies on the stock exchange in New Zealand using information of 207 companies during 2004-2007 which financial information was available. The results indicated that there was a positive significant relationship between different characteristics of the board of directors, board independence and its size with the company performance. Moreover, the managing director duality of responsibility had a negative significant relationship with the company's performance (Bathula, 2008). Investigated the relationship between corporate sovereignty and corporate value in the stock exchange of Venezuela. The findings revealed that

there was a positive relationship between corporate sovereignty mechanisms and the created value for the company (Garay and Gonzalez, 2008).

Explored the relationship between corporate performance and the size and composition of the board of directors. The finding showed that there was a reverse relationship between the size and performance of the board of directors and this negative impact is less for smaller companies. In addition, the percentage of non-executive managers (independence of the board of directors) had a positive effect on the company's performance.

Investigated the effect of the characteristics of the board of directors and audit quality on the financial performance of Malaysian firms. The results showed that there was a significant positive relationship between audit quality, the size of the board of directors as well as independence of the board of directors and the firm's performance. In addition, there was a negative relationship between the managing director duality of responsibility and the firm's performance (Fooladi and Shukor, 2012).

Investigated the effect of the ownership structure, corporate sovereignty, investment decisions, financing decisions and dividend policy on the value of companies listed on the Indonesia Stock Exchange. The findings showed that ownership structure and corporate sovereignty had a positive effect on the investment decisions and company's value (Nasrum, 2013).

Explored the relationship between corporate strategy and shareholder returns of companies listed in Tehran Stock Exchange. They tried to estimate the excess return of shareholders in companies with good strategy by studying the institutional shareholders and investigating its effect on shareholder returns. They found there was no significant relationship between institutional shareholders and shareholder returns in Iran (Modares *et al*., 2009).

Investigated the relationship between indicators of corporate strategy and shareholder returns of companies listed in Tehran Stock Exchange. In this study, the relationship between indicator of corporate strategy and shareholder return was explored using the comprehensive indicator of corporate strategy obtained from the strategy system bylaw of Tehran Stock Exchange. Based on the literature, a significant positive relationship between corporate strategy indicator and shareholders return was expected. But, according to the tests done, there was no significant relationship between them and research hypothesis was not confirmed.

MATERIALS AND METHODS

The purpose of the research was applied and it was a descriptive-correlation study. The data was provided as panel in order to test research hypotheses using multivariate regression and econometric models. To analyze the data, descriptive and inferential statistical techniques were used. After data collection and determining the model, the data were placed as panel data and then the Chow test was used to determine the integrated data or fixed effect model. If the probability of this test was <5%, the model will be a fixed effect model. In addition, the Hausman test was used to determine the Fixed Effects Model (FE) and Random Effects (RE); that is, if the probability of Hausman test is <5%, the model should be estimated using fixed effects.

Research hypotheses: Research hypotheses which are in line with research questions and according to the research purpose are as follows:

- H_1: The independence of the board of directors has an effect on the stock return of exchange companies
- H_2: The managing director responsibilities have an effect on the stock return of exchange companies
- H_3: Ownership of institutional shareholders has an effect on the stock return of exchange companies
- H_4: The size of the audit institution has an effect on the stock return of exchange companies
- H_5: The auditor proficiency has an effect on the stock return of exchange companies

The overall research model: In order to explore the effect of corporate sovereignty mechanisms on the stock return of listed companies in Tehran Stock Exchange, the econometric model is specified as follows based on the conducted theoretical and empirical studies: The statistical population of the study was the listed companies in Tehran Stock Exchange that due to the restrictions for sampling, 93 companies were selected. Thus, the number of observations was 744 (year-the company).

Independent variables

The non-executive members of the board of directors: The non-executive members of the board of directors have no administrative position in the company and by monitoring responsible managers, influence and control their decisions. If the non-executive independent managers constitute the majority of the members of the board of directors, the board will be more efficient. The non-executive members of the board of directors are

obtained by dividing the non-executive members of the board of directors into the all members of the board of directors.

The duality of responsibility of the managing director: Centralized decision-making power as a result of the dichotomy of managing director responsibility may results in the reduction of the independence of the board of directors and the reduction of their natural tendency for voluntary disclosure of information. Moreover, with the presence of the managing director in the board of directors, there is less threatening for the loss of the present job. This duality of responsibilities reduces the managing director's motivation for the improvement of corporate performance and has a negative effect on the corporate performance (Minnick and Noga, 2010).

Lack of separation between the responsibility of the managing director and membership in the board of directors can lead to a decrease in the effectiveness of the supervisory role of the board of directors and may violate the stakeholder's rights. The duality of responsibilities of the managing director in this research was the dummy variable of zero and one; if the managing director was the vice chairman or a member of the board of directors, number 1 was attributed to him; otherwise number zero was attributed to him.

Institutional ownership: Active institutional investors in the capital market can play a key role in promoting corporate governance system and consequently increase the efficiency and productivity of the company based on the knowledge and expertise, access to effective communication networks and the necessary incentive to monitor management performance.

In order to estimate the amount of institutional ownership, total shares held by the bank and insurance, investment companies, pension funds, holdings, financing companies, investment funds and government organizations were divided into the entire stock issued from the company.

Auditor quality: Audit quality increases the reliability of information available to users and with the increase of audit quality, the quality of informationalso increases. In fact, the audit reduces the information asymmetry between managers and usersso that the users of financial reports have the ability to evaluate and forecast financial performance. The following two criteria were used to measure the quality of the auditor.

The size of the audit institution: In order to determine the size of the audit institution, dummy variable was used; if the audit institution was the audit organization, the artificial variable number one was used; otherwise, number zero was used.

Auditor specialization in industry: In this study, the approach of market share, according to Palmers model has been used as an indicator of auditor industry specialization. As the auditor market share increases, his specialization in industry and his experience in comparison with other competitors increases. Having a dominant market share implies that the auditor has successfully distinguished himself from other competitors in terms of quality.

The auditor specialization in industry equals to auditor's market share which is obtained from dividing the total possessions of all employers of each audit institution in the industry into the total possessions of all employers in this industry. In this equation, institutions are considered as expert in industry which the result of their market share, (i.e., the above equation) is higher than {(1/2* (the number of existing companies/2)}.

After measuring the market share of an audit institution, if the obtained amount is higher than the above mentioned equation, the audit institution is an expert on that industry. Therefore, if the audit is an expert in the industry, number one is attributed to him; otherwise number zero is attributed to him.

Control variables

The size of the company: Size determines the amount and dimension of the activity of a company. The increase in the size of the company indicates a lack of opportunities for growth in the company. Due to the inflation in the country and the irrelevance of the historical figures of asset and in order to ensure comparability of the study with previous research, the following formula was used for the company's size:

$$Size_{it} = Ln\,(Assets_{it})$$

Sales growth of the company: The amount of sales changes during a financial period can be obtained from the following equation:

$$Growth = \frac{Sale_{it} - Sale_{t-1}}{Sale_{t-1}}$$

Financial leverage: In this study, financial leverage is obtained from dividing the total debt (short-term and long-term) into total assets.

RESULTS AND DISCUSSION

Descriptive statistics

Descriptive analysis of quantitative data: In descriptive analysis, the data were described using tables and indicators of descriptive statistics such as measures of central tendency and dispersion. According to Table 1, the lowest amount of the independence of the board of directors was (0/000) and the highest amount was (1) and the average of the independence of the board of directors was 0/650 which showed that in the company's board of directors there was about 65% independence of board of directors; that is >3 individuals had the non-executive role in the board of directors. Institutional investors ownership was (0/741) on average which showed 74% of the corporate ownership structures constitutes institutional investors. The lowest initial return of stock was -0/765 and the highest amount was 2/726 and the initial return of stock on average was 0/051 which showed that about 5% of companies obtained return from their stocks.

The descriptive analysis of qualitative data: In many studies, some variables may not be continuous and have only two results. The value of one means the occurrence of the incident and the value of zero means the non-occurrence of it (or vice versa). Logistic regression was used for such cases (Table 2).

The results of hypotheses testing: For the normality of the data, Kolmogorov-Smirnov test was used. The results are presented in Table 3 and show the normality of data, especially the dependant variable.

Table 1: The results of the descriptive analysis of quantitative data of the study

Variables	Minimum	Maximum	Mean	SD
NEDP	0/000	1	0/650	0/171
INSOWN	0/050	0/990	0/741	0/188
Stock return	-/765	2/726	0/051	0/603
Size	11/035	18/454	13/866	1/345
Gsales	-/679	1/460	0/198	0/313
Lev	0/103	0/946	0/611	0/170

Table 2: The results of the descriptive analysis of quantitative data of the study

Variables	Frequency	Valid (%)	Results
Auditor	192	25/80	The audit institution was the audit organization (1)
	552	74/20	Other audit institution was the audit organization (0)
RDual	674	90/60	The managing director was the vice chairman or a member of the board (1)
	70	9/40	Non the managing director was the vice chairman or a member of the board (0)
Specialization	541	72/07	Auditor specialization in industry (1)
	203	27/03	Non auditor specialization in industry (0)

The first hypothesis testing: According to Table 4, the independence of the board of directors with the coefficient of 0/155 and significant value of 0/184 had no effect on the stock return. Among the other control variables, sales growth with the significant value of 0/013 had a direct (positive) effect on the stock return. In addition, the financial leverage had a reverse (negative) effect on the stock return (0/000).

Second hypothesis testing: The results of Table 5 showed that the responsibilities of the managing director with the coefficient of -0/037 and significant value of 0/580 had no significant effect on the stock return. In addition, among the other control variables of the model, sales growth with the coefficient of 0/168 and the significant value of 0/011 had a direct (positive) effect on the stock return but

Table 3: The test results of data normality (Kolmogorov-Smirnov)

Variables	z-statistics	Sig.
NEDP	2/313	0/000
INSOWN	2/231	0/000
Stock return	1/129	0/159
Size	1/150	0/205
Gsales	2/348	0/000
Lev	1/089	0/187

Table 4: The test results of the first hypothesis (dependent variable: stock return)

$Return = \beta_0+\beta_1 NEDP_t+\beta_2 SIZE_t+\beta_3 Gsales_t+\beta_4 Lev_t+\varepsilon$

	Standardized coefficients			
Variables	Coefficient	SE	t-statistic	Probability
C	0/467517	0/223518	2/091632	0/0368
NEDP	0/155945	0/117507	1/327106	0/1849
Size	-0/020858	0/015489	-1/346638	0/1785
Gsales	0/164591	0/066768	2/465125	0/0139
LEV	-0/410922	0/120096	-3/421612	0/0007

The independence of the board of directors has an effect on the stock return of exchange companies; R^2 = 0/255850; F-statistic = 21/37903; Adjusted R^2 = 0/243883; Durbin-Watson stat = 2/180303; Prob. (F-statistic) = 0/000000, Type data (statistic), (Prob.); Chow test = 31/113202, 0/0000; Hausman test = 6/854831, 0/1438

Table 5: The test results of the second hypothesis (Dependent variable: stock return)

$Return = \beta_0+\beta_1 RDUAL_t+\beta_2 SIZE_t+\beta_3 Gsales_t+\beta_4 Lev_t+\varepsilon$

	Standardized coefficients			
Variables	Coefficient	SE	t-statistic	Probability
C	0/583261	0/228226	2/555625	0/0108
RDUAL	0/5801	0/067968	-0/037618	-0/553474
Size	0/2106	0/015470	-0/019384	-1/253031
Gsales	0/0118	0/066766	0/168577	2/524890
LEV	0/0007	0/120573	-0/412941	-3/424828

The managing director responsibilities have an effect on the stock return of exchange companies; R^2 = 0/254268; F-statistic = 21/20175; Adjusted R^2 = 0/242275; Durbin-Watson stat = 2/175126; Prob. (F-statistic) = 0/000000, Type data (statistic), (Prob.); Chow test = 0/0000, 31/188810; Hausman test = 0/7841; 1/736501

Table 6: The test results of the third hypothesis dependent variable: stock return (dependent variable: stock return)

$Return = \beta_0+\beta_1 INSOWN_t+\beta_2 SIZE_t+\beta_3 Gsales_t+\beta_4 Lev_t+\varepsilon$

	Standardized coefficients			
Variables	Coefficient	SE	t-statistic	Probability
C	0/404253	0/224057	1/804242	0/0716
INSOWN	0/238147	0/104563	2/277555	0/0231
Size	-0/020385	0/015382	-1/325254	0/1855
Gsales	0/161174	0/066588	2/420458	0/0158
LEV	-0/438873	0/119958	-3/658575	0/0003

Ownership of institutional shareholders has an effect on the stock return of exchange companies; R^2 = 0/259549; F-statistic = 21/79650; Adjusted R^2 = 0/247641; Durbin-Watson stat = 2/196478; Prob. (F-statistic) = 0/000000, Type data (statistic), (Prob.); Chow test = 31/430487, 0/0000; Hausman test = 0/7935; 1/684629

Table 7: The test results of the fourth hypothesis (dependent variable: stock return)

$Return = \beta_0+\beta_1 Auditor_t+\beta_2 SIZE_t+\beta_3 Gsales_t+\beta_4 Lev_t+\varepsilon$

	Standardized coefficients			
Variables	Coefficient	SE	t-statistic	Probability
C	0/488752	0/226276	2/159976	0/0311
Size auditor	-0/040358	0/049320	-0/818280	0/4135
Size	-0/013658	0/016595	-0/823052	0/4108
Gsales	0/164767	0/067009	2/458870	0/0142
LEV	-0/425347	0/120282	-3/536249	0/0004

The size of the audit institution has an effect on the stock return of exchange companies; R^2 = 0/254663; F-statistic = 21/24602; Adjusted R^2 = 0/242677; Durbin-Watson stat = 2/175388; Prob. (F-statistic) = 0/000000, Type data (statistic), (Prob.); Chow test =31/131491, 0/0000; Hausman test = 0/7090; 2/145338

financial leverage with the coefficient of -0/412 and the significant value of 0/000 had a reverse (negative) effect on the stock return.

Third hypothesis testing: The results of Table 6 indicated that institutional investor's ownership with the coefficient of -0/238 and the significant value of 0/023 had a negative effect on the stock return. Moreover, among the other control variables of the study, sales growth with the coefficient of 0/161 and significant value of 0/015 had a direct (positive) effect on the stock return but financial leverage with the coefficient of -0/438 and the significant value of 0/000 had a reverse (negative) effect on the stock return.

Fourth hypothesis testing: According to Table 7, the size of the audit institution with the coefficient of -0/040 and the significant value of 0/413 had no effect on the stock return. In addition, among the other control variables of the study, sales growth with the coefficient of 0/164 and significant value of 0/014 had a direct (positive) effect on the stock return but financial leverage with the coefficient of -0/425 and the significant value of 0/000 had a reverse (negative) effect on the stock return.

Table 8: The test results of the fifth hypothesis

$Return = \beta_0+\beta_1 Specialization_t+\beta_2 SIZE_t+\beta_3 Gsales_t+\beta_4 Lev_t+\varepsilon$

	Standardized coefficients			
Variables	Coefficient	SE	t-statistic	Probability
C	0/772707	0/223815	3/452442	0/0006
Specialization	0/180215	0/050350	3/579263	0/0004
Size	-0/046999	0/017206	-2/731589	0/0065
Gsales	0/168253	0/066110	2/545037	0/0111
LEV	-0/366900	0/119874	-3/060720	0/0023

The auditor proficiency has an effect on the stock return of exchange companies; R^2 = 0/267650; F-statistic = 22/72548; Adjusted R^2 = 0/255873; Durbin-Watson stat = 2/214568; Prob. (F-statistic) = 0/000000, Type data (statistic), (Prob.); Chow test = 32/652448, 0/6661; Hausman test = 2/380959, 0/6661

Fifth hypothesis testing: The results of Table 8 showed that the auditor proficiency in industry with the coefficient of -0/191 and the significant value of 0/000 had a negative effect on the stock return. In addition, among the other control variables of the study, the size of the company with the coefficient of 0/419 and significant value of 0/000 had a direct (positive) effect on the stock return.

CONCLUSION

This study explored the effect of corporate governance mechanisms on the stock returns of the companies within the framework of the governance system bylaw of Tehran Stock Exchange. According to the literature review and the previous empirical research, a positive relationship between all the corporate governance mechanisms and the stock returns of the companies was expected. But according to the tests done, there was only a significant relationship between institutional shareholder's ownership as well as auditor's proficiency and the stock return of listed companies in Tehran Stock Exchange. According to the results of the study, it seems that the criteria of corporate governance contrary to expectations cannot mainly reduce the agency problems in Iran and cannot affect the shareholder's return; because not only the corporate governance mechanisms affect the stock return of the companies but also the efficiency of the capital market plays a very important role. In addition, the reaction of people to the published information is different and in some cases, their reaction to new information is not completely logical. However, it is expected that if there is an improvement in political relations and economic prosperity as well as an increase in foreign investment in Iran's capital market, it will be possible to clearly see the growing effect of corporate governance factors on the stock return and the increase of transactions in the listed companies of Tehran Stock Exchange. This effect shows that the desirable

performance of the companies results in the operational efficiency and meeting the expectations of other stakeholders. Moreover, it can be a favorable point for the shareholders to meet their expectations of investing in the companies.

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