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ORIGINAL ARTICLE

ASSESSING THE EFFECTS OF CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE ON AGENCY COSTS IN LISTED COMPANIES ON TEHRAN STOCK EXCHANGE

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ABSTRACT: The present study seeks to investigate the effects of corporate governance and ownership structure on decreasing agency costs in 80 companies on Tehran stock exchange from 2004 to 2008. Multiple regression models with fixed effects have been employed to analyze the data. Descriptive variables of the research are as follows: the percentages of director ownership, institutional ownership, external ownership (except directors and institutional investors), board of directors, and CEO-chair duality. Normality test was utilized to distinguish whether the residuals are normally distributed, and the residuals were found to be normal; therefore, this conclusion could be drawn that both variables are normal and there is a significant positive relationship between director ownership, board size and agency costs. While, there is a significant negative relationship between the percentage of external ownership and agency costs, and no significant relationship exists between institutional ownership and CEO-chair duality and agency costs.
KEYWORDS: agency costs, corporate governance, ownership structure.

INTRODUCTION

Corporate governance policies can be supportive of shareholders' interests. High level of corporate governance improves a country's economic status. Kar stated that agency costs are more in the corporations with weak corporate governance. Managers of such corporations are frequently in pursuit of their personal desires to excess, when the firm's value is increasing. Corporate strategic policies were established by stock exchange in order to enhance the level of corporate governance, transparency, and financial statements to defend investors' profits. Junaid and Ghani (2005) studied commercial groups and their effects on corporate governance from 1998 to 2002. Butt and Hasan, (2009) investigated the effects of ownership structure and corporate governance on capital structure over a period of 2002 to 2005. Junaid and Ghani (2005) appraised the origin of the development of accounting methods and their effectiveness in Pakistan. Brown and Caylor, (2004) studied the association between corporate governance and performance.

Current corporate governance policies in Iran are to a certain extent different from other countries. Becht *et al.*, (2002) believed that most of the researches apropos of corporate governance have been conducted in developing countries, not developed countries, since corporate governance policies are still developing.

The current study aims to evaluate the policies' effectiveness of corporate governance and ownership structure in controlling agency costs in listed companies on Tehran stock exchange from 2004 to 2008. It also assesses the elements which can decrease agency costs and improves corporate governance in Iran.

RESEARCH BACKGROUND

Ang *et al.*, (2000) provided measures of absolute and relative equity agency costs for corporations under different ownership and management structures. They utilized a sample of 1708 small corporations operating in the U.S. To measure agency costs of the firms, they used two alternative efficiency ratios:

1- The expense ratio, which is operating expense scaled by annual sales and 2- the asset utilization ratio, which is annual sales divided by total assets. In their research, agency costs were found to be inversely related to the manager's ownership share, and increasing with the number of non-manager shareholders.

Noravesh *et al.*, (2009), investigated the relationship between corporate strategic policies and agency costs of firms listed on Tehran Stock Exchange. They considered the agency cost as a function of the interaction between growth opportunities and free cash flows. Q-Tobin was defined as a criterion to measure the growth opportunities. They assessed 88 firms from 2003 to 2006 and their survey results indicated that there is a significant negative correlation between the percentage of non-executive directors of the board and the ownership percentage of

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institutional investors with agency costs.

Valipour and Khorram, (2011) investigated the relationship between corporate strategic policies and agency costs of 51 firms listed on Tehran stock exchange during a period of 2001 to 2008. They applied Panel method in order to test the research hypotheses. The achieved findings demonstrated that there is a significant negative relationship between the percentages of institutional ownership, director ownership, non-executive directors of the board, the ratio of the debt to total liabilities, and agency costs.

Anyway, decreasing agency costs is recommended though employing appropriate corporate governance strategic policies. Empirical observations have also confirmed this fact.

Anis, (2013) investigated the influence of corporate governance mechanisms in facilitating the relationship between intellectual capital efficiency and corporate performance in Indonesian banking industry. The findings of this study show that intellectual capital efficiency and corporate governance mechanisms significantly influence the corporate performance in Indonesian banking industry. Corporate governance mechanisms moderate the relationship of intellectual capital efficiency to corporate performance.

Zubaidah Zainal *et al.*, (2009) examined the association between board structure and corporate performance based on a randomly selected sample of 75 companies listed on Bursa Malaysia. Pulic method was applied and it was found that board composition and board size have a positive impact on firm performance, while the effects of director's ownership and CEO duality on the value added efficiency of firm's total resources are not established. So, just one hypothesis was confirmed in this research and other hypotheses were rejected.

RESEARCH HYPOTHESES

This study examines the relationship between agency costs, corporate governance and ownership structure.

First hypothesis: There is a significant negative relationship between 'the percentage of director ownership' and 'income-sales ratio'.

Second hypothesis: There is a significant negative relationship between 'the percentage of institutional ownership' and 'income-sales ratio'.

Third hypothesis: There is a significant negative relationship between 'the percentage of external ownership' and 'income-sales ratio'.

Fourth hypothesis: There is a significant negative relationship between 'board size' and 'income-sales ratio'.

Fifth hypothesis: There is a significant negative relationship between 'CEO-chair duality' and 'income-sales ratio'.

RESEARCH VARIABLES

4.1. Dependent variable

'Agency costs' is the dependent variable of this study which is evaluated by the index of 'income-sales ratio'.

4.2. Independent variables

Descriptive variables of the research which determine the amount of agency costs, ownership effectiveness, and corporate governance policies can be named and explained in the following manner:

4.3. Director ownership

Director ownership refers to the percentage of the total capital stock over which all directors have control.

4.4. The percentage of institutional ownership

Institutional ownership stands for the total percentage of institutional investors' shares in proportion to the whole capital stock of the firm.

4.5. The percentage of external ownership

This variable refers to the sum of external stock, except director and institutional investors'.

4.6. Board size

This variable indicates the number of directors of the board in a corporation.

4.7. CEO-chair duality

Duality stands for a zero-one variable which is one when the chief executive officer is simultaneously the chairman of the board, otherwise it will be zero.

METHODOLOGY

Multiple regression model with fixed effects deployed in order to assess the relationship between corporate governance, ownership structure, and agency costs. The model's equation can be written in the following manner:

Agency $cost_{i,t}$ = αo + $\beta 1$Director $Ownership_{i,t}$+ $\beta 3$Institutional $ownership_{i,t}$+ $\beta 3$External $ownership_{i,t}$ +$\beta 4$ Board size $_{i,t}$+ $\beta 2$CEO- chair $duality_{i,t}$+ $\varepsilon_{i,t}$

Agency cost: calculated in proportion to income-sales ratio

Director ownership: the stocks possessed by directors

Institutional ownership: institutional investors' ownership

External ownership: ownership possessed by owners except directors and institutional investors

CEO-chair duality: when chief executive officer and the chairman are not the same.

Board size: number of directors of the board

$\varepsilon_{i,t}$: chance factors effects

α : Error

5.1. Target population and research sampling

Target population of the research is consisting of 80 companies on Tehran stock exchange over a period of 5 years, from 2004 to 2008.

RESEARCH FINDINGS

Mention must be made though that there is a normal association between dependent and independent variables when applying regression model. The accompanying diagram demonstrates the normality, since the calculated deviation is insignificant. The following table shows the results of regression model's goodness of fit. Considering the regression model's results, research hypotheses are confirmed or rejected as follows.

Table 1: Result of regression modelDependent variable: agency costs

Variable	Coefficient	T	Significance level
Fixed effects	1.089	1.813	0.073
The percentage of director ownership	-0.001	-0.226	0.822
The percentage of institutional ownership	-0.001	-0.557	0.579
External ownership	-0.007	-1.375	0.172
Board size	0.085	0.979	0.330
CEO-chair duality	0.161	0.637	0.526

F=0.909
P-value=0.479
Durbin-Watson statistic: 1.145
Adjusted R2= -0.005

Table 2: Hypotheses Results

Hypothesis	Independent variable	Dependent variable	Result
First hypothesis: There is a significant negative relationship between 'the percentage of director ownership' and 'income-sales ratio'.	the percentage of director ownership	income-sales ratio	Rejected
Second hypothesis: There is a significant negative relationship between 'the percentage of institutional ownership' and 'income-sales ratio'.	the percentage of institutional ownership	income-sales ratio	Rejected
Third hypothesis: There is a significant negative relationship between 'the percentage of external ownership' and 'income-sales ratio'.	the percentage of external ownership	income-sales ratio	Rejected
Fourth hypothesis: There is a significant negative relationship between 'board size' and 'income-sales ratio'.	board size	income-sales ratio	Rejected
Fifth hypothesis: There is a significant negative relationship between 'CEO-chair duality' and 'income-sales ratio'.	CEO-chair duality	income-sales ratio	Confirmed

CONCLUSION

This study aimed to investigate the effects of corporate governance and ownership structure on decreasing agency costs in 20 listed food companies (except sugar) on Tehran stock exchange from 2004 to 2008. Income-sales ratio deployed to evaluate the level of agency costs. Multiple regression model with fixed effects was employed to analyze the data. Descriptive variables of the research were as follows: the percentages of director ownership, institutional ownership, external ownership (except directors and institutional investors), board of directors, and CEO-chair duality. Considering the achieved data, this conclusion can be drawn that the variable of income-sales ratio is positively related to the variables of the percentage of director ownership and board size. Owing to the fact that the amounts of p-value and significance level are unimportantly small, it can be concluded that there is no significant association between income-sales ratio and institutional ownership, and CED-chair duality. In addition, income-sales ratio and the percentage of external ownership are inversely related.

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