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Research Paper

Ownership Structure and Firm Performance: Evidence from the Tehran Stock Exchange [1]

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ABSTRACT

Pyramidal and network ownership structures, which give ultimate owners greater control rights over companies than cash flow rights, are prevalent in the Iranian stock market. Given the complex shareholding networks and significant changes in the ownership structures of large Iranian firms over the past two decades, this study aims to examine the relationship between ownership structure and company performance. Four measures are used to analyze ownership structure: cash flow right of the largest shareholder, wedge between control right and cash flow right of the largest shareholder, difference in cash flow rights of the two largest shareholders, and type of ownership. The study investigates their relationship with the performance and stock returns of 261 listed companies during the period of 2015 to 2020.

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INTRODUCTION

Minority shareholders do not have the ability or incentive to monitor managers and since the gains they obtain from monitoring are usually lower than the costs they bear (Jensen and Meckling, 1976; Grossman and Hart, 1980). In contrast, large shareholders can monitor management and potentially improve the company's performance. The presence of large shareholders, however, brings about another conflict of interest in which large shareholders pursue their own interests at the expense of small shareholders. (Shleifer and Vishny, 1986; Burkart et al., 1997). One of the key factors that exacerbate the conflict of interest between small shareholders and large shareholders is the wedge between cash flow rights and voting rights (Bebchuk and Kraakman, 2000).

Several studies including La Porta et al. (2002), Joh (2003), Lemmon and Lins (2003) and Lins (2003) have found that there is a positive relationship between the cash flow rights of the largest shareholder and firm performance. Furthermore, Claessens et al. (2002) and Laeven and Levine (2007) show that firm performance decreases with the increase in the difference between the control rights and cash flow rights of the largest shareholder. They also find a negative relationship between the dispersion of cash flow rights among large shareholders and firm performance.

Pyramidal and network ownership structures, which provide ultimate owners with more control rights than cash flow rights over companies, are common in the Iranian stock market. Given the multi-layered shareholding networks and the significant changes that have occurred in the ownership structure of the large Iranian companies in the past decades, the purpose of this study is to investigate the relationship between ownership structure and performance of the Iranian listed firms.

MATERIAL AND METHODS

The key variable in our analysis is the wedge between cash flow rights and voting rights calculated based on the chain of ownership for the listed firms. Large shareholders often structure their ownership through multiple layers of direct and indirect ownership which in turn leads to increased control rights over cash flow rights. This structure increases the owner's ability to divert the company's resources for personal gain but reduces the owner's dividend. Ultimate owners are typically defined as having at least 15% voting rights over any companies that they are affiliated with, either directly or indirectly, through a chain of ownership. To determine the ultimate owners and business groups, an algorithm similar to the one used by Almeida et al. (2011) is used in this study. After identifying the ultimate owners of the listed companies, their cash flow and control rights are calculated similar to Almeida et al. (2011).

Two widely used measures of firm performance, return on assets (ROA) and return on equity (ROE), are used to evaluate firm performance, and annual stock returns are also used to assess stock performance. To estimate the effect of ownership on firm and stock performance, we use panel regression method including time-fixed effects, industry-fixed effects, and clustered standard errors.

Finally, ownership structure is measured using four measures; the cash flow right of the largest shareholder, the wedge between control right and cash flow right of the largest shareholder, the difference between the cash flow rights of the two largest shareholders, and the type of ownership.

FINDING

The results indicate a positive and significant association between the cash flow right of the largest shareholder and firm performance, but only when the largest shareholder owns at least 15% of the company's shares. For firms with only one owner and less than 50% in control rights, there is no significant correlation between the cash flow right of the largest shareholder and performance. The study also reveals that ownership by insurance companies has a positive correlation with firm performance, while quasi-governmental ownerships have a negative correlation with performance.

CONCLUSION & RESULTS

We examine the effect of ownership structure, as measured by ownership concentration, the wedge between the cash flow rights and voting rights of the largest owner and the type of the owner, on firm performance and stock price return. Our

results have important implications for both investors and policymakers in the realm of corporate governance.

Keywords: Ownership Structure, Type of Ownership, Pyramidal Structures, Firm Performance, Stock Return.

JEL Classification: G32, G34.