

Evaluation of the Effect of Rewarding Managers on the Capital Structure and Financial Performance of Companies Listed on Tehran Stock Exchange

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Abstract

Object and purpose of the study: The aim of this study was to evaluate the effect of rewarding managers on the capital structure and financial performance of the companies listed on Tehran Stock Exchange in the time period of 2005-2012.

Methods: Data of 58 companies and research hypotheses were tested using panel data and ordinary least squares of regression model.

Findings: Based on the results of the study, factors such as size of the company and the changes in cash and ratio of market value to book value of equity have significant negative impact on the capital structure of the company, the other conclusion is that there is a significant positive relationship between board bonus and financial performance and parameters such as the size of the company.

Conclusion: Rewarding managers causes to increase their efforts and thus increment of productivity and improvement of company performance.

Keywords: Rewarding managers, Capital structure, Financial performance, JEL Classification.

1. Introduction

The performance of many companies and organizations were evaluated based on financial indexes. But the managers and shareholders should consider this important case that a company may be profitable due to monopolized condition or informal communication, whereas it has not a good situation in terms of different productivity levels. So, in addition to financial indexes, it should be considered indexes which have had possibility of evaluation and conclusion about the production of goods and services in terms of productivity of production factors, quality, added value, the result's time and customer satisfaction (Hunt, 1991). Nowadays, public limited companies listed on stock exchanges are considered as the most efficient, effective and economical business agencies in each country and are the most important economic bases of the country. Due to this importance, it is one of the key issues that how to measure financial performance of companies (Aldrich Howard, 1994). Financial performance measurement is the basis of many decisions such as rewarding managers, stock price, stock risk, making decisions on investments and many other cases. Making decisions is one of the main and most important tasks of managers. They must decide for planning, organizing and executing. These decisions should be based on the results of assessments conducted (with criteria and performance indexes) in accordance with the organization's business processes. Continuous evaluation of performance would bring managers documented, on time and valuable information to make decisions that will be adopted on the aim of organization's promotion and improvement of its business activities in various fields. Different approaches are used to evaluate the performance of companies and the most important of these approaches can be divided into four groups as follows:

1. The accounting data such as earnings per share returns on equity, process of changing in the sales price.
2. The financial management data as well as returns per share, dividend yield, capital market line equations and capital assets pricing model.
3. The economic data like economic value, adjusted economic value.
4. Pooled data which are the result of combination of market value and accounting information. As the ratio of P/E, price to profit index, Tobin Q ratio and the ratio of market value to book value per share.

So, the present study aimed to find a significant relationship between rewarding managers on the capital structure and financial performance to help both local and foreign users by gathering factual information and indicating the presence or absence of this relationship.

2. Theoretical Foundations and research history

2.1. Capital structure

Capital structure issue was raised first by Modigliani and Miller in 1960s. In their point of view, recognition and valuation of companies based on assets and how to finance them is dependent to the recognition of capital. According to performed researches, in certain circumstances called the "efficient market" capital structure was major factor in determining the company's value.

Different definitions have offered for capital structure that each of these definitions states an aspect of financing methods as a capital structure up to now. Cooper (1983) defined capital structure as older securities (more rated) to the total investments. Hussey (1999) believed that the capital structure would be the balance between debt and assets, the nature of the asset and company's borrowing composition and is the combination of common stock, preferred shares and their related subsidiaries including retained earnings and long-term debt that a business unit uses them to finance its assets. Belkobi (2000) introduced capital structure as the general claim on the assets of the company. He had known the capital structure including public issued securities, private investment, bank debt, commercial debt and lease agreements which are usually measured by ratios such as the ratio of debt to equity.

2.2. Rewarding managers

The systems of pay and bonuses based on returns and performance have been common in industry over 70 years (Bowie, 1990). Each year the large amounts of money as a reward of increased production paid staff in many manufacturing enterprises and other organizations according to these plans. Incentive payments have increased only in the United Kingdom from 2003 to 2004 almost 1.5 million pounds. Why such huge payments made? Most economists and executives believed this type of payments increases efforts of employees thus the productivity, otherwise it would not have happened such large payments (Freeman, 2004). Staff reactions to material rewards constitute the cornerstone of work economic theory. In particular, the prevailing theory is that the payment of bonuses based on the production leads staff to try to work and produce more (Lazera 2000). However, financial rewards have different forms and kinds, but the most common types are cash payments in all organizations (Rynes and Gerhart, 1999). The most striking feature of all the material rewards is spending a part of the organization's financial resources. While the motivational power for any reward except money depends on payment mechanisms, environmental features and so on. The usefulness of money arises from the fact that it is convertible to any appreciable and tangible gain for the holder of it (Bandivra, 1986). So, the value of the incentive of money depends on the replace property of it. According to the switching property, money can be changed with any product or service (Bandivra et al., 1986; Velitnes, 2001).

The rewarding plan considers the total incentive rights and benefits of executives. A managing director might receive equivalent stock sheets, right to rise in stock, performance shares or other forms of incentive payments in addition to salaries and bonuses. The committee of encourage and rewards can select different performance criteria such as returns on stock exchange, efficiency of accounting and non-financial criteria to select the amount of the incentive received by the executive.

2.3. Research history

Tarek et al. (2008) preceded to the examination of the stimuli of capital structure and asymmetric systematic risk classes in their study. Companies were classified in terms of systematic risk into three categories of high, medium and low-risk companies. The study was included 99 Egyptian companies during the period of 7 years from 1998 to 2004. The results showed that the factors of size, profitability, and cost of representation, growth

opportunities, interest rates and liquidity of assets had inverse relationship with long-term debts, and all of these factors except for liquidity of assets had significant positive relationship with short-term debts. Other results showed that liquidity of assets was inversely related to short-term debt.

Tarek et al. (2007) examined the factors affecting capital structure in three theories such as static equilibrium, the pyramid and the free cash flow theories in their research. The study was conducted on 90 Egyptian companies. The results showed that long-term debt was positively related to tax rate and being evident of assets; and had inverse relationship with the risk of bankruptcy, current ratio, and quick ratio and growth opportunities. Other results of research also showed that short-term debt was negatively correlated to being evident of assets, current ratio and quick ratio; and had positive relationship with the tax rate and growth opportunities.

Eriotis (2007) examined the effect of the capital structure factors on the 129 companies on the stock market in Greece for the time period of 1997-2001. He selected capital structure factors based on theories issued in the field of capital structure. The results showed that the ratio of corporeity's debt had negative relationship with growth, current ratio and interest coverage ratio and debt ratio is negatively correlated to the size of company.

Taghi-zadeh and Poor-rabbi (2014) evaluated the assessment of effect of capital structure on intellectual capital of firms listed on Tehran Stock Exchange in their study. The results showed that there was significant negative relationship between the ratio of short-term debt to total assets and intellectual capital and also significant positive relationship existed between the ratio of equity to total assets and intellectual capital. Sajadi and Zare-zadeh-mehrizi (2011) investigated the effect of the two variables of paid rewards to managers and the percentage of their share ownership on company performance. The results showed a significant relationship between paid rewards to managers with economic criteria of performance assessment such as economic value added; market value added and modified economic value added. Results also showed a significant correlation between the percentage of ownership of the managers' stock with added value market and no significant relationship with other economic criteria of performance assessment.

Kimiyaie and Ein-ali (2008) examined the factors affecting capital structure. The samples consisted of 78 companies listed on Tehran Stock Exchange in the time period of 2001-2006. The results showed that the profitability was one of the factors affecting capital structure and had a significant negative correlation with it.

Sinaie (2008) studied the effects of company internal factors (size, assets status, profitability and growth opportunities) on how did the capital structure of companies listed on the Tehran Stock Exchange form and concluded that among the studied variables, firm size and growth opportunities had more important role in determining the capital structure.

Namazi and Shirzad (2005) reviewed the impact of capital structure on profitability of companies listed on Tehran Stock Exchange in the years 1996-2000. The results suggested that no strong significant relationship existed between capital structure and profitability of companies.

Bagher-zadeh (2003) tried to explain pattern of capital structure of companies listed on the Tehran Stock Exchange. Findings of 158 manufacturing companies studied from 1998 to 2002 suggested that pattern of capital structure of stock companies was as a function of variables such as the amount of fixed assets, the company size and its profitability.

Jahankhani et al (1995) examined the factors affecting and determining the financial structure and the impact of the industry type, firm size and business risk on using financial lever on Tehran stock Exchange's companies. The results of their study showed that industry type did affect on the financial structure of the company, but the variables of firm size and business risk and operating lever had no effects on the financial structure.

3. Research variables

3.1. Independent variables

The independent variable in this study was consisted of bonuses paid to managers which its related information was extracted from the notes along with financial statements.

3.2. The dependent variable

The dependent variables were used in this study included financial performance and capital structure;

1. Financial performance: It measured by the ratio of returns on assets according to research (Noorbakhsh-langroodi et al., 2012).
2. Capital structure: It measured with the ratio of debt to assets according to research (Rahimiyan et al., 2013).

3.3. Control variables

Control variables used in this study as other factors affecting financial performance and capital structure are consist of:

1. Size: The natural logarithm of total assets as representative of the company size (Sin et al., 2012).
2. The changes in cash.
3. The ratio of book value to market.
4. Growth opportunity: That is equal to the book value of assets plus the total market value of equity divided by the book value of assets.

4. Research hypotheses

This study consists of two main hypotheses as follows:

The first hypothesis: There is a significant relationship between paid rewards to managers in the current year and future financial performance.

The second hypothesis: There is a significant relationship between paid rewards to managers and capital structure (financial lever).

5. Statistical population and statistical sample

The statistical population of this study was all the companies listed on Tehran Stock Exchange during the time period of 2005 to 2012 (8 years period). Only companies that have all the following conditions were selected as statistical sample using the elimination method (screening). These conditions were as follows:

1. They had accepted in Tehran Stock Exchange by the end of March 2004 and their financial year ended to the March.
2. The Companies must not have altered their financial year during the period in question.
3. They fully provided the financial data needed to conduct the research for the period of 2005 to 2012.
4. They were not as the investment, bank and financial intermediation companies.

According to the mentioned terms 58 companies were selected as sample and had surveyed.

6. Methods and data collection

This study was correlational in this respect that is sought to determine the relationship between rewarding managers and financial performance and the company's capital structure and is applied in the case that can be used by a large group of users of financial information of companies. This research used ex post facto approach to carry out. Ex post facto research method uses when the subject examined after the event by researchers, in addition to this, there is no possibility of the manipulation of independent variables (Reshad quoted by Namazi, 2010).

In this research, data and variables were collected from data of sample companies referring to the financial statements, explanatory notes, weekly reports and the stock exchange monthly magazine using Rah-avard-novin software.

7. The method of data analysis and hypotheses test

The research reviewed the relationship between rewarding managers with future financial performance and capital structure of the company using pooled/panel regression analysis in the following models:

The first hypothesis test of study:

$$ROA_{i,t} = \beta_0 + \beta_1 CV_{i,t-1} + \beta_2 Size_{i,t} + \beta_3 \Delta Cash_{i,t} + \beta_4 MB_{i,t} + \beta_4 GO_{i,t} + \varepsilon_{i,t}$$

The second hypothesis test of study:

$$DA_{i,t} = \beta_0 + \beta_1 CV_{i,t-1} + \beta_2 Size_{i,t} + \beta_3 \Delta Cash_{i,t} + \beta_4 MB_{i,t} + \beta_4 GO_{i,t} + \varepsilon_{i,t}$$

Where:

$ROA_{i,t}$ =Returns on assets of company i at the end of the financial year t.

$DA_{i,t}$ =The ratios of debt to assets of company i at the end of the financial year t.

$CV_{i,t-1}$ =The paid rewards to managers of the company i at the end of the financial year t-1.

$SIZE_{it}$ =The natural logarithm of the assets of company i at the end of the financial year t.

$\Delta Cash_{i,t}$ =The changes in cash in the company i at the end of the financial year t than the end of the financial year t-1.

$MB_{i,t}$ =Book value to market of the company's stocks i at the end of the financial year t.

$GO_{i,t}$ =The growth opportunity of company i at the end of the financial year t.

$\varepsilon_{i,t}$ =Regression remains of company i at the end of the financial year t.

The integration of cross-sectional and time series data (pooled data) and the need to use it was more due to increase the number of observations, raise the degree of freedom, reduce variation anisotropy and reduce co-linearity between the variables.

8. Research data analysis

8.1. Descriptive statistics of the research variables

Table 1 shows the descriptive statistics of the research variables. It should be noted that the number of observations to estimate the models studied in this research were 464 observations from 58 companies during years from 2005 to 2012.

Table1. Descriptive statistics of the research variables

The research variables	Average	Median	Maximum	Minimum	Standard deviation
Paid rewards to managers	2.441	2.435	3.305	1.613	0.269
Size of company	12.419	12.475	15.043	9.778	0.964
Returns on assets	0.136	0.130	0.700	-0.310	0.151
Growth rate	2.806	0.695	46.559	0.026	6.386
The changes in cash	0.151	0.102	1.708	0.001	0.170
Capital structure (financial lever)	0.668	0.561	1.824	0.146	0.198
Market value to book value of equity	0.544	0.559	0.883	0.075	0.208

8.2. Reliability of the research variables

The results of the research variables reliability are presented in table 2. According to Unit Root Test of a Levin et al test type, since the P-Value has been less than 5% all the variables have been at stable level throughout the study period.

Reliability means that the mean and variance of variables has been fixed over time and so do the covariance of variables between different years. As a result, studied companies had no structural changes and use of these variables in this model didn't cause false regression.

Table 2: Results of the stagnation test (reliability) of the research variables

The research variables	Levin, Lin & Chu	
	Test statistic	Sig.
Paid rewards to managers	-23.730	0.000
Size of company	-8.203	0.000
Returns on assets	-17.601	0.000
Growth rate	-15.844	0.000
The changes in cash	-17.594	0.000
Capital structure (financial lever)	-16.756	0.000
Market value to book value of equity	-23.171	0.000

8.3. The first hypothesis test

To test the second hypothesis on "rewards paid to managers have a significant effect on financial performance", the ordinary least squares regression model with panel data was used. Table 3 shows the results of the integration capability test for the model related to the second hypothesis of the research.

Table 3: Results of the integration capability test for model –the first hypothesis

Test statistic	Degree of freedom	Significance
1.977	(57, 401)	0.000

As table 3 shows, the F statistic's significance is smaller than 0.05 which represent superiority of using panel data methods versus integrated data methods. Hausman test is used in order to choose one of the fixed effects and random effects methods. Table 4 shows the Hausman test results for the model related to the second hypothesis of this study.

Table 4: Results of the Hausman test model - the second hypothesis

Chi-square statistic	Degree of freedom	Significance
5	(57, 401)	0.391

Regard to table 4, the chi-square statistic's significance is larger than 0.05 which reflects the preference of using panel data of random effects method versus fixed effects. So, the random-effects panel data method used to estimate the second hypothesis model of research. The results of the regression model estimation are provided in tables 5 and 6.

Table 5: Results of the general review of the model - the second hypothesis

The coefficient of determination	The modified coefficient of determination	F Statistic	Sig.	Durbin-Watson statistic
0.444	0.433	4.203	0.000	2.040

As can be seen in table 5, the F statistic and the significance level of this statistic state that the statistical null hypothesis that shows the whole model to be nonsense (all zero coefficients) is rejected and the estimated regression model is significant totally. In this model, the coefficient of determination is equal to 0.444. It means 4.44% of the change in the dependent variable explained by the independent and control variables. The amount of Durbin-Watson statistic is 2.040 located between 1.500 and 2.500 and indicates that there is no self-correlation between the errors of the model.

Next, it is explained the results of the model variables coefficients' analysis which are presented in table 6. As seen in table 6, the independent variable coefficient indicates that board rewarding has a positive impact on financial performance. Also, the t-statistic and significance related to this statistics shows that this effect is statistically significant.

Therefore, the second hypothesis is accepted. A significant level and coefficients of t-statistic related to the control variables also shows the factors that have significant positive effect on the financial performance of the company such as the size of the company, the changes in cash, market value to book value of equity and growth rate.

Table 6: Results of the analysis of partial coefficients of the model - the second hypothesis

Variables	Coefficients	Standard error	t statistic	Sig.
Paid rewards to managers	0.005	0.002	3.492	0.000
Size of company	0.214	0.054	3.964	0.000
The changes in cash	0.025	0.008	3.160	0.001
Market value to book value of equity	0.119	0.024	5.009	0.000
Growth rate	0.005	0.003	1.995	0.047
Constant value	2.240	0.230	9.755	0.000

8.4. The second hypothesis test

Ordinary least squares regression model with panel data was used for studying the first hypothesis test on "rewards paid to managers have a significant effect on the capital structure ". To estimate the model at first, integration capability test has used in order to selection of panel data methods and pooled data. In the integration capability test, the null hypothesis represents that the intercepts are the same (pooled data) and the contrast hypothesis represents the difference in intercepts (panel data). Table 7 shows results of integration capability for the model related to the first hypothesis of the study.

Table 7: Results of the integration capability test for model –the first hypothesis

Test statistic	Degree of freedom	Sig.
1.985	(57, 401)	0.000

As table 7 shows, the F statistic's significance is smaller than 0.05 which represents superiority of using panel data methods to integrated data methods. Since the null hypothesis of integration capability test is not accepted (the panel data method is preferred), the question arises that which of the fixed effects or random effects methods

can be estimable in the studied model? So, Hausman test was used to choose one of the fixed effects and random effects methods. Table 8 shows results of Hausman test for the model of the first hypothesis of the study.

Table 8: Results of the Hausman test model - the first hypothesis

Chi-square statistic	Degree of freedom	Sig.
6.016	5	0.305

As table 8 shows, the chi-square statistic's significance is larger than 0.05 which reflects the preference of using panel data of random effects method versus fixed effects. So, the random-effects panel data method was used to estimate the first hypothesis model of research. The results of the regression model estimation are provided in tables 9 and 10.

Table 9: Results of the general review of the model - the first hypothesis

The coefficient of determination	The modified coefficient of determination	F Statistic	Sig.	Durbin-Watson statistic
0.444	0.433	4.187	0.000	2.096

As can be seen in table 9, the F statistic and the significance level of this statistic state that the statistical null hypothesis that shows the whole model to be nonsense (all zero coefficients) is rejected and the estimated regression model is significant totally. The coefficient of determination is also a criterion that explains dependent variable unaffected by the control and independent variables. In this model, the coefficient of determination is equal to 0.444. It means 4.44% of the change in the dependent variable can be explained by the independent and control variables. The amount of Durbin-Watson statistic is also, 2.096 located between 1.500 and 2.500 and indicates that there is no self-correlation between the errors of the model. The results of the model variables' analysis which are represented in table 6 that will explain in following.

Table 10: Results of the analysis of partial coefficients of the model - the first hypothesis

Variables	Coefficients	Standard error	t statistic	Sig.
Paid rewards to managers	-0.002	0.004	-0.541	0.965
Size of company	-0.215	0.054	-3.988	0.000
The changes in cash	-0.025	0.008	-3.175	0.001
Market value to book value of equity	-0.120	0.024	-5.061	0.000
Growth rate	-0.005	0.003	-1.977	0.049
Constant value	2.254	0.226	9.951	0.000

As seen in table 10, the independent variable coefficient indicated that board rewarding had a negative impact on capital structure. Nevertheless, the t-statistic and significance related to this statistics showed that this effect was not statistically significant. Therefore, the first hypothesis was not accepted. A significant level and coefficients of t-statistic related to the control variables also showed the factors that have significant negative impact on the capital structure of the company such as the size of the company, the changes in cash and market value to book value of equity.

9. Conclusio and Recommendations

In recent study, data gathered from the financial statements of companies listed on Tehran Stock Exchange were analyzed using ordinary least squares regression models with panel data in order to examine the effect of rewarding managers on the capital structure and financial performance. The results are as follows:

1. The paid rewards to managers have a negative impact on the capital structure which was not significant in terms of statistics, so, the first hypothesis of this study was refused and represented the size of the company,

cash changes and ratio of market value to book value of equity have significant negative effect on the company's capital structure and board rewarding had positive effect on financial performance.

2. The size of the company, cash changes, market value to book value of equity and growth rates had significant positive effect on the company's performance, so the second hypothesis was confirmed.
3. There was no significant relationship between paid rewards to managers and the capital structure, but there was significant relationship between the paid rewards to managers and financial performance of companies which was correspond to the result of researches of Lambert and Larcker (1987), Jensen and Murphy et al. (1990).

10. Suggestions for future researches

- The analysis conducted in this study was done only at the level of all companies, so it is suggested to implement the research hypotheses in the level of industry and separately again.
- Bonuses paid to executives made managers to do their responsibilities well, so it can be studied its impact on other factors of the financial statements of the companies.

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