

Corporate Governance Mechanisms and Chief Executive Officer (CEO) Duality Evidence from the Food Industry of Iran

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Abstract: The objective of this study is to examine the effects of corporate governance mechanisms on Chief Executive Officer (CEO) Duality in the food industry of companies listed in the Tehran Stock Exchange (TSE). There are several aspects and dimensions of corporate governance, which may influence a CEO Duality but this study focused on three aspects namely Ownership Concentration (OWNCON); Institutional Ownership (INOWN) and Board's Independence (BOIN). This study utilizes a panel data analysis of 47 firms over a four-year period from years 2008 to 2011. In this study, log of total assets (SIZE) and total debt divided by total assets (LEV) are control variables. A logistic regression analysis is used to test the hypotheses. The results show has a positive and significant relationship between Ownership Concentration; Institutional Ownership; Board's Independence; Leverage and Chief Executive Officer Duality. Also, there is a negative and significant relationship between size and Chief Executive Officer Duality.

Keywords: Agency theory, chief executive officer, corporate governance

INTRODUCTION

According to the Cadbury Report (U.K.), corporate governance is defined as the "system by which businesses are directed and controlled (Cadbury, 1992)." In other words, corporate governance is a general set of customs, regulations, habits and laws that determine how a firm should be run.

"Corporate governance is a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined (Hand *et al.*, 2004)."

The literature generally distinguishes between internal and external governance mechanisms. The primary concerns of internal mechanisms are the boards of directors which monitors management operations and processes, while the external mechanisms include ownership structure, protection of minority shareholders, legal infrastructure and market for corporate control (Gillan, 2006). On the other hand, corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability (OECD, 2004). CEO duality occurs when the same person occupies both the CEO

and board chairperson positions in a corporation (Rechner and Dalton, 1991). On the other hand, if different individuals serve in these two pivotal positions, the firm can be said to adopt a separate leadership structure. There is little by way of evidence on Corporate Governance and CEO duality. And the evidence on the relation between CEO duality and Corporate Governance is mixed. The food industry of companies accepted into the Tehran Stock Exchange (TSE) of Iran has been selected for this study to examine the effects of corporate governance mechanisms namely Ownership Concentration and Institutional Ownership on CEO Duality.

THEORETICAL FRAMEWORK

The Fig. 1 shows the relationship of variables with each other. This model assumes that corporate governance is affected by ownership concentration can affect on CEO duality i.e., the holding of both the top offices of the chairman and the CEO by the same person. Moreover, the CEO duality has been determined by Institutional Ownership, namely, Institutional investors have come to play an important part in the debate about ensuring that shareholders' funds. The impact on another variable that would be seen on corporate governance is board independence. The fraction of Board's Independence is expected to

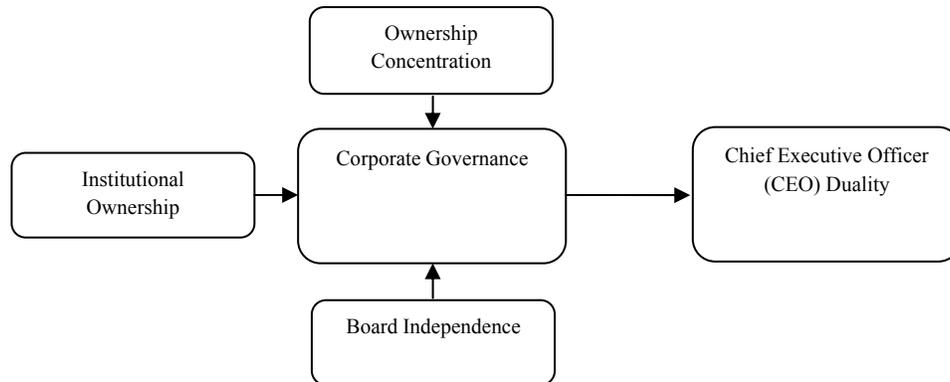


Fig. 1: Conceptual framework of the research

reduce agency problems and shareholders' monitoring costs. Fama and Jensen (1983) argue that manager-monitoring activities of the board will be more effective when they are dominated by independent-outside directors.

LITERATURE REVIEW

Loebbecke *et al.* (1989) argue that firms whose CEO is also the chairman are likely to exhibit lower financial reporting quality because the CEO can manipulate financial reporting to achieve their own aims. In 75% of the fraud cases they examine, a single person controls the firm's operating and financial decisions. Catherine and Dalton (1994) examine the relationships among corporate governance structures and corporate bankruptcy using data from 1972 to 1982. Logistic regression statistical technique was used to measure the relationship between dependent and independent variables. Profitability, Liquidity and leverage are dependent variables and CEO duality and proportion of affiliated directors are independent variables. The results show that there is a significant relationship between corporate governance structures and corporate bankruptcy. Brown and Caylor (2004) looked at 2327 U.S. firms and found that better governed firms are also more profitable, more valuable and pay higher dividends. Similarly, Gompers *et al.* (2003) found that firms that have strong shareholders' rights have higher firm value, higher profits and higher sales growth. Mitton (2001), in a cross-country study of the Asia-Pacific region, found that firm level differences in corporate governance have significantly influenced firm performance during the East Asian crisis. The study also showed that higher price performance is related to higher disclosure quality, higher outside ownership concentration and with firms that are focused rather than diversified.

In the study, Arlman (2004) shows the results empirical research into the practice of CEO duality in S&P 500 and FTSE 100 firms. For both groups of firms the data was collected in August of 2004. The

composition and data for the S&P firms was accessed from The Corporate Library (including Board Analyst) and individual company websites. Information for the FTSE firms was acquired from FTSE, Hemscoff and also from individual company websites. In his sample of 486 S&P 500 companies, he found that 24% (119 companies) had a different chairman than CEO. For the FTSE 100 companies 96% had a split between the function of CEO and chairman. In comparison with the results of Dalton and Kesner (1987), it seems that the amount of firms with a separate chairman from CEO has grown in the past years. However, while today the UK has almost complete separation between the office of chairman and CEO, the Americans still prefer to combine the two jobs in more than three out of four companies.

Kholief (2008) re-examining the predictions of agency theory with regard to the negative association between CEO duality and corporate performance by using the financial statements for the year 2006 of most actively traded companies in the Egyptian stock market. It examines the role of other corporate governance mechanisms (board size, top managerial ownership and institutional ownership) as moderating variables in the relationship between CEO duality and corporate performance. Moderated Regression Analysis is used to analyze the empirical data. Findings indicated that the hypothesized relationship between CEO duality, the moderating variables (top management ownership, board size and institutional ownership) and corporate performance has changed. He found that board size was the only moderating variable, top management ownership was a suppressor variable and institutional ownership was simply another independent variable. For companies characterized by large boards and low top management ownership, corporate performance is negatively affected by CEO duality and positively impacted by institutional ownership.

Based on a sample of 290 large U.S. corporations, Hee Kim and Buchanan (2008) find that dual positioning on both CEO and board chairperson

positions at the corporate top leads to reduced firm risk-taking propensity, serving managerial risk minimization preferences. They also find empirical evidence that traditionally emphasized control mechanisms of board independence and managerial ownership are ineffective in controlling managerial behavior when CEO duality leadership exists. Additionally, the power balance obtained from concentrated shareholder ownership in the firm has significant impact on controlling managerial behavior regarding firm risk taking. The findings of this research contribute to reducing the controversy surrounding CEO duality leadership by furnishing empirical evidence of how CEO duality leadership in corporate governance structure affects managerial behavior in corporate strategic management.

Sampson-Akpuru (2010) investigates the likelihood that a firm with a combined CEO/chair will pursue an international acquisition using 2,271 firms in the S&P 1500 from 1992 to 2007. He finds evidence that firms with a dual CEO/chair are more likely to announce an international acquisition, although the strength of the association varies with the specification of his control variables. International acquisitions are also more likely for larger, high-sales-growth firms with lower leverage and lower cash levels. This study extends prior work on the relationship between leadership structure and acquisitions by investigating international acquisitions.

Dung (2011) investigated the relation between corporate governance and firm value by using information taken from of Vietnamese Listed Companies on Ho Chi Minh Stock Exchange (HOSE) and Ha Noi Stock Exchange (HNX) at the year-end 2009. The empirical findings show that the dual position of CEO and Chairman has a positive relation with firm value. Besides, age of director and the number of directors meeting play important roles in firm value. However, no significant impact of board size, board gender diversity, top ten shareholders concentration and levels of state ownership on firm performance. Lastly, regression model of market performance shows that the duality of CEO and Chairman and the number of independent directors are significant impact on firm value.

RESEARCH METHODOLOGY

Research hypotheses: In order to evaluate the effects of corporate governance mechanisms on CEO duality, hypotheses are tested:

H1 : There is a significant relationship between ownership concentration and CEO duality in food industry accepted companies in Tehran Stock Exchange.

H2 : There is a significant relationship between institutional ownership and CEO duality in food industry accepted companies in Tehran Stock Exchange.

H3 : There is a significant relationship between board's independence and CEO duality in food industry accepted companies in Tehran Stock Exchange.

Data and methodology: To analyze the effect of corporate governance mechanisms, on CEO duality, independent and dependent variables are analyzed from two different aspects. From one, these variables are tested among various companies and from the other; they are tested in the period of 2008 to 2011. Therefore in this examination, we use panel data methodology.

Sample and data collection: In this study, a sample of food industry of companies accepted into the Tehran Stock Exchange over the period 2008-2011 is used. By doing so, our sample comprises data from 47 firms and consisting of 188 years-firm observations. Each firm had to meet specific criteria to be included in the sample:

- They must close their fiscal year on mid-March (end of Persian calendar)
- They must also have data regarding the ownership concentration, percentage of ownership structure and board structure
- They must have full financial data for the whole period of investigation

Data collection method: The data needed for analysis taken in annual general meetings. In doing so, the main part of data is collected from the data base that belongs to the Islamic Research Management Center of the Tehran Exchange Market (www.rdis.ir) and the remaining data are gathered from the second version of Tadbir Pardaz and Sahra and RahAvard Novin software's (three Iranian software programs).

The empirical model: According to the previous researches (Catherine and Dalton, 1994; Adeyemi and Fagbemi, 2010), the hypotheses formulated for this study were tested with the use of logistic regression. This was used to examine the relationship between dependent and independent variables. According to Field (2000), logistic regression is multiple regression but with an outcome variable that is a categorical dichotomy and predictor variables that are continuous or categorical. The general multiple logistic regression models are as follows (Peng *et al.*, 2002).

$$\text{Logit}(Y) = \ln\left(\frac{\pi}{1-\pi}\right) = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_n X_n \quad (1)$$

Therefore,

π = Probability ($Y = \text{outcome of interest} \mid X_1 = x_1, X_2 = x_2$)

$$= \frac{\exp(\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_n X_n)}{1 + \exp(\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_n X_n)}, \quad (2)$$

Research model: Based on the empirical research previously described and the theoretical considerations discussed above, the logistic regression model used in this study is defined as follows:

$$\ln\left(\frac{\pi}{1-\pi}\right) = \beta_0 + \beta_1 \text{OWNCON}_{it} + \beta_2 \text{INOWN}_{it} + \beta_3 \text{BOIN}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{LEV}_{it} + e_{it} \quad (3)$$

where,

- OWNCON = Ownership Concentration
- INOWN = Institutional Ownership
- BOIN = Board's Independence
- SIZE = Log of Total Asset
- LEV = Total Debt divided

Total Asset and e_{it} is the error term.

Measurement of variables:

Dependent variable: CEO duality is coded as 1 if an individual simultaneously serves as both CEO and chairperson of the board and 0 otherwise.

Independent variables:

- **Ownership concentration (OWNCON):** the proxy for ownership concentration is measured by Herfindahl-Hirschman Index that is the squared sum of shares in the hands of shareholders $HHI = \sum_{i=1}^n \left(\frac{p_i}{p}\right)^2$ above 5% (Dickson, 1994; Santerre and Neun, 1993)
- **Institutional ownership (INOWN):** consists of the percentage of shares held by institutional shareholders

- **Board's independence (BOIN):** consists of the percentage of independent directors on board, i.e., the ratio of independent directors to total number of directors on board. Independent directors refer to those directors who have been explicitly and clearly announced as independent directors in a listed company's annual report.

Control variables: This study also includes two control variables into regression analysis to control for firm characteristics. A set of control variables employed means that this study is quite carefully controlled. According to studies such as Catherine and Dalton (1994) and Adeyemi and Fagbemi (2010), Log of total assets (SIZE) is employed as proxy for firm size effect. Leverage (LEV) is included as a control variable to proxy for financial leverage and is defined as total debt divided by total assets.

RESULTS

Descriptive analysis: Table 1 provides the descriptive statistics for all variables used in the study over the period 2008 to 2011.

Table 2 shows all the observations of different years. On average, about 57.98 per cent of the sample firms have a duality role. As such, Arlman (2004) document that majorities of the Chairman and CEO positions in sample of 486 S&P 500 companies, found that 24% (119 companies) had a different chairman than CEO. For the FTSE 100 companies 96% had a split between the function of CEO and chairman. In comparison with the results of Dalton and Kesner (1987), it seems that the amount of firms with a separate chairman from CEO has grown in the past years.

Empirical results: In this study a multiple logistic regression model is used. The results of investigating the firms presented in Table 3. As you can see, R2 nagelkerke index in the model is 38.15%, which is indicative of the model's power of prediction. The comparison made for hosmer-lemeshow statistics with a 5% degree of error indicates the conformity of the model with real observations.

Table 1: Summary descriptive statistics of all variables

Variable	Mean		S.D.		Min.		Max.	
	Non-duality	CEO duality						
OWNCON	0.455	0.486	0.324	0.121	0.000	0.000	0.971	0.952
INOWN	0.578	0.411	0.133	0.254	0.000	0.000	0.890	0.981
BOIN	0.431	0.491	0.221	0.276	0.000	0.000	0.800	0.875
size	5.44	9.52	0.475	0.441	3.98	6.12	15.06	11.89
LEV	0.375	0.448	0.354	0.284	0.129	0.157	0.687	0.801

Table 2: Summary descriptive statistics

Year	No. of Obs.		Percent. of Obs.		No. of firm
	CEO duality	Non-duality	CEO duality	Non-duality	
2008	32	15	68.08	31.92	47
2009	28	19	59.57	40.43	47
2010	25	22	53.19	46.81	47
2011	24	23	51.06	48.94	47
Sum	109	79	57.98	42.02	188

Table 3: Statistical results

Statistics	Model
-2 Log-Likelihood	375.635
Cox-Snell R ²	0.3194
R ² nagelkerke	0.3815
Chi-square stat	127.876
Degree of freedom	4
Sign	0.000
Goodness-of-fit test: hosmer-lemeshow stat	5.7458
Sign	0.4985
The power of prediction of model	72.66

Table 4: Insignificant coefficients of model

Variables	β	SE (β)	Wald's χ^2	p-value	Exp (β)
Constant	0.037	0.7034	0.2496	0.784	0.7713
OWNCON	1.687	0.2693	3.4751	0.000	1.0886
INOWN	0.745	0.2788	4.9648	0.002	1.9842
BOIN	1.745	0.4185	3.4526	0.005	0.2587
Size	-0.587	0.3530	5.5921	0.028	0.3694
LEV	0.532	0.1961	2.4966	0.045	0.4585

The meaningfulness values presented in Table 4 show that the coefficients of the percentage variables of ownership concentration; (OWNCON) Institutional Ownership (INOWN) and Board's Independence (BOIN), with a confidence level of 95% are all meaningful.

As shown in Table 4, the ownership concentration on CEO duality, that is H1, is statistically significant and the coefficient is 1.687 on CEO duality. The result supports the predicted hypothesis H1. Result from effect of institutional ownership coefficient on CEO duality is positive and statistically significant at 5 per cent level ($p < 0.05$) and thus, the result supports the hypothesis H2. As for the coefficient of board independence is meaningful. The coefficient for firm size is significantly negative and On the other hand, the coefficient for leverage, LEV, is statistically significant and positively related to CEO duality.

CONCLUSION AND DISCUSSION

This study, based on the data of Food Industry of Iran and using panel data methodology has proved the hypothesis that, "relationship between corporate governance mechanisms and CEO Duality". The results from the first hypothesis test reveal a positive and meaningful relationship between ownership concentration and CEO duality, which proves the active

monitoring hypothesis. Also, the odd ratios (Exp (β)) related to the variable of ownership concentration shows that increasing this variable will increase the possibility of choosing the Chairman and CEO. This result agrees with the findings of Dung (2011) and Chang and Shazali (2005) have argued that a strong dominant CEO may be essential for a developing economy where the system may be dependent on a few power corporate players to push performance. The results from the second hypothesis test show a significant positive relationship between the institutional ownership and CEO duality. This result is in line with the findings of Hee Kim and Buchanan (2008) study. The findings from the other hypothesis test of the study show there is a significant relationship between board's independence and CEO duality. The coefficient for firm size is significantly negative and the coefficient for leverage, LEV, is statistically significant and positively related to CEO duality. CEO duality causes information problems as he determines the agenda and information to the board (Jensen, 1993).

Our research was conducted in Food Industry of Iran. Since it may be different in many ways from other industries, the findings may not be generalizable to other industries. We call for future research to test our theory in other industry.

Further research: A further study may be carried out including more factors in corporate governance mechanisms and by expanding its scope to other nations for better understanding and generalizing of the findings. We focused on corporate governance and CEO duality. We recognized that better corporate governance is advocated for reasons aside from split between the function of CEO and chairman. It is plausible that governance factors unrelated to CEO duality are important for other purposes. Future research should examine corporate governance in these and in other contexts.

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