



Investigate the relationship between transactions with related parties with abnormal stock returns of listed companies in Tehran stock exchange

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ABSTRACT

The present article examined the relationship between related party transaction and abnormal stock returns. The methodology was based on the application of panel data and testing the hypotheses through the analysis of multiple regression. The results obtained from 71 companies listed on Tehran Securities Exchange from 2007 to 2013 represented a significant negative relationship between related party transaction and abnormal returns.

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INTRODUCTION

Hoping to acquire more wealth, investors venture to invest. An important factor in investors' decision-making is the rate of stock return. Return on the investment process is a driving force that motivates and rewards investors. Indeed, every investor should first make sure that by the first stage the main investment will return and then the expected return will be obtained to be able to decide on investment. A strong, stable and entrepreneur leadership in a company has a major effect on stock prices. According to the hypothesis of a conflict of interest, sometimes managers can use transactions with related parties (opportunistic) to expropriate the assets out of a company's ownership for the benefit of related parties, and exercise earnings management as a cover. In such cases the regulatory mechanisms of corporate governance can convert these transactions to efficient ones. The present research study aimed to answer the questions "Can managers use related party transaction to earn abnormal returns?" and "Do related party transactions confirm the hypothesis of a conflict of interest?"

Literature Review

Related Party

Related party refers to those one of whom could remarkably influence major financial and operational decisions of the other party directly or indirectly; or both are under common control or significant influence of a third party, so that, the independent interests of one is influenced by the other's in a transaction.

Related Party Transactions

According to Iran's Accounting Standard, No. 12 related party transaction is defined as the transfer of resources,

services or obligations between related parties, regardless of any claims thereof.

Related party transaction could be considered from two perspectives:

- The hypothesis of a conflict of interest
- The hypothesis of efficient transactions

Related Party Transactions and Corporate Governance

According to the hypothesis of a conflict of interest, related party transactions is sometimes motivated by expropriating the assets out of a company's ownership for the benefit of related parties, and exercise earnings management as a cover.

Corporate governance plays a vital role in improving the productivity and quality of financial reporting. This regulatory system may prevent the manipulation of financial statements and assure investors about the quality of information disclosed by the company.

Therefore, a corporate governance mechanism may reduce the negative impact of related party transactions. In addition, it discloses related party transactions to help users of financial statements to make proper judgments about these transactions. Appropriate corporate governance mechanisms effective reduce opportunistic behavior of managers, improve companies' reports and value.

Internal Studies

Khoddami poor, Amini and Houshmand Zaferanieh, (2012) investigated the effect of related party transactions disclosure on earnings management according to Standard No. 12 adopted in 1386. The dependent variable was market value of every share and the independent variables included earnings of every share. The dummy variable was vending of products and assets to related parties. The results revealed that after the approval of new disclosure obligations, the

earnings value coefficient reduced for companies vending the inventory to related parties. In addition, the earnings value coefficient due to vending of assets to related parties reduced in the period next to new disclosure obligations. The researchers found no significant relationship between new disclosure obligations and its impact on reducing the manipulation of earnings through related party transactions. She'ri and Hamidi (2012) indicated that the hypothesis of opportunistic behavior in related party transactions could not be rejected and signs of opportunistic behaviors could be observed in the business environment of Iran.

Sarlak and Akbari (2013) showed that there is a significant positive relationship between related party transactions and earnings management.

Foreign Studies

Gordon and Henry (2005) examined the relationship between earnings management and related party transactions. The results showed that discretionary accruals have a positive relationship with certain types of transactions. They concluded that the concern about transactions with related parties is only about certain types of related party transactions.

Sskayev, Lafand and Long (2006) stated that when related party transactions are not closely examined, managers have great incentives to expropriate the company's resources and earnings management.

Henry, et al. (2007) discussed the role of related party transactions in financial reporting. The results showed that these transactions are not necessarily causes of fraudulent financial reporting. They advised that the nature of the related party transactions, the amount of disclosure and corporate governance structure should be noted on the role of related party transactions in fraudulent financial reporting.

Cheung, et al. (2008) examined the issue of related party transactions among companies listed on the Stock Exchange of Hong Kong. The results indicated that on average, companies received negative excess returns in the announcement of related party transactions and also within 12 months after. The returns were significantly lower than returns on fair similar transactions. Excess returns were negatively correlated with the percentage of ownership of controlling shareholders and information disclosure alternatives. Finally they found little evidence indicting the market as a predictor of the company resources takeover.

Chen, et al. (2009) investigated assets pricing in related party transactions among 254 companies during the period of 1998-2000. Their findings showed that companies with related party transactions enter the transaction with inappropriate costs compared with those with actual transactions; companies gain assets from related parties with a higher price compared to similar genuine transactions; when assets are sold to related parties, less prices are determined than similar transactions; and companies with an Audit Committee gain higher prices from related parties.

Meskarilov (2010) examined the incentives of related party transactions in Italy Securities exchange. The goal was to identify the reasons behind related party transactions and whether or not these transactions were efficient or opportunistic. Given the centralized ownership structure in Italian companies, the possibility of using related party transactions by major shareholders to acquire the company's

resources were evaluated to the detriment of small shareholders. Evidence suggested opportunistic behavior in these transactions. In addition, a significant relationship was observed between the amount of the transactions with the variables that affect incentives and property acquisition costs.

Chen and Su (2010) examined the relationship between related party transactions and performance and whether or not corporate governance has any positive effect on the relationship between related party transactions and the company's performance. To measure the effect of corporate governance, independence of the board of directors was used; and it was assumed that the effect of related party transactions on the company's performance is affected by the corporate governance mechanisms. The results showed that corporate governance mechanisms turn these opportunistic transactions to efficient ones and independence of the board plays a moderating role in these transactions.

Cowan, Tower, Rasmin and Mitchell (2010) investigated the relationship between related party transactions and earnings management. The study was based on a investigation of sample of fifty Indonesian companies in 2004-2005. The research hypothesis was developed based on the theory of representation and a conflict of interest. Experimental results indicated a statistically significant relationship between related party transactions and earnings management.

Bin Nouri, et al. (2012) found that audit quality affects the occurrence of related party transactions for French companies.

Research Questions

According to the theoretical foundations, the research questions are proposed as follows:

1. Is there any statistically significant relationship between related party transactions and abnormal stock returns?

Research Hypotheses

To answer the research questions, the following hypotheses have been developed:

H1: There is a statistically significant relationship between related party transactions and the company's abnormal stock returns.

Research Population

The population of the study included all companies listed in Tehran Securities Exchange that maintained their membership on the Securities Exchange since April 2007 to March 2013.

Sample and sampling

In this study an appropriate representative sample of the target population was first selected through the screening test. For this purpose, the following inclusion criteria were considered.

- The company should be adopted before April 2007 at Tehran Stock Exchange and be active by the end of March 2013.
- The company should not have any fiscal year change during the mentioned period. The fiscal year should end in March. The reason is provide the ability to compare data at different times.
- Data should be available for the research.

• The company should not be listed as investment companies or financial intermediary including insurances and banks, since the nature and classification of financial statement items of this group of companies is different from other companies.

Research Variables

In the present study due to the limitations listed, 71 companies were selected as the sample to be investigated.

variable	Symbol variable nature of the measure	Type	Measurement Method
Culmative abnormal returns	CAR	Dependent	This variable is calculated by the difference between the monthly returns of the company stock and the average market return
Related party transaction	RPT	Independent	This variable is calculated by the natural logarithm of related party transactions.
Free Cash Flow	FCF	Independent	The company's free cash flow is calculated as follows: FCF represents free cash flows, CFO represents operating cash flows and represents and FCInv represents capital expenditure (net investments in fixed assets) (Moradzadeh Fard et al., 210).
Firm size	SIZE	Control	This variable is calculated by the natural logarithm of the total of the company's assets value.
leverage	LEV	Control	This variable is calculated by the ratio of total debt book value to total assets book value.
Book value to Market value	BTM	Control	This variable is calculated by the ratio of equity book value to market value.
Turn over ratio	Turn over	Control	This variable is calculated by the ratio of transaction lots to total company's shares in a certain period.
Return on assets	ROA	Control	This variable is calculated by the ratio of net profit divided by total assets book value.

Table (1): descriptive statistics research

Findings

Descriptive Statistics

Descriptive statistics for the variables are provided in Table 1. The results presented in Table 1 provide an overview of the status of research data.

Date:
Time:

Sample: 2007 2013

	CAR	RPT	FCF	BTM	LEV	ROA	SIZE	TURNOVER
Mean	-0.234245	0.555654	0.044588	0.776499	0.651053	0.098491	13.81586	0.088227
Median	-0.220000	0.120000	0.038000	0.620000	0.660000	0.090000	13.53000	0.049000
Maximum	1.250000	5.970000	0.692000	4.350000	0.980000	0.610000	18.44000	0.759000
Minimum	-1.370000	0.000000	-0.615000	0.050000	0.030000	-0.290000	11.72000	0.000000
Std. Dev.	0.486516	1.102858	0.139684	0.569542	0.171954	0.106003	1.315253	0.110358
Skewness	0.294635	3.541029	0.059048	1.769173	-0.466226	0.677253	1.163801	2.387956
Kurtosis	3.247350	16.37732	5.601776	8.288276	3.754829	5.976956	4.289458	10.21759
Jarque-Bera	8.457700	4744.447	139.9032	838.3923	29.62421	221.5161	146.6240	1551.116
Probability	0.014569	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Sum	-116.4200	276.1600	22.07100	385.9200	321.6200	48.95000	6866.480	43.84900
Sum Sq. Dev.	117.4021	603.2830	9.638794	160.8917	14.57705	5.573368	858.0251	6.040765
Observations	497	497	495	497	494	497	497	497

According to the above values indicating the descriptive statistics of the variables it could be argued that there is an average distribution in all variables which could be deduced

from the standard deviation. In addition, based on the mean and median values, it is concluded that all variables have relative symmetry.

Balanced sample (listwise missing value deletion)

Included observations: 492

Sample: 2007 2013

Date: Time:

variance Analysis: Ordinary

Correlation Coefficients

To detect the presence and direction of a linear relationship between variables, Pearson Correlation Coefficients was performed. The results are provided in Table (2).

Correlation Probability	CAR	RPT	FCF	BTM	LEV	ROA	SIZE	TURNOVER
CAR	1.000000 -----							
RPT	0.039907 0.3771	1.000000 -----						
FCF	0.319691 0.0000	0.104855 0.0200	1.000000 -----					
BTM	-0.070074 0.1206	-0.063448 0.1600	-0.205836 0.0000	1.000000 -----				
LEV	-0.217211 0.0000	-0.051907 0.2505	-0.464132 0.0000	-0.062942 0.1633	1.000000 -----			
ROA	0.330630 0.0000	0.122200 0.0067	0.590038 0.0000	-0.187057 0.0000	-0.572369 0.0000	1.000000 -----		
SIZE	-0.073224 0.1048	-0.229807 0.0000	-0.041850 0.3543	0.078469 0.0821	0.168490 0.0002	-0.025620 0.5708	1.000000 -----	
TURNOVER	0.026586 0.5563	0.243901 0.0000	-0.002607 0.9540	-0.003186 0.9438	0.056319 0.2124	0.000149 0.9974	0.111866 0.0130	1.000000 -----

Table (3): test the reliability of variables

As seen in Table (2), the correlation coefficient between the independent variables in the model indicates the lack of high multicollinearity.

Variables	Dickey-Fuller test	Significance level
CAR	177/59	0/023
RPT	309/19	0/000
FCF	237/98	0/000
BTM	336/61	0/000
LEV	272/92	0/000
ROA	258/89	0/000
SIZE	242/34	0/000
TURN OVER	794/61	0/000

Results of the hypothesis:

As you can see unknown variables are stable at 95 percent. Parameters can be estimated without the worry of them being false.

Case	Description
Hypothesis reviews	The hypothesis
Question assumptions	Is there any statistically significant relationship between related party transactions and abnormal stock returns?
Target hypothesis	Investigating whether there is any statistically significant relationship between related party transactions and abnormal stock returns.
Models used to test the first hypothesis	$CAR = \alpha_1 + \alpha_2 RPT + \alpha_3 FCF + \alpha_4 SIZE + \alpha_5 LEV + \alpha_6 BTM + \alpha_7 TURNOVER + \alpha_8 ROA + \varepsilon$
Variables	Independent variables: Related party transaction Dependent variable : Culmative abnormal return
Test	Durbin-Watson statistic (the assumption of autocorrelation between the sentences of the remaining models) F statistic Fisher assumption of significant adoption of the model (there was a significant linear relationship between independent and dependent variables)
The results of the estimation model 1	Variable related party transactions: -0.031 Significant level of related party transactions: 0.000
The results of research	There is a significant negative correlation between related party transaction and abnormal stock returns.

The results of the hypothesis indicated a significant negative correlation between related party transaction and abnormal stock returns.

Practical suggestions

A. Training managers and stakeholders can help the implementation of proper corporate governance. Shareholders should be aware of the benefit of the existence of independent outside directors on the board, the audit committee, institutional investors etc. which are among the standards of corporate governance.

B. Since the quality of national legal systems facilitates related standards of corporate governance by strong laws protecting investors who are in normally contact with broader and deeper capital markets, more dispersed shareholders and more efficient allocation of financial resources, it is suggested that more attention be paid to this issue.

C. Obliging the listed companies to develop a comprehensive and unified form for annual reporting, which includes all financial, non-financial, governance and future predictions information etc. needed for of market decisions, leads to transparency of information and the quality of research.

D. Separating the roles of chief director and CEO is one of the ways for reducing the problems of representation.

E. It is suggested that the Securities and Exchange Organization applies a coherent system to assess the quality of corporate governance of listed companies.

F. It is suggested that more corporate governance information disclosure is conducted through notes or other instruments, so as to ensure the users of financial statements and quality of information.

Suggestions for Future Research

A. Future research are suggested to study other variables such as the size of the board, the number of board meetings, the board of directors' sex, age, holding or not-hodings shares research costs etc. as independent variables and the their relationships with abnormal stock returns.

B. The use of different scales for measuring related party transactions, such as the number of parties involved, the type of related party transactions etc.

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