

## Explaining the Effects of Institutional ownership and increased capital ratios on Return of the time Increased Capital Stock: Evidences of Iran's Capital Market

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**Abstract:** According to this research, the effects of capital increasing on return and then the effects of increased capital ratios and percentages of institutional ownership on this relationship have been studied. Active companies in Iran's capital markets are considered as the statistical society during the period of 2003-2007 which is divided to capital increasing of cash receivable - demands and of the reserves. The results of the research indicate that companies which have capital increasing through their reserves between 0 and 50 percentage and the companies which have capital increasing through their cash receipts- demands upper 100 percentage, the positive returns have pursued the relationship between these two variables and institutional ownership has no effect. In the capital increasing of the cash receipts – demands 0 to 100 percentage, the study demonstrated there is not any relationship between variables.

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### 1. Introduction

In modern world, the capital because of considerable flexibility in transforming into other production factors, the capital is considered as one of the basic factors in the production process of goods and services. So, deficiencies and the failure to access to the capital, either fixed or working capital in the process, suffered the ravages of the recession and may even stop it. The company's capital which is listed in the statute, ensures the demands of creditors. But during the lifetime of a company, may occur circumstances to force to reduce or increase the capital effectively. For increasing the capital in Iran, one of following points is possible to happen:

1. Stock increasing with accepting new shareholders; issuing new shares with priority rights, increasing the nominal value each share according to approval of all shareholders (the share of cash payments)
2. Issuing of new shares with the agreement of creditors or bondholders (to convert the demands of new shares)
3. Transferring undivided profit, bonus stock or profit share to company's capital (converting profit sharing (reserve) into added value income value of the company's capital)

Who are called the Institutional investors? According to definition of Bushee (1998), institutional investors, large investors such as banks, insurance companies, investment companies, and pension organizations (Bushee, 1998). According to Velury & Jenkins research, institutional investors because of

significant ownership stock in companies, have essential influences and can affect their practices and performance as well. The main reason is supervising activities of these investors (Velury & Jenkins, 2006).

The target of the present research is to study the effects of capital increasing on return and also the examining effects of different percentages of institutional ownership and different ratios of capital increasing and also the relationship between these variables. This article reviews the previous researches background, assumptions, methodology, data analysis and finally it deals with the conclusions..

### 2. Research background

According to Hajyvnd and Noravsh (1997), in a research titled "check the transmission of data on capital stock of accepted firms in Tehran exchange stock" states: it depicted that Iranian companies use capital increasing as the main source of financing and the numbers and percentage of their capital increasing have been raised every year. They states that the supplying of new shares, in the Iranian capital market as good news and contains new information to investors and companies of the future is favorable (Hajyvnd & Noravsh, 1997).

Miller and Rock (1985), in a paper titled "Dividend policy under asymmetric information", argued that in the situation of asymmetry of information between managers and investors, the issuing of new shares by a company may warn that the funds generated inside the company is lower than expected, and finally

the profit and cash flow will be weak (Miller & Rock, 1985).

What things make the market react to issue new shares?

In response to this question, D'Mello & Ferris (2000), in a paper titled "The information effects of analyst activity at the announcement of new equity issues" argued that asymmetry of information as a determining factor or affecting the market reaction to news of new stock issuing (D'Mello & Ferris, 2000).

Bayless and Chaplinsky (1996) in their study titled "Is there a window of opportunity for seasoned equity issuance?" stated that returns are less and more negative in efficient markets and this efficiency of issuing of shares, is related to different degrees of information asymmetry (Bayless & Chaplinsky, 1996).

Korajczyk and others (1991), in their study titled "The effect of information releases on the pricing and timing of equity issues" found that the managers before issuing new shares, at first publish as to lower the reliable information, reduce information asymmetry and then proceed to issue the shares so the market's negative reaction (Korajczyk and others, 1991).

Myers and Magluf (1984), in their study titled "Corporate financing and investment decisions when firms have information that investors do not have" stated that the announcement of shares issuing will be effective for existing shareholders that is in their favor. Therefore, rational investors, based on understanding the behavior of managers to issue the new shares show a negative reaction. (Myers & Magluf, 1984).

According to Vadeie and Razavirad (2008), in their research which titled, "Examining effect of increased capital on market value of the of accepted firms in Tehran exchange stock" it determined that announcement the news of capital increasing will affect the market's added value, also the understanding of investors from the stock bonus (profit share) is more favorable than their understanding of capital increasing in cash receivables and creditors demands. Because Added Value of the capital increasing from retained earnings, had the positive and raising trend, however increasing of cash receivables had put more impact on the added value the market. The effects of decreasing trend after the capital increasing are detected (Vadeie & Razavirad, 2008).

Does the issuance of new shares affect the return?

The Smith (1997) in a paper titled "Alternative Methods for Raising Capital" and Panahian & Ramezani (2007) in a research titled "The Examining relationship between earnings quality and capital market reaction to the increasing demands from shareholders and the cash" suggests that the return of does not create new shares on offer (smith, 1997), (Panahian & Ramezani, 2007).

The research Tsangarakis and Nicholas (1996), which titled "Shareholder wealth Effects of equity issues in emerging markets: Evidence from rights offerings in Greece" in Greece stock market, suggested an return performance creation before the announcement of issuance of new shares (Tsangarakis & Nicholas, 1996).

Jabbarzadh & Asgari (2010), in their study titled "Identify factors affecting the efficiency of the initial public offering in of accepted firms in Tehran exchange stock" concluded that positive returns occurs over 12 months and 24 months after the initial offering of shares of companies in Tehran stock exchange (Jabbarzadh & Asgari, 2010).

Ansarizadh (2005), and Mirmehrabi & Fadaenezuad (2001), studied the Comparative effects of capital increasing on return in the capital Tehran Stock Exchange, so stated that the capital increasing with increasing in stock return factor is completely neutral (ansarizadh, 2005), (Mirmehrabi & Fadaenezuad, 2001).

Abbasi (2009), in their study titled "Effect of bonus shares issued in different percentages of company stock returns in of accepted firms in Tehran exchange stock" studied the effects of different percentages of bonus shares on efficiency of Tehran Stock Exchange companies. The results show that the companies rate return which have shared bonus is higher than of companies that have not distributed the bonus and also issuance of different percentage of bonus shares have a positive impact. (abbasi, 2009).

Can institutional investors be affective on returns?

Dennis & Strickland (1998), in their study titled "The Effect of Stock Splits on Liquidity: Evidence from Shareholder Ownership Composition" stated that the returns of institutional ownership before announcing the share split has a reverse relationship. In other words, the companies announced that the level of institutional ownership of shares is lower before the announcing share split, returns after of the announcement is more than other companies. Also, the results confirm a positive relationship between share split and return (Dennis & Strickland, 1998).

Further evidence in the field of investment firms in investigating Bartov & others (2000), have been done. They showed that the return rate of after profit announcement, is reduced with increased share ownership by investment firms (Bartov &..., 2000).

### 3. Research Hypothesis

**Hypothesis 1:** there is difference between the average returns after increasing capital than before that.

**Hypothesis 2:** there is a relationship between increased capital stock ratio and returns on companies that have increased their capital.

**Hypothesis 3:** there is a relationship between percentage of institutional ownership and returns on companies that have increased their capital.

#### 4. Methodology

This research is categorized as applied research and in terms of the method is considered as correlation analysis. The goals of this study are investigation of the effects of increased capital on return in companies which are accepted in Tehran Stock Exchange as well as of the relationship between the different percentages of institutional ownership (the two categories below 50 percent and between 50 to 100 percent divided) and the relationship of different ratio of increased capital (the ratios three categories: below 50%, between 50 to 100 percent and more than 100 percent is divided) on the return in the companies to raise current capital, this is a study in the period of 12 months before announcing increasing and 12 months later. They are considered through the cash receipts-demands and reserves separately. Linear regression model was used to examine the relationship between variables. The research hypotheses were examined in the 95% confidence level. It should be noted that test was conducted to study the nonlinear relationship between research variables and in regard to the value of F statistics and Significant level, it was clear that linear regression had presented the best variables offers. To examine the validation of the normal distribution of data and remainders hypothesis the Kolmogorov-Smirnov test has been used and to examine the validation of errors lack of autocorrelation hypothesis the Durbin-Watson method has been utilized. Correlation coefficient is a criterion to determining the strength of relationship and the type of relationship (direct or reverse). Determination coefficient shows that what percentage of the changes of the dependent variable is explained by the independent variable. Significance test of the regression equation using the F statistic, and significance test of regression coefficients using the T statistics have been taken as well. In the multiple regressions, the lack of multi co-linearity between independent variables has been made sure.

##### (i) Statistical society and sample selection

In this study, librarian method & archives were used to collect the required data. Research tool include Financial Statements, accompanying notes and financial reports of the above mentioned companies, which they are collected through Novin Rahavard software and Tehran Stock Exchange official website and then it was calculated the variables in the classification and ultimately data analysis by SPSS software.

The statistical society included all accepted companies in the Tehran Stock Exchange during 2003 to 2007 and the sample is selected in regard to the following features:

1. They should have been accepted in Tehran Stock Exchange before the financial year 2003 and on the

basis of reserves and the cash receipts - demands have increased Capital.

2. Companies that have been profitable in each year are at least 70 trading days.

3. Companies which have not stop for a long time after increasing capital meeting and the end of their financial year should coincide with the end of March.

4- They should present the Financial Information from 2003 to 2007 required in this research and should not change their financial year during the period in question.

##### (ii) Research model and measurement method of variables

At first average compared test examined the effects of capital increasing on returns has been calculated. The following model is estimated to test the second and the third hypothesis;

$$\Delta \text{Return} = \alpha + \beta_1 \log (P_j / P_m) + \beta_2 (\text{Increased Investment}) + \beta_3 (\text{Size}) + \beta_4 (\text{Institutional}) + \epsilon_{it} \quad (1)$$

In this research, to normalize the distribution of variable dependent on intellectual capital and its components, the conversions of square root, square, and Ln are used. The variables used in the study were defined and calculated as follows.

##### Independent variables

Independent variables in this research are:

\*Increased Capital ratio: This ratio which is the ratio of newly issued shares to old shares.

\*Institutional Ownership percentage: This percentage is the firm's outstanding shares held by institutions at the shareholder annual assembly.

\* $\Delta$ Return: This is the dependent variable in this study. Return change percentage is defined as the change in return between the post announcement and pre-announcement period increased capital divided by pre-announcement period return. Return is defined as the 12 month prior and 12 month after announcement increased capital. the stock returns in period t is:

$$R_{it} = \frac{(P_{it} - P_{io}) + D_{ps} + (P_{it} - P_{io}) \cdot A + P_{it} \cdot B}{P_{it-1}} \times 100 \quad (2) \quad it:$$

Rate of return on stock i at time t, monthly

$P_{it}$ : Price of stock i at end time t, monthly

$P_{io}$ : The price of stock i at first time t, monthly

$D_{ps}$ : Dividends paid by firm i at time t, monthly

$P_n$ : Per share nominal price

A: Increased investment percentage of Cash receipts-demands

B: Increased investment percentage of reserve

\*Log (Pj/Pm): This is a dummy variable and that is the Log of the ratio of a firm's month ending price in the month prior to the increased Capital announcement to the average market price in the month prior to the increased capital announcement.

\*Size (control Variable): This is a control variable and that is measured as the Log of total assets and entered

in the book value of total assets at the shareholder annual assembly.

**5. Findings and analysis**

**(i)The first hypothesis test results**

**Table1. average Comparison test between the return and capital increasing**

The Effects of capital stock increase on return	Mean	95%confidence Interval of the difference		df	t	Sig	Confirmed Hypothesis
		Lower	Upper				
The Effects of capital stock increase of reserves	4.8046	0.7627	8.8464	67	2.373	0.021	H <sub>1</sub>
The Effects of capital stock increase of Cash receipts-demands	0.5468	1.4115-	2.5050	67	0.557	0.579	H <sub>0</sub>

To explain the effects of capital increasing on returns, the average compared test (paired) was used. As Table 1 demonstrates, Sig in capital increasing through Reserves is less than 0.005 and equal to 0.021, so the 95% confidence level is obtained, it can be stated that model is significant. Note that:

$$0.76271 < \mu_1 - \mu_2 < 8.84641$$

$$\mu_1 > \mu_2$$

$\mu_1$ : the average of returns after of capital increasing

$\mu_2$ : the average of returns before of capital increasing

The return after the capital increasing from reserves in comparing the before, shows that the trend has accelerated.

In the capital increasing through cash receipts - demands which is a significant level equal 0.579, Note that this level is greater than 0.05, then we conclude that there is not any difference between two communities average. So we can say with 95% confidence level, through capital increasing of the cash – demands no efficiency on the return happened.

**(ii)The second hypothesis test results**

**Table 2. The regression test results between increased capital ratio and return**

Panel A: The regression test results between increased capital ratio below 50 percent of the reserve and returns

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	-0.013	0.033	20.627	0.017	0.513	0.263	0.181	2.120	5.214 (0.000)	H <sub>1</sub>
t-test (sig)	-4.078 (0.000)	2.840 (0.000)	2.140 (0.000)	1.485 (0.253)						
Pearson Correlation	-0.052	0.275	0.260	0.133						

Panel B: The regression test results between increased capital ratio below 50 percent of the Cash receipts - demands and returns

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	0.037	0.033	20.627	0.017	0.476	0.226	0.044	2.055	2.122 (0.560)	H <sub>0</sub>
t-test (sig)	1.052 (0.212)	1.054 (0.306)	-0.534 (0.600)	0.551 (0.589)						
Pearson Correlation	0.398	0.272	-0.121	0.214						

Panel C: The regression test results between increased capital ratio 50 to 100 percent of the reserves and returns

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	FValue (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	0.000	0.000	-9.169	0.004	0.464	0.215	0.006	1.761	1.029 (0.752)	H <sub>0</sub>
t-test (sig)	-1.750 (0.100)	-0.149 (0.883)	-1.099 (0.289)	1.184 (0.255)						
Pearson Correlation	0.710	0.883	0.791	0.624						

Panel D: The regression test results between increased capital ratio 50 to 100 percent of the cash receipts-demands and returns

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	0.010	0.001	14.864	0.002	0.229	0.052	-0.083	2.027	0.387 (0.912)	H <sub>0</sub>
t-test (sig)	0.708 (0.485)	0.032 (0.975)	0.991 (0.330)	0.066 (0.948)						
Pearson Correlation	0.115	-0.086	0.187	-0.003						

+Panel E: The regression test results between increased capital ratio upper 100 percent of the Cash receipts- demands and returns

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	-0.010	0.004	-8.107	0.046	0.867	0.752	0.690	1.956	15.253 (0.000)	H <sub>0</sub>
t-test (sig)	-2.497 (0.024)	2.952 (0.009)	-3.448 (0.003)	5.048 (0.000)						
Pearson Correlation	0.016	0.347	-0.462	0.588						

Notes: the all panels, dependent variable is return. The independent variables are institutional ownership which is the percentage of a firm's outstanding shares held by institutions in the ending annual finance, Increase stock capital ratio which is the ratio of newly issued shares to old shares, Log(P<sub>j</sub>/P<sub>m</sub>) which is the log of the ratio of a firm's month ending price in the month prior to the increase announcement to the average market price in the month prior to the increase announcement, and Firm Size which is measured as the Log of total assets.

To examine the relationship between independent variable (capital increasing ratio) concerning the dependent variable (return), multivariate linear regression model is estimated. Model estimation Results and Matrix of correlation coefficients between all variables are presented in Table 2. As in Panel A can be seen, the F statistics value and significance level are respectively, 5.214 and 0.000 that is, the error level of 0.05 the model is significant. D-Watson statistic equal to 2.120 calculated and shows the remaining sovereignty. Statistic t-test, Sig and the Pearson correlation for the independent variable of capital increasing ratio below 50 percent, respectively equal 2.840, 0.000 and 0.275, beta coefficient of 0.333, positive relationship and significant between the capital increasing ratio below 50 percent through reserve and return approved. Also, the coefficient of determination (0.263) means that multiple regression models explain 26.3 percent from the total changes in abnormal stock returns and 73.7 percent of the changes is influence of other factors. It should be noted that none of control variables in model are Significant.

Finally, the relationship between capital increasing below 50 percent of reserves and returns are accepted and regression model is presented as following:

$$\Delta \text{return} = 0.333 \text{ Increase Capital} - 0.013 \text{ ownership Institutional} + 20.627 \text{ Log (pj/pm)} + \epsilon \text{it}$$

According to Panels B,C and D, the significant level for F statistics for the capital increasing below 50 percent of the cash receipts – demands, capital increasing between 50 to 100 percent of reserve and of the cash receipts – demands, are respectively, 0.560, 0.752 and 0.912 and in all cases are greater than 0.05, so that we can say with 95 percent confidence level between the capital increasing below 50 percent of the cash receipts – demands, capital increasing between 50 to 100 percent of reserve and of the cash receipts – demands there is not any relationship on return.

As in Panel E can be seen, the F statistics value and significance level are respectively, 15.253 and 0.000 that is, the error level of 0.05 the model is significant. D-Watson statistic equal to 1.956 calculated and shows the remaining sovereignty. Statistic t-test, Sig and the Pearson correlation for the independent variable of capital increasing ratio upper 100 percent, respectively equal 2.952, 0.009 and 0.347, beta coefficient of 0.004, positive relationship and significant between the capital increasing ratio upper 100 percent through cash receipts -demands and return approved. Also, the coefficient of determination (0.752) means that multiple regression models explain 75.2 percent from the total changes in abnormal stock returns and 24.8 percent of the changes is influence of other factors. It should be noted that all of control variables in model are Significant.

Finally, the relationship between capital increasing upper 100 percent of cash receipts -demands and returns are accepted and regression model is presented as following:

$$\Delta \text{return} = -2.810 + 0.004 \text{ Increase Capital} - 0.010 \text{ ownership Institutional} - 8.107 \text{ Log (pj/pm)} + 0.046 \text{ Size} + \epsilon \text{it}$$

### (iii) The third hypothesis test results

**Table 3. The regression test results between the institutional ownership percent and returns**

Panel A: The regression test results the institutional ownership of below 50 percent and returns in the increased capital of the reserve

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	0.001	0.011	15.649	-0.001	0.371	0.138	-0.065	2.121	0.679 (0.920)	H <sub>0</sub>
t-test (sig)	0.037 (0.971)	0.984 (0.339)	0.707 (0.489)	-0.122 (0.904)						
Pearson Correlation	0.099	0.333	0.293	0.009						

Panel B: The regression test results the institutional ownership of below 50 percent and returns in the increased capital of the cash receipts-demands

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	0.005	0.000	-15.224	0.023	0.202	0.041	-0.053	2.246	0.436 (0.840)	H <sub>0</sub>
t-test (sig)	0.156 (0.877)	0.026 (0.980)	-0.953 (0.346)	0.718 (0.477)						
Pearson Correlation	0.046	-0.088	-0.148	0.132						

panel C: The regression test results between the institutional ownership of 50 to 100 percent and returns in the increased capital of the cash receipts –demands

Variables	Institutional ownership	Increased Capital	Log (P <sub>j</sub> /P <sub>m</sub> )	Size	Demonstration power			D-W	F-Value (sig)	Result
					R	R <sup>2</sup>	Adj R <sup>2</sup>			
Regression coefficients	-0.003	0.003	1.858	0.001	0.118	0.014	-0.061	2.414	0.186 (0.152)	H <sub>0</sub>
t-test (sig)	-0.203 (0.840)	0.806 (0.424)	0.244 (0.808)	0.067 (0.947)						
Pearson Correlation	-0.030	0.109	0.023	-0.020						

Notes: The all panels, variables are institutional which is the percentage of a firm's outstanding shares held by institutions in the ending annual finance, Increase stock capital ratio which is the ratio of newly issued shares to old shares, Log(P<sub>j</sub>/P<sub>m</sub>) which is the log of the ratio of a firm's month ending price in the month prior to the increase announcement to the average market price in the month prior to the increase announcement, and Firm Size which is measured as the Log of total assets.

To examine the relationship between the independent variable (the institutional ownership percentage) with the dependent variable (return), multivariate linear regression model is estimated. Results of estimation models and the matrix of correlation coefficients among the variables in the study are shown in table 3. As the panels A, B and C show, the significant F statistics for the institutional ownership below 50 percent in the capital increasing through the reserve and cash receipts -demands and the percentage of institutional ownership between 50 to 100 percent in capital increasing from the cash receipts -demands of the order are considered respectively, 0.920, 0.840 and 0.152, which is larger than 0.05 in all three cases, so we can say with 95% confidence: there is no relationship between the institutional ownership percentage and returns on capital increasing.

## 6. Conclusion

Capital increasing as a means of financing is always considered by the directors of the companies.

The company's ability to identify potential funding sources (both internal and external) for the purpose of finances for investment and financial planning is considered as business development and growth of the main factors<sup>1</sup>.

In explaining the effects of increased Capital on returns (dependent variable) we have concluded that the capital increasing of reserve influence on return efficiency and this is positively effective. The result of this study are according to findings of Jabbarzadh and Asgari (2010), Dennis & Strickland (1998). The capital increasing through cash receipts - demands on return after capital increasing, remained unchanged. This result is according to finding of research Smith (1997). The interpretation of these results can be stated that in Iranian stock market there is information asymmetry in the capital increasing of the reserves, because it is caused by returns. But at the time capital increasing of the cash receipts - demands market are effective and efficient. In this study, return as the dependent variable under the influence of the independent variable was considered.

In conclusion, companies through the accumulated capital increasing of reserve have positive relationship between the capital increasing percentage below 50 and return, but any relation between capital increasing of reserve 50 to 100 percent relationship wasn't found. In capital increasing Cash receivables-

demands, there is not any relationship between the capital increasing ratio 0 to 100 percentage with returns, companies through the accumulated capital increasing of reserve have positive relationship between the capital increasing percentage upper 100 and return. In examining the returns as the dependent variable, which affects the independent variable institutional ownership percentage in time capital increasing, we reached the conclusion that there is not any relationship between the institutional ownership percentage and returns. This result disagrees with the findings of the study Dennis and Strickland (1998) at the time of stock splits, and Bartov and others (2000) at the time of gain dividends, which is a negative relationship between returns and institutional ownership of stocks reached. The results suggest that institutional investors are subject to in time increase capital to receive and interpret the data as appropriate and there is no information asymmetry between investors and the market so that it can be a sign of skill and efficiency of institutional investors in Iran.

In interpreting the results of this study should be noted that due to different definitions of returns, Likely to use the definition of returns and using a different model from the model used for its calculation, other results can be achieved. It is worth noting that several factors (various independent variables) can influence the returns. It is proved in this study these factors and other factors equally affect the independent variables investigated.

Study limitations:

1- One of the limitations is that the study suffers the lack of samples, So actually the lack of appropriate statistical methods to test and to extend the results of the study did not test the hypotheses that led to the hypothesis was deleted, was not tested

2- One of the important factors for better investigation is the availability of adequate and timely information sources. Being carried out to study the problem of institutional ownership percentages on a monthly basis so that there was a result of the annual percentages.

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