



Measuring the efficiency of securities companies by corporate governance in a financial holding and non-financial holding system

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ABSTRACT

This paper applies data envelopment analysis (DEA) and a Tobit regression model with corporate governance variables to analyze and compare the operational efficiency of 14 securities companies in financial holding system, and 12 in non-financial holding system in Taiwan. The results suggest four commonalities in the modules. (1) A securities company's operating results can be enhanced when joining the financial holding system. (2) Board size does not affect the efficiency of a securities company. (3) The holding of concurrent posts of president and general manager would not affect a securities company's operating performance. (4) An increase in the average director bonus would reduce company efficiency. In addition, there are two differences. (1) An increase in the major shareholders' shareholding ratio would increase the operational efficiency of a securities company that has joined the financial holding system; however, the impact on those in the non-financial holding system would be insignificant. (2) Profit from the sale of securities would increase the efficiency of a securities company in a non-financial holding system but would not lead to an increase of those in the financial holding system.

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1. Introduction

A securities market is at the core of capital markets in that it diverts capital and activates financial markets. Within securities markets, the stock market is one of the leading indicators of the state of an economy; through flows of capital, it realizes sustainable economic growth, activates sources of funding for domestic industries, and promotes economic prosperity. A company's stocks or bonds, which are administered by securities companies, can be issued in domestic and foreign markets to raise capital, which is the most important means of raising finance in today's business circles.

In order to implement the land policy, the Taiwanese government issued land in kind bonds in January 1953, and the compensation cost of land acquisition was granted to landowners with the four major public utilities' stocks, the bonds, stocks, and together with the patriotic bonds began circulating in the market. As a result, companies involved in securities trading emerged during the period. The government then invited applications for setting up securities brokerages in 1988 and the securities market began to grow rapidly; this resulted in the upsurge of individual investment in securities and the value of stock turnover reaching new heights.

Because of globalization and an increased awareness that capital has no boundaries, international capital flows and overseas investments increased. Due to these financial developments and in order to promote internationalization and liberalization, Taiwan passed the Financial Institutions Merger Act and the Financial Holding Company Act in December 2000 and July 2001, after which it entered the WTO on January 1, 2002. Being in the mainstream of internationalization, liberalization, and consolidation, Taiwan's securities industry is facing unprecedented change and transition, with some securities companies having joined financial holding companies¹ while others have adopting the merger model² so as to respond to and resist the pressure of foreign competition. At present, there are 12 listed/OTC securities companies that have not joined the financial holding system in Taiwan, with the capital of those that have already joined it, accounting for about 40% of the overall securities industry. The crucial question that arises is to whether securities companies can benefit or their efficiency can be improved through joining a financial holding company. This interesting topic will be explored in this paper.

According to "Taiwanese Securities Firms—2005 Review and 2006 Outlook" report released by Fitch Ratings in May 2006, the Taiwan stock market has experienced considerable structural change in the past 5 years with local securities brokerages being

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¹ Each of the 14 financial holding companies of Taiwan has securities subsidiaries.

² e.g., KGI Securities merged with Tai Yu Securities.

confronted with two major difficulties: a fall in brokerage fees and difficulties in expanding market share. Because of excessive fragmentation in the securities industry and intense price competition, profitability has therefore tended to decline. To ensure future development of the securities industry—whether this involves expanding economic scale or merging into the financial holding system—securities dealers need to improve operational efficiency and profitability to survive. Since the overall financial environment is moving toward increased internationalization and liberalization, domestic securities companies have realized the potential advantages and have thereby adjusted their operating strategies to meet the potential challenges from future competition.

Linda and Jagtiani (2000) suggested that the three major subsidiaries of a financial holding company are the bank, insurance, and securities companies. Since the Financial Holding Company Act was passed on July 9, 2001, a number of financial holding companies have been established successively, and there are now total of 15 companies in Taiwan that have been created through acquisition, merger, and other approaches. These 15 companies also currently have securities subsidiaries.³ The main benefits to securities companies joining financial holdings lie in the financing and expansion of marketing channels. However, in reality, many securities companies have not yet joined the financial holding system. Therefore, whether securities companies under financial holding companies have better operational efficiency due to sufficient capital and diverse marketing channels of the financial holding companies, as compared to those not in the financial holding system, is an important question that will be discussed further below.

According to the literature review, one of the common difficulties in measuring efficiency concerns multi-dimensional factors, which are not easy to measure using a common baseline. How to measure outputs and inputs from a variety of securities companies is an important issue that should be overcome first when choosing efficiency indicators in relation to assessing such companies. Data envelopment analysis (DEA) is a reliable method that has been applied to securities efficiency analysis for many years. Hossein (2005), Zhang, Zhang, and Luo (2006), and Castro-Lacouture, Medaglia, and Skibniewski (2007) used DEA to evaluate the efficiency of a securities company. This paper therefore aims to assess efficiency of listed securities companies in Taiwan through a DEA that will determine whether efficiency might be increased when companies join the financial holding system.

Furthermore, when assessing the efficiency of DEA, some exogenous variables that are beyond the control of or cannot be used by policy-makers and are likely to impact on efficiency, also need be taken into account—of which the variable Corporate Governance is particularly important.⁴ In this respect, Taiwan draws on both Company Law and the Securities and Exchange Law for corporate governance. The Securities and Exchange Law was enacted in 1968 to improve the governance of listed companies and to promote investor confidence. This law is enforced by the Securities and Futures Commission (SFC), a governmental agency supervised by the Ministry of Finance and the market regulator of the Taiwan Stock Exchange (TSE). Taiwanese firms operate under a two-tier structure, with a board of directors and numerous supervisors of Company Law. The board has authority over the strategic operations of the company, and is obligated to undertake all decisions with the aim of maintaining the value of the company. The Company Law does not specify the number of supervisors; it does however, stipulate that all supervisors should be either directors, managers, or other employees of the company. The supervisors have the right to attend

meetings of the board of directors, with the objective being that each supervisor should have an understanding of operations and some insider knowledge. Supervisors are also responsible for appointing auditors, and can convene shareholders' meetings. Because the supervisors in Taiwan are also shareholders, they tend to support the management rather than other stakeholders.

Among researches on corporate governance, Yermack (1996) explored the relationship between board size and financial performance, and identified a negative relationship. Conyon and Peck (1998) also suggested a negative correlation. However, according to Golden and Zajac (2001), the relationship between board size and corporate governance is not simple; performance would show a positive relationship when the size is optimal; otherwise it has been found to be negative. Bhagat and Black (2002), however, indicated that there is no important relationship between non-financial performance and size. In addition, Gorton and Schmid (1996) used Deutsche Bank as an example and found that major shareholders could improve their performance. However, some studies showed that the major shareholder have no significant impact on the company performance (Agrawal & Knoeber, 1996; McConnell & Servaes, 1990). Moreover, Shivdasani (1993), and Fich and Shivdasani (2006) suggested that employing managers holding concurrent positions can lead to an increase in the agency problem. In contrast, Ferris, Jagannathan, and Pritchard (2003) found that managers occupying such concurrent positions have a positive correlation with performance. Diacon and O'Sullivan (1995) pointed out that when a board is rewarded it leads to a relatively high performance. This paper therefore argues that company efficiency and corporate governance-related variables are related in that the latter variables are taken as exogenous variables of a securities company efficiency, which provides a means of understanding the effects efficiency may have on corporate governance variables. In contrast to previous studies that have measured efficiency through financial indicators, the analysis in this paper is based on corporate governance and therefore makes an important and original contribution to the debate.

This paper's central focus is on securities companies in the financial and non-financial holding systems of Taiwan. The main purposes of the study are as follows: (1) to assess the operational efficiency of listed/OTC securities companies for basis and reference; (2) to compare the operational efficiency of securities companies in a financial holding system and non-financial holding system for reference; and (3) to test securities companies when joining a financial holding system using a Tobit regression model in order to assess whether its efficiency is significantly different from those in the non-financial holding system. In addition, the corporate governance-related variables are taken as the exogenous variable of efficiency that enables its impact to be assessed. Finally, the economic implications are described according to the empirical results, along with providing business strategy and suggestions that may be useful to company operators.

The remainder of this paper is organized as follows. Section 2 presents research methods, and introduces DEA and the Tobit regression model. Section 3 discusses the empirical analysis and empirical results. Section 4, the conclusion, summarizes the empirical results and proposes detailed findings and recommendations.

2. Research methods

This empirical analysis is divided into two parts: in the first part, a securities company efficiency is obtained by way of DEA; in the second part, the efficiency is taken as a variable for discussion of the exogenous variables in relation to how it affects efficiency. As the efficiency values range from 0 to 1, and the research period covers the period 2001–2007, data types include a time series and cross-section, both of which utilize panel data.

³ As the Taiwan, financial holding company was set up in 2007 and is an unlisted company, the availability and collection of data has been limited, and is therefore not included in this paper's empirical samples.

⁴ DEA requires input and output variables to have a positive correlation.

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