



Investigating the relationship between corporate governance and earnings of accepted banks in Tehran Stock Exchange

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ABSTRACT

The purpose of this study was to investigate the effect of corporate governance characteristics on the profitability of banks accepted in Tehran Stock Exchange. The variables of board size, the percentage of non-executive managers, the dichotomy of the role of manager and institutional stakeholders are used to evaluate corporate governance and are used from the rate of return on assets to measure banks' profitability. The statistical sample of the study consists of 9 banks accepted in Tehran Stock Exchange during the years 2011-2011. To test the hypotheses, Eviews 7 software has been used. The findings of the research show that there is no significant relationship between corporate governance variables (board size, dichotomy of manager's role, the percentage of non-executive managers and institutional shareholders) and bank profitability.

Keywords: Corporate Governance, Profitability, Board Size, the percentage of non-executive managers, dichotomy of manager's role, Institutional Shareholders.

1. Introduction

Accounting profit is one of the most important indicators used by users of financial statements for various purposes such as stock valuation, management performance assessment, resource allocation, and so on. Therefore, the optimal allocation of resources in the markets depends entirely on the quality of the reported accounting earnings. The question posed here is how stockholders and law enforcement agencies, in spite of the problems of representation, such as lack of information symmetry and moral hazard are able to assure the quality of profits provided by managers and, generally, the quality of financial reporting quality? (Mahdavi et al., 2013). This important issue has been taken into consideration since recent financial scandals, and as a result, regulatory authorities in different countries have taken various actions. One of these measures is to reform the corporate governance (Jelic, B. et al., 1998). Corporate governance mechanisms, by reducing the agency's problems, can reduce the opportunities for profit management and thus increase the quality of profit (Mashayekh and Ismaili, 2006). Therefore, one of the operational measures to reduce the agency's problems and, consequently, increase the quality of profit, is to develop appropriate codes for the application of corporate governance (Mahdavi et al., 2013). In Iran, in recent years, with the aim of improving the quality of reporting financial regulations of the corporate governance system have been ratified and enforced. The question is whether compliance with these regulations by companies improves the quality of financial reporting, and in particular the quality of accounting earnings? This is a question that the answer to it can improve the allocation of resources in the Tehran Stock Exchange.

2. Literature Review

The ability to predict the growth of profits, which is related to the ability of investors to predict future earnings or future Free Cash Flow of companies based on income information, is one of the determining factors and alternative to the quality of profit. Profit information terms will have high quality, with the help of which they can analyze the company's current performance and best estimate its future and its future (Hussainey, 2009). It will only be possible at a time when the quality of the figures is high and the stock markets are more reliant on cash flow information in corporate valuation (Cheng et al., 2013) In general, corporate governance includes legal, cultural, and institutional arrangements that determine the direction and functioning of companies. The elements that are present in this scene include: shareholders and their ownership structure, members of the board of directors and their constituents, company management, led by the CEO or chief executive officer, and other stakeholders that can influence the company's move. In the meantime, what is most noticeable is the increasing presence of institutional and legal investors in the circle of owners of public corporations and the effect that the active presence of this group can have on the way of governance on the organization and their performance, and the most basic The issue of corporate governance is to ensure that shareholders are properly governed by corporate governance Nevertheless, the existence of specific circumstances makes it difficult for the shareholder to deal with the obstacles. Hence, one of the important issues in corporate governance is the awareness of the company's operational

performance and its grading in standard scales, so that it can formulate the strategies necessary for the establishment of corporate governance (Abbasi, 2013). The Organization for Economic Co-operation and Development defined corporate governance as "corporate governance is the system by which companies are controlled." The corporate governance structure outlines the distribution of rights and responsibilities between different departments in the company, such as board members, managers, shareholders and other stakeholders, and clarifies the roles and responsibilities for corporate decision making".

Different countries have taken or are doing the right thing due to the importance of the corporate governance system. For example, in the United States, the Sarbanes Oxley Law has been passed which deals with the governance of American companies. In Iran, after the formation of the Tehran Stock Exchange, the regulations of the corporate governance system were approved and implemented in 2007. The reason for paying attention to the issue of corporate governance is that corporate governance can be a guarantor of the quality of accounting information (Khodadadi and Tucker, 2012). Several studies have been carried out on the impact of corporate governance on performance improvement and valuation by investors, which show deep attention to the issue of corporate governance and its mechanisms (Norouz et al., 2009). Today, there are many analyzes of profits as the main factor and the only valid factor for describing the performance of companies. Based on this simple approach, the company works worse with increasing net profit, better and decreasing it. In general, it is said that a company that has had a net profit in the past year has created more wealth and prosperity for its shareholders than companies with lower net profits. Also, according to the same logic, companies with positive net profits will increase and companies with losses will reduce the value of "shareholders" of companies. On the other hand, one of the internal factors of the companies is the size of the company. The size of the company is one of the determinants of the volume and variety of activities that the company does. In fact, the larger size of the company has the greater volume and variety of activities that it performs. Many researchers believe that larger corporations are more prestigious in terms of capital markets, so companies will have easier access to low-interest resources, so the smaller the company is, the more capital markets and credit institutions, they will have less credit and credit with more interest (Sajadi and Ghorbani, 2011).

On the other hand, the existence of asymmetric information and the conflicts of interest between managers and users of financial statements as a potential factor of good corporate governance are expected to improve the quality of financial statements. Establishing a domestic sovereignty process to support corporate financial credibility and keep safe is imperative to manipulate profits. A weak governance structure may have created an opportunity for managers to manipulate profits, thereby leading to a reduction in reported earnings quality. Opportunistic behavior of managers can be explained by the representation theory (Wan and et al., 2010).

3. Methodology

This research methodology is correlation and causal after the occurrence and in terms of the purpose is application. Also, since this text describes what it is or describes the existing conditions without affecting (and not the specific requirement and recommendation), and

because valuation judgments are poor in this research, this research is part of a descriptive study in Accounting.

In addition, considering that historical information is used in testing its assumptions, it is classified in the pseudo-experimental research group. The present study is also experientialist epistemologically, its inductive reasoning system, and in terms of the field-library study type, using historical information as a post-event (i.e., the use of past information). The statistical society of the research includes 9 banks Accepted in the Tehran Stock Exchange, which has been active on the stock exchange for the period of 1388 until the end of 1392. This research is based on the library method. In this research, information on the subject literature, theoretical fundamentals, background and history of previous research on the subject of the research from library sources and through the study of books and articles of journals, theses, including Internal and external resources will be collected. The information and data needed to examine and test the research hypotheses will be derived from the financial assumptions and reports submitted by companies to the stock market, as well as software development, modernization as well as compilation of corporate financial information.

Based on Jon's (2015) research and other research, the following model has been developed:

$$ROA = \beta_0 + \beta_1 B\ SIZE + \beta_2 INDEAD + \beta_3 DUALITY + \beta_4 AUDIT + \beta_6 FSIZE + \beta_7 GROWTH + \beta_8 LEV + \epsilon_i$$

B SIZE:: Board size; INDEAD: percentage of non-executive directors; DUALITY: Separation of the role of CEO from the board of directors; AUDIT: Institutional shareholders; FSIZE: Firm size; GROWTH: Company growth; LEV: Financial leverage

Where the dependent variable is:

ROA: Return on Asset

Independent Variables:

B SIZE or board size: number of managers on the board

INDEAD or Independence: The percentage of non-executive directors in the board

DUALITY or DUALITY: the zero and one variables; if the CEO's role is not interrupted by the chairman, one, and otherwise zero.

AUDIT: Or institutional shareholders: Investment firms or other companies that hold other companies' ordinary shares are institutional shareholders. In order to calculate the percentage of institutional shareholders in each company, the number of institutional investors' shares is divided into the total number of ordinary shares of the company at the beginning of the period.

Control variables:

FSIZE: The size of a company measured by the natural logarithm of the total assets.

GROWTH: Income growth in the last two years.

LEV: Financial leverage, which is the total breakdown of debt over total assets.

4. Finding

-Examination of unit root test

One of the issues that arise in the discussion of data is the reliability or Stationary of the data. In other words, reliable data is data that has an average, variance, and constant self-sufficiency.

Simply, when the data is stable, we will not have a false regression. To test the reliability has been used Unit Root test.

In this research, Philips & Perron (PP) test was used to test the root (unit reliability) of the unit (the reliability test). The statistical hypothesis is presented below:

Phillips and Peron's (PP) statistical hypothesis:

H₀: The data have a single root and are not stable.

H₁: The data have not unit root and are stable.

The results of the data reliability test are presented in Table (1):

Table 1: Data reliability

test	result	Significant	statistic
PP-FISHE CHI-SQUARE	Reliability Confirmation	0.0000	101.489

Source: Research findings

As shown in Table (1), all data are stable and the reliability of the data indicates that the estimation of the regression model is non-false.

Analysis of the nature and characteristics of the research variables

Considering that in the present research information about the banks accepted in Tehran Stock Exchange has been gathered and the information extracted consists of eight variables, the purpose of this study is to investigate the effect of independent variables on dependent variables. Therefore, regression analysis is the most appropriate method for Test of research hypotheses.

For linear regression, there are assumptions. Minimum distance of measurement scale, normal distribution of variables, linear relationship between independent and dependent variables, equivalence of residual dispersion, uniformity of variance of studied variables, lack of self-correlation and lack of coherent relationship are assumptions Use of regression analysis.

In the present study, the scale of the measurement of the variables of the research is proportional, the relationship between the independent variables and dependent variables are linear affinities. Regression coefficient test was used to study the linear relationship between independent and dependent variables. Finally, regression analysis has been used to examine the effect of independent variable on dependent variables.

The Study of research model

Invariance analysis

To investigate the existence of the heterogeneity of the variance of the disrupted sentences had been done the LM test in the research. The results of the heterogeneity of the variance of Arch LM are as follows:

Table 2: Archived LM Difference Test Results

Describe	probability	the amount of statistics
F-statistic	0.0000	259.3253
Obs*R-squared	0.0000	158.5728

Source: Research findings

Given that the test statistic is significant at 5% level, the assumption of the variance is rejected and the disparity of the variance of the disrupted sentences is accepted.

F test and Hausman test

The F test for estimating the equation of width coefficients from the origin of different sections and the Hausman test has been estimated in order to explain the fixed model effects and random effects. The results of these two tests are shown in Table 3.

Table 3: F test results

Description	probability	Degree of freedom	the amount of statistics
Cross-section F	0.0000	(9,43)	5.607806

Source: Research findings

The calculated F is compared with the table F, and if the H0 is rejected, the validity of the fixed effects method is acceptable. The results of this test show that the value of the statistic is 5.607806 and the probability for it is 0.0000, which indicates the difference in width from the sources of different sections, and the method of fixed effects is accepted.

Table 4: Hausman Test Results

Description	probability	Degree of freedom	the amount of statistics
Cross-section random	0.0490	7	14.589675

Source: Research findings

The value of the Hausman test here is equal to 14.589675, and given that the probability for this is 0.0000, the assumption H1 of this test is accepted based on the preference of the fixed effect method on random effects, and fixed effects method is selected.

Regarding the above mentioned issues, the generalized least squares regression (GLS) and static effects model are used in this study.

Test of the research model

The research model is as follows:

$$ROA = \beta_0 + \beta_1 B\ SIZE + \beta_2 INDEAD + \beta_3 DUALITY + \beta_4 AUDIT + \beta_6 FSIZE + \beta_7 GROWTH + \beta_8 LEV + \epsilon_i$$

According to the results of the model test, it can be seen from Table (7-4) that P-value of the F (prob (F-statistic) statistic, which indicates the significance of the total regression, is equal to 0.0000 and suggests that the model has a significance of 99% confidence level.

The determination coefficient is equal to 0.73, and this means that approximately 73% of variations of the dependent variable with the model variables can be explained. In order to investigate the lack of self-correlation in the model, the camera-Watson statistics are used. This statistic is based on the findings of 1.82. According to the obtained statistics, it can be stated that in the stated model, there is no correlation between the residual

Table 4: Results of the combined regression test of the research model

variable	coefficient	standard deviation	T statistic	PROB	Type of relationship
C	1.252935	0.463584	2.702718	0.0098	Positive and meaningful
INDEAD	0.098084	0.134440	0.729574	0.4696	meaningless
DUALITY	0.034944	0.036338	0.961635	0.3416	meaningless
FSIZE	-0.027529	0.014984	- 1.837219	0.0731	Negative and meaningful
BSIZE	-0.055751	0.030944	- 1.801693	0.0786	Negative and meaningful
GROWTH	0.000696	0.000244	2.857498	0.0066	Positive and meaningful
LEV	-0.271915	0.097236	- 2.796444	0.0077	Negative and meaningful
AUDIT	0.008962	0.089276	0.100381	0.9205	meaningless
	The coefficient of determination	Adjusted coefficient of determination	F statistics	probability of F	camera-Watson
statistics	0.737024	0.639173	7.532078	0.000000	1.821335

Source: Research findings

First hypothesis: There is a significant relationship between the size of the board of directors and the banks accepted in the Tehran Stock Exchange.

According to the test, and the values obtained in Table 7-4, there is no significant relationship in 10 percentage error levels between **the size of the board and the size of the banks accepted in the Tehran Stock Exchange**, and the above hypothesis is not confirmed.

Second hypothesis: There is a meaningful relationship between the non-executive directors and profits of accepted banks in Tehran Stock Exchange.

According to the test, and the values obtained in Table 7-4, there is no meaningful relationship between **the non-executive directors and profits of accepted banks in Tehran Stock Exchange**, and the above hypothesis is not confirmed.

Hypothesis 3: There is a significant relationship between the separation of the role of the CEO of the board directors and the management of the banks accepted in the Tehran Stock Exchange.

According to the test, and the values obtained in Table 7-4, there is no meaningful relationship between the variability in **the role of the CEO of the board directors and the management of the banks accepted in the Tehran Stock Exchange**, and the above hypothesis is not confirmed.

Fourth hypothesis: There is a meaningful relationship between the existences of institutional partnerships of the banks admitted to the TSE.

According to the test, and the values obtained in Table 7-4, there is not a meaningful relationship between **existences of institutional partnerships of the banks admitted to the TSE**. The above hypothesis is not confirmed.

5. Discussion & Conclusion

The purpose of this study was to investigate the relationship between profitability and corporate governance of accepted banks in Tehran Stock Exchange. Therefore, in order to achieve the goal,

the theoretical foundations and research on profit and corporate governance should be studied in order to obtain the main indicators we need. In this regard, a documentary review of relevant subject literature, frameworks and approaches for corporate governance components has been investigated that In this study, by attention to the various indicators presented in terms of components Corporate Governance and their adaptation to the issues were extracted in the studied banks by Indices for assessing corporate governance of banks and By collecting information from financial statements we assess the corporate governance and earnings quality using in regression model. Using the statistical tests, the relationship between the variables and the correlation between the variables has been evaluated. According to the results of the research, the following suggestions are presented:

1. Investors as custodians and chief operators of the industry cycle are better placed to invest in the information contained in the financial statements, in particular corporate governance, as it can have a significant impact on determining the correct decision.
2. It is recommended to the Stock Exchange organization as the main responsible for systemic and informational activities in order to clarify the activities of enterprises, which will provide shareholders, investors as well as stock market experts and other interested parties with a view to raising public awareness and more favorable use of the Financial statements to enable stakeholders to invest more in a position not to suffer and invest in companies that are likely to predict the growth of profits in those companies, which, as a result, will help the community economy.
3. Establishing and encouraging financial analysts and financial intermediaries to increase transparency of corporate profits, as well as more reasonable expectations of expected gains and information contained in financial statements.
4. According to the results of the research, to attract cash in the market and to inject it into the bourse companies, the realization of which could lead to improvement of the business process, it is better to provide quality and reliable information by the owners of the companies and auditors are given to investors to be more confident in investing.
5. One of the most important suggestions of the present research, given the theories in the research, is the attention to the corporate governance system and how they are managed, in other words, the extent to which companies are guided either by internal or external factors With the help of external factors, the system will be systematically targeted, changing the type of look for investors and analysts for the company to invest in.

Scientific proposals for future research

By doing any research, opens new path and the continuation of the path involves conducting other research. Therefore, according to the researcher, each of the following cases can be considered in future research as subjects for research:

1. Investigate the relationship between additional free cash flow and corporate governance with profit information content;
2. Investigate the relationship between additional free cash flow and corporate governance with sales growth;

3. Investigating the impact of qualitative audit features on profit growth forecasts;
4. Investigate the relationship between the increased trust management "management optimism" on the prediction of profit growth.
5. Impact of environmental uncertainty on company activity and profit growth.

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