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ARTICLE

THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FIRM VALUE IN COMPANIES LISTED ON TEHRAN STOCK EXCHANGE (TSE)

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ABSTRACT

This article aims to study the relationship between corporate governance and firm value in companies listed on Tehran Stock Exchange (TSE). Corporate governance was measured through a check list divided into two sections (Internal and external governance components). Tobin Q ratio was employed to operate the firm value. Data were collected using 62 companies listed on TSE from 2009 to 2013. Combined data analysis and multivariate regression were used to analyze the data. The study has two hypotheses. The results indicate that internal and external elements of corporate governance have a positive, significant relationship with firm value.

KEY WORDS
Corporate Governance, Firm Value, Tobin Q Ratio

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INTRODUCTION

Through the development of information and communication technology, global arena has created a small and compact world. Globalization has been applied not only to trade but also to many other professions. Accounting is not an exception and tries to keep pace with its rapidly changing environment. During the last few years, the competition among economic firms has caused multiple changes in accounting. TSE growth is the last few years led to numerous empirical studies in accounting and finance. Corporate governance is the most important tool to create trust in accounting [1]. One the most important tasks of corporate governance is to ensure the quality of financial reporting process. In case of appropriate structure, optimal performance of board of directors, and its supervisory role in financial reporting quality, violations can be somewhat reduced. This article aims to study the effect of corporate governance disclosure on firm value in listed companies in TSE. The importance of firm value and factors affecting it for the actual and potential shareholders caused to shed light on the topic. Multiple studies have been conducted in Iran and other countries concerning the factors affecting the firm value. This article would be beneficial considering the role of corporate governance and the creation of supervision on financial reporting through the creation of governance mechanisms for financial information transparency. The variable used here is internal and external corporate governance disclosure ability. Multivariate regression and combined data are employed to analyze two hypotheses.

METHODS

Statistical population, sample size, and methodology: This is a causal-descriptive applied study. Field study was employed to collect the data. Data collection is performed in two stages: In the first stage, articles and studies related to the topic are reviewed and then, the hypotheses are theoretically developed in order to examine the relationship between dependent and independent variables. In the second stage, essential information and documents are examined. To this end, financial statements are collected and the information is extracted. Therefore, data collection is performed through field study. The statistical population consists of all companies listed on TSE from March 2009 to March 2013 (5 years) through which they have maintained their membership in TSE. Systematic elimination sampling method was employed. Considering the inclusion criteria, the sample size consists of 62 companies for hypothesis testing.

Evaluation Tool

Financial statements and documents are collected in order to extract the essential information.

Definitions and Concepts

Corporate Governance

Corporate governance is the system of rules, practices, and processes applied by board of directors and managers in order to determine the strategic path to achieve objectives, control risk, and consume resources responsibly. Corporate governance is divided into external and internal ones. Corporate governance consists of managing and monitoring the performance of managers and employees. It is a set of relationships between management, board of directors, shareholders and other stakeholders of the

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company. Monitoring includes internal and external components. Internal monitoring consists of strong internal controls and internal audit. Internal controls are a set of practices developed by the management and implemented to reach the objectives. Internal audit is a department supervised by the board of directors. Its task is to ensure the optimal implementation of internal controls and help the efficient and independent audit. Independent audit is one of external components in corporate governance system. Quality, independent audit causes reduced agency problems and ensures the stakeholders to fairly display the financial statements.

The Concept of Corporate Governance

The term "corporate governance" did not exist in English until 1980. Therefore, the topics related to corporate governance have become important in both academic literature and public politics during the last two decades. Corporate governance was identified with ownership, financial restructuring, and institutional investors in this period [2]. Corporate governance is derived from the Greek word "Kyberman" which means to manage and guide. It changed into the Latin word of " Gubernare" and old French word of " Governor". The term has been defined in different ways by various organization or committees based upon their ideological interests [3].

Internal Components of Corporate Governance

They are a set of internal mechanisms to maintain the interests of stakeholders such as the Board of Directors characteristics including non-executive board members, number of board of directors' members, the proportion of managers in the company's stock ownership, and internal audit.

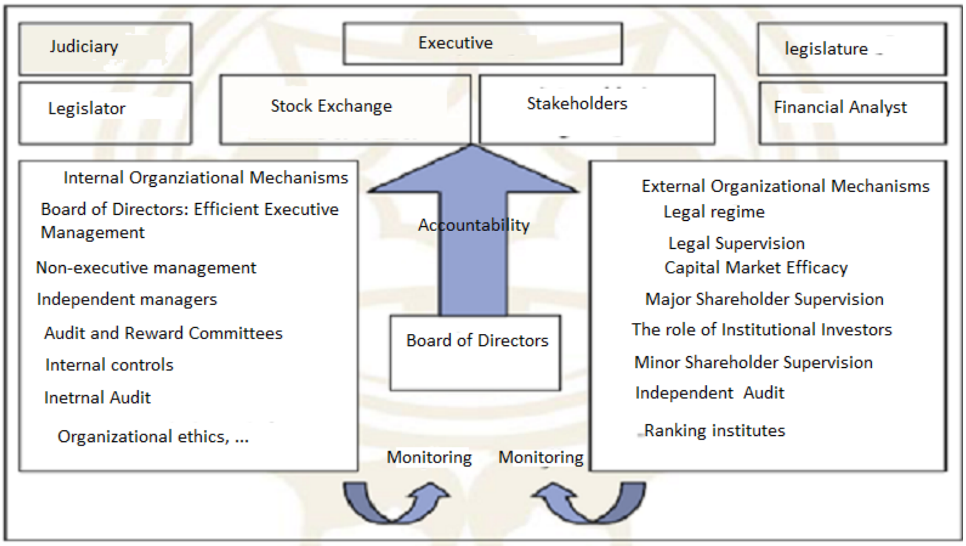
External Components of Corporate Governance

They are a set of external mechanisms to maintain the interests of stakeholders such as the institutional shareholders, government ownership, ownership concentration, etc.

Corporate Governance Mechanisms

Studies show that every country has its own corporate governance system. It is characterized by the number of external factors such as ownership structure, economic status, legal system, government policies, and culture. Some attempts to classify the corporate governance have faced some problems. Yet, internal and external classification is one of the best of these efforts welcomed by many scholars. External corporate governance is a system in large companies owned by external stakeholders, leading to the separation of ownership and management.

Table 1: Corporate Governance Structure



Firm Value

Firm value is an economic measure reflecting the market value of a business. Since measuring fair value of the net assets of the company is not easy, some indicators such as Tobin Q ratio are used to operate the firm value.

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Tobin Q ratio

It is one of firm value indicators introduced by Tobin. It is calculated by total assets deducted by book value of equity added by the fair value of equity divided by total assets.

Non-executive members of board of directors

Since board of directors plays a key role in financial reporting process, it is considered an important corporate governance mechanism. Among multiple features of board of directors in corporate governance structure, the percentage of non-executive members is taken into account in this study. The board is the highest decision-making body in organizations, playing a key role in the company's fate. Selecting the chief executive officer (CEO), adopting many important organizational decisions, and monitoring the process of implementation are performed by the board of directors. Generally, board of directors consists of two independent groups. The first group is responsible for the management and directs the executive managers. Another group is non-executive members who are responsible for the firm. The latter has a determining role in the board of directors. The basis is to separate the executive tasks from monitoring and controlling ones [4]. Since the responsibilities of non-executive members are closely related to CEO, monitoring management is expected to be the responsibility of non-executive members of board of directors. Therefore, these members play a key role in solving agency problems among managers and owners [5]

Independence of Board of Directors (toward the non-executive members)
Independence of the Board of Directors can be viewed from two points of views:

Agency Theory

The presence of non-executive managers in the board of directors and their supervisory performance as independent individuals dramatically helps the conflict of interests among stakeholders and managers in the board of director meetings. With their professional and impartial opinions, non-executive managers judge the decisions. Fama and Jensen (1983) showed that non-executive managers are motivated to be effective observers in order to maintain their reputation. [5]Considering their independence from the company management, it seems that they are at better situations compared to executive managers for protecting the interests of stakeholders against managerial opportunism. Studies in this regard indicate that the effectiveness of the board of directors to support the interests of stakeholders follows a positive function of non-executive manager ratio in the board of directors [7]. This independence means not to select the members in the board of directors among the executive managers.
According to the Cadbury report, the balance of power is recommended between the members in board of directors so that no one would be unconditionally able to control the company decision making. This report recommends that the Chairman of the Board and CEO are not similar individuals. The Chairman of the Board is responsible for monitoring CEO performance and managing the meetings. If CEO and stakeholders have different interests, the influence of CEO would be problematic on the board of directors. If CEO is the chairman of the board, it is known as CEO-duality. Here, CEO is potentially authorized. This dual structure allows CEO to control the accessible information of the board of directors. Therefore, CEO might prevent the effective monitoring.

The size of Board of Directors

From the perspective of agency, it is argued that a larger board of directors is likely to be alert to agency problems because more individuals would control the management [8]. Most studies conducted in this field pays attention to the size of board of directors to evaluate the performance increase, not its role in improving financial reporting accuracy. Considering the fact that the main role of board of directors is to observe the management, studies concerning the size of board of directors are targeted at observation.

Institutional Investors

The composition of stakeholders is different in various firms. Partial ownership of companies is available to minority shareholders and individuals. This group relies on published financial statements in order to monitor the performance of managers. Yet, another part of ownership belongs to the professional shareholders. Despite the first group, the latter receives valuable internal information about the future prospects, commercial strategies, and long-term investment through direct communication with managers [9]. Institutional investors are large investors such as banks, insurance companies, and investment companies. It seems that the presence of institutional investors might change the behavior of companies. This is rooted in the regulatory activity performed by such investors [10]. Institutional investors have the opportunity, resources, and ability to monitor, regulate, and affect the managers. Monitoring companies through institutional investors can force managers to pay more attention for the firm performance and less attention to opportunistic behavior. Institutional investors are considered expert investors who have higher capability to analyze the profit and normal and abnormal elements compared to the non-institutional ones.

The process of Corporate Governance in Iran

In Iran, Stock Exchange was founded since 1960s. It was partially raised in the amended Commercial Code in March 1995 concerning the establishment of companies. Corporate Governance was, however, introduced in the last few years in the early 1980s by Stock Exchange officials of Parliament Research Center. A specific committee was dedicated to corporate governance in the Ministry of Economic Affairs and Finance [11]. Corporate Governance was first offered in the national conference of Capital market, an Engine of Economic Development held by Allameh Tabatabee University on November 27th and 28th, 2004 in Razi Convention Center. The article entitled "Corporate Governance and its Role in Capital Market Development" was presented by Hassass Yeganeh and then used in accounting in Ph.D. level entitled "Development of Accounting and Auditing Ideas". It was then presented in two seminars entitled " Financial Reporting and Future Development" and " Corporate Governance System and Internal Audit" on December 28th and 29th , 2004 and November 21st and 22nd 2005 in Razi Convention Center by the Iranian Institute of Certified Accountants. Following this, Capital Market Research and Development Center of Stock Exchange published the first version of Corporate Governance Code which is accessible in Stock Exchange website. Article 12 provides definitions, board of directors' tasks and stakeholders, information disclosure, accountability, and auditing. The code was devised considering the ownership structure and capital market status which is consistent with the internal organizational system of corporate governance.

RESULTS

Table 2: Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Standard Deviation
TobinsQ	1.1428	1.1294	3.3203	-0.6896	0.0899
InterGover	5.6937	5.3245	8	3	0.2638
ExterGover	6.0354	5.6969	9	4	0.5631
PGSales	0.2413	0.2667	2.3454	-0.7652	0.2491
Cash	0.1836	0.2182	0.6842	0.0387	0.1664
CAPEX	0.3758	0.3889	0.8804	0.1123	0.1964
LEV	0.3894	0.4472	0.7356	0.1174	0.2016
ROA	0.2136	0.2182	0.4193	-0.1634	0.0668

Definition of Variables:

TobinsQ: (Dependent variable) shows the firm value.

InterGover: (Dependent variable) shows the ability of internal elements of corporate governance

ExterGover: (Dependent variable) shows the ability of external elements of corporate governance

PGSales: (control variable) indicate the annual sales growth in the past year

Cash: (Control variable) shows the Cash Flow Ratio

CAPEX (Control variable) shows the investment expenditure ratio

ROA: (control Variable): Returns on Assets

Source: Researcher calculation

As it can be seen concerning Tobins Q, the mean and median were 1.142 and 1.129, respectively. The median shows that almost half of data are greater than this value and the other half is less. The data also show that the maximum is 3.3203 and the minimum is -0.6896.

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Table 3: The results of normal test of model residuals

Variable		RESIDUAL
Jarque-Bera test	P-value	1.8966
		0.1648

Source: Researcher calculation

As it can be seen in [Table 3], the normality test of residuals and significance level indicate that H1 is not verified and H0 is verified. In other words, residuals of regression model have no non-normal distribution.

Table 4: The results of model test

$$TobinsQ = \alpha + \beta_1 InterGover + \beta_2 ExterGover + \beta_3 PGSales + \beta_4 Cash + \beta_5 CAPEX + \beta_6 LEV + \beta_7 ROA + \varepsilon$$

Variable	Symbol	Coefficient		t-static	p-value
Constant factor	C	A	-1.4167	-9.2449	0.0283
Internal components of corporate governance	InterGover	β1	0.1804	6.9368	0.0000
External components of corporate governance	ExterGover	β2	0.2364	2.6093	0.0144
annual sales growth in the past year	PGSales	β3	1.2056	2.4763	0.0438
Cash Flow Ratio	Cash	β4	0.0698	3.2961	0.0263
investment expenditure ratio	CAPEX	β5	0.1934	4.8904	0.0029
Financial leverage ratio	LEV	β6	-0.4527	-1.2883	0.2179
Returns on Assets	ROA	β7	1.4291	12.3648	0.0000
R2				0.4689	
Adjusted R2				0.4438	
F-static (p-value)				11.4487(0.000)	
D-W				1.9682	

RESULTS

First Hypothesis

Internal elements of corporate governance have a significant relationship with the firm value.
H0: No significant relationship is found between internal elements of corporate governance and the firm value.
H1: Internal elements of corporate governance have a significant relationship with the firm value.
In this hypothesis, firm value is dependent variable and internal elements of corporate governance are independent variable. According to [Table 4], t statistics for the dependent variable in the first hypothesis and significance level (p-value) are 6.9368 and 0.000, respectively. Since the significance level is less than 0.01, the first independent variable (interGover) is significant. It means that a significant relationship is found between corporate governance elements and firm value with Tobin Q ration at 99% confidence level. Therefore, the first hypothesis is verified.
The Result of the Second Hypothesis

Second Hypothesis

External elements of corporate governance have a significant relationship with the firm value.
H0: No significant relationship is found between external elements of corporate governance and the firm value.
H1: External elements of corporate governance have a significant relationship with the firm value.
In this hypothesis, firm value is dependent variable and external elements of corporate governance are independent variable. According to [table 4], t statistics for the dependent variable in the second hypothesis and significance level (p-value) are 2.6093 and 0.014, respectively. Since the significance level is less than 0.05, the second independent variable (exterGover) is significant. It means that a significant relationship is found between corporate governance elements and firm value with Tobin Q ration at 95% confidence level. Therefore, the second hypothesis is verified.

CONCLUSION

This article studied the relationship between corporate governance elements and firm value. The unit of measurement was Tobin Q. The results showed that both hypotheses are verified. In the first hypothesis, we examined the relationship between the internal elements of corporate governance and firm value. Internal elements of corporate governance consist of all features board of directors and other preventive factors. The variable was measured through a checklist related to the most important internal elements of corporate governance by financial statements and notes. According to the regression model, the results indicate that the internal elements of corporate governance have a positive, significant relationship with firm value with Tobin Q ratio. Therefore, the first hypothesis is verified.

In the second hypothesis, we examined the relationship between the external elements of corporate governance and firm value. External elements of corporate governance consist of all shareholders and other preventive factors. The variable was measured through a checklist related to the most important external elements of corporate governance by financial statements and notes. According to the regression model, the results indicate that the external elements of corporate governance have a positive, significant relationship with firm value with Tobin Q ratio. Therefore, the second hypothesis is verified.

CONFLICT OF INTEREST
There is no conflict of interest.

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