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The study of improvement in corporate governance of firms accepted in Tehran stock exchange after enforcing corporate governance regulation

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ABSTRACT: Corporate governance regulation was approved in 2007 by Tehran stock exchange. This research studies quality of corporate governance during 2006-2007 before approving corporate governance regulation and years 2008-2009 after approving corporate governance regulation. Purpose of this study is evaluating quality of corporate governance after enforcing it in Tehran stock exchange. Number of studied companies in this research is 80 companies during 2006-2009. This variable is calculated based on presented index by Dasilveria (2007). Results showed that after enforcing corporate governance, score of corporate governance quality has been increased.

***Keywords*:** firms, Tehran, enforcing, regulation.

INTRODUCTION

One of main factors in improving economic efficiency is corporate governance which includes a set of relationship between board of directors, shareholders and other beneficiaries. Corporate governance is a system that companies are guided and controlled by it. Corporate governance provides a structure through it goals are set and means for achieving these goals and monitoring on performance of managers become clear. Desired corporate government should provide suitable motivations for board and management to follow objectives which are on behalf of firm and shareholders and also facilitates efficient and useful monitoring (Hasas Yeganeh, 2006). Monitoring authorities like stock exchange organization have great attitude toward efficient corporate government because it is a necessary factor of desired and correct performance and if it is not effectively enforced, it leads to risk.

Definitions of corporate governance

International monetary fund (IMF) and organization for economic corporation and development (OECD) in 2001 have defined corporate governance as: structure of relations and responsibilities among major group which includes shareholders, board members and directing manager for extending better competitive performance required for achieving primary functions of corporation. Kayzi and Wright (1993) have written: corporate governance includes structures, processes, cultures and systems which provide successful operation of organizations.

Purpose of corporate governance is achieving responsible and value-based management and control of company. Corporate governance rules develop and enhance trust among real and potential shareholders, creditors, employees, trade partners and public in national and international markets (German corporate governance code 2002).

Shelifer and Vishney (1997) stated that corporate governance mainly deals with methods which create trust in suppliers of funds for companies about gaining reasonable return from their investment in company (Shelifer & Vishny, 1997).

Corporate governance systems

In order to reduce agency costs, corporate governance uses different monitoring systems which can be classified into three groups: a) organizational external mechanisms (environmental), b) public codes (Hasan, 2009).
Corporate governance system in a country is determined by number of internal factors like firms' ownership structure, economic condition, public policies and culture. Legal structure and framework are the most important detriments of corporate governance system.

External factors like amount of capital from outside to inside, global economy condition and institutional investment influence corporate governance of a country (Hasas yeganeh, 2006).

Corporate governance in Iran

Regarding corporate governance systems' characteristics, it seems that it is close to inter-organizational system in Iran. Regarding existence of capital market and attempts about its expansion, inter-organizational corporate governance occurs in Iran.

Regarding studies in recent years, we can say that using corporate governance mechanisms is a basic action for increasing transparency in organizations, meeting rights of all beneficiaries and minority shareholders become aware of corporate operation; as a result, essential steps occur in developing capital market because financial transactions will be clear. In fact, in these conditions, financial misuses reduce but considering that corporate governance in Iran is more closer to inter-organizational system, we should try to make it external because in this condition, firms are directly controlled by managers and indirectly by external members and achieving goals of corporate governance i.e. accountability, transparency, justice and rights of beneficiaries is possible (Hasas Yeganeh, 2006).

Effectiveness of corporate governance in capital market

Corporate leadership means with high quality reduce capital cost, increase liquidity and potential financial options, facilitate ability of coping crisis and prevent rejection of countries with suitable management in capital markets. Suitable corporate management procedures in the case of countries prevent exiting internal cashes, increases foreign investment, increases economy competitive power and capital markets, coping crisis, efficient allocation of resources and achieving higher level of development and progress (Cansizlar, 2003). Firm management system provides a structure through which goals of firm are set and means to achieving goals and performance monitoring are determined. This system develops necessary motivation for meeting goals of firm in management and provides effective monitoring. In this case, firms use resources with higher effectiveness (Makrami, 2006). Results of different research showed that firms that implemented corporate management measures have experienced strong growth in different corporate sections and have higher ability in absorbing capital than other cases. Main objective of corporate management is reducing capital costs of firm by improving trust of investors in order to attain suitable efficiency from their investment. Therefore, firms which have better growth opportunities apply corporate governance more usefully and will have better performance (Dasilveria, 2007).

Corporate governance theories

Beneficiaries' theory: this theory is a combination of organizational and social theories. In fact, this theory is more a widespread research tradition which mixes philosophy, ethic, political, economic theories, law, organizational sciences and social theories. Basis of beneficiaries is that firms have enlarged and their influence on society are so deep that they should consider more parts of society than shareholders which have mutual interests and be accountable; in other words, not only beneficiaries are influenced by firm but they influence firms (Benvisi, 2006).

Modern governance theory: this theory goes beyond external value of ethics and studies internal feelings of a situation. It presents a more comprehensive method in which firms give priority to goals (March, 2013).

Resource allocation theory and attention of management to shareholders' relations: this theory will have useful results for shareholders and organizational culture (Heth, 2004).

Transactions cost theory: this theory is one of basics of industrial economy and financial theories. In this theory, firm is not only an economic unit but it is an organization composed from individuals with different views and goals. This theory is based on this principle that firms become enlarged so that they can replace market in allocating resources. In fact, firms are so complex and wide that they guide production, regarding price fluctuations in market and balance transactions' market. Some transaction will be eliminated inside firms and managers harmonize production with transactions they prefer (Benvidi, 2006).

Ranking corporate governance

In most countries, ranking firms regarding corporate governance has begun in 1990s. Researchers have used different indices in order to measure suitability of corporate governance during past years.

Ranking based on corporate governance is important because of two reasons:

1. Large part of investors including institutional investors which have important role in investment market, use this ranking for economic decisions.
2. Placing firms in low ranks is an alarm for corporate management to pay more attention toward corporate governance (Hasas Yegane & Dadashi, 2010).

Measuring quality of corporate governance: Dasilveria (2007) conducted a research titled "quality of corporate governance and corporate value in Brazil" and tried to introduce an index for evaluating quality of corporate governance. He has designed a questionnaire with 20 questions. Each correct answer has one point in questionnaire but negative answer has no point. Therefore, corporate governance quality will have a score between 0-20 in this scale. Obtained points determine corporate governance rank.

Studied industries and sample size:

Number of studied firms in this research is 80 firms during 2006-2009 and sampling is as follows: Dispersion of samples in different industries is:

Sample industries

Number	Industry
7	Chemical products
1	Computer and related
1	Machinery and equipment
6	Food & drink
17	Automobile parts
1	Transportation, store, communication
4	Non-metal mining
15	Pharmaceutics
1	Coal extraction
4	Tile & ceramic
12	Cement, lime & gypsum
1	Metal products
1	Tire and plastic
3	Electrical machines
1	Basic metals
2	Extracting metals
1	Agriculture, husbandry
2	Oil products, nuclear
80	Total

Descriptive statistics

Corporate governance score for all study years:

SD	Min	Max	Med	Mean	Quality of corporate governance
1.36	11.00	16.00	14.00	13.67	*CGM*

CGM is corporate governance score which is between zero and 20.

Corporate governance score for each study year

SD	Min	Max	Med	Mean	Variables	Year
1.31	11.00	16.00	14.00	13.45	*CGM*	*2007*
1.30	11.00	16.00	13.00	13.44	*CGM*	*2007*
1.32	11.00	16.00	13.00	13.50	*CGM*	*2008*
1.33	12.00	16.00	14.00	14.30	*CGM*	*2009*

Results showed that mean corporate governance score year 2008 (13.5) and 2009 (14.30) is higher than its mean during 2006 and 2007, after approving corporate governance code

Frequency distribution diagram (table 1) and observation diagram (table 2).

Table 1

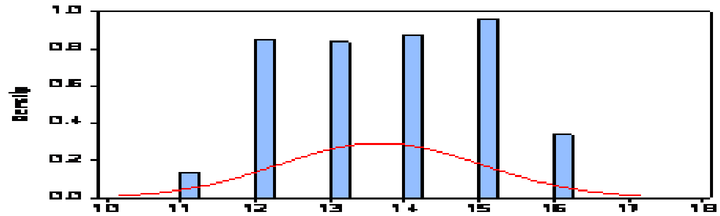
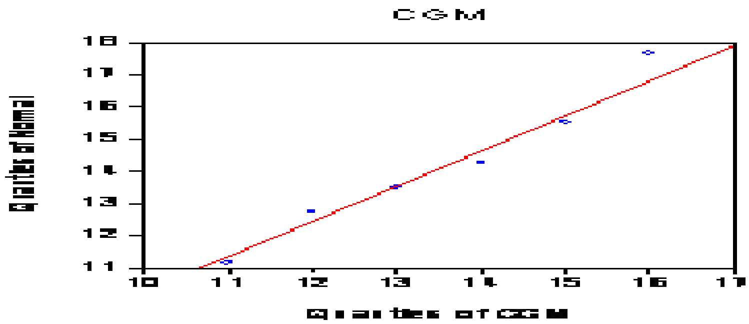


Table 2



RESULTS AND DISCUSSION

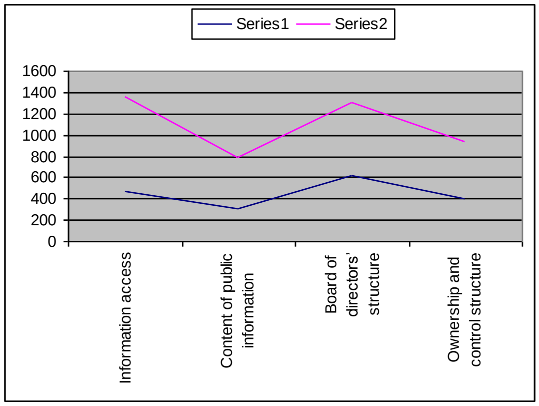
Table of obtained scores by firms is as follows:

Score in 2008-2009	Score in 2006-2007	Ranks
881	475	
487	303	
680	621	
539	400	
2587	1799	Total

Regarding obtained results from table, we can conclude that in all ranks and total score of two years, corporate governance score years 2008-2009 after enforcing corporate governance code was higher than years 2006-2007. These results show that firms listed in stock exchange tried to enforce corporate governance instructions.

Based on obtained results, if firms try to improve corporate governance, this has positive influence on value and performance of firm. For example, about board members number, differentiating duties, transparency and access to information and observing shareholders' rights. If they improve reporting quality and observing shareholders rights and have internal auditing and accounting committees inside firm, they can see performance improvement. Differentiating role of managing director and head of board is one of reasons for increasing corporate governance rank during 2008-2009 and transparence and increase in information content.

Comparison diagram for both years regarding corporate governance score is as follows;



1- Is the firm's Annual Report (AR) available on the Internet? 2-Does the website contain corporate governance documents, such as corporate governance guidelines, board of directors' by regulations, explanation of the CG model, etc?. 3-Does the website make available presentations for analysts or data useful for operational and financial forecasts of the company? 4-Is the website bilingual (Portuguese and English versions at least) and doeit contain an Investor Relations section? 5-Was it unnecessary to have direct contact with the firm in order to obtain corporate information?	Information access
6-Does the AR contain a specific section describing the corporate governance model and/or current governance practice? 7-Does the AR or another document explain the executives' global remuneration (incentives system in place for executives)? 8- Are the financial statements also presented in US-GAAP or IFRS? 9-Does the AR or the website include a section with profit estimates or forecasts of financial return (ROA, ROE, etc)? 10 -Does the AR or some other corporate document present the value added/destroyed by the business during the period based on an economic profit measure (EVA®, etc)?	Content of public information
11-Is there a separation between CEO and Chairman of the board positions (different persons in charge)? 12- Does the firm have a board of directors comprised from 5 to 9 members? 13- Does more than 80% of the board consist of external directors? 14- Does the board of directors have a unified one-year term? 15-The firms does not have a Shareholder Agreement (such agreements between large shareholders are often used to restrict board's independence and to lot management positions among these shareholders)?	Board of directors' structure
16- Does the firm only issue common stock (voting shares-ON)? 17- Does preferred stock correspond to less than 50% of total outstanding stock? 18 -Does the controlling stockholder possess less than 70% of total common stock? 19-Is the difference of controlling shareholder's control rights (% votingshares) and cash flow rights (% of total shares) lower than 23%? (controlling shareholders' wedge)? 20- Does the firm voluntarily grant tag along rights to preferred shareholders?	Ownership and control structure

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