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Comparison of Profitability Proportions before and after the Implementation of Corporate Governance in Companies Listed in Tehran Stock Exchange

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ABSTRACT: The aim of this study was to compare the profitability proportions in companies before and after the use of corporate governance in the companies listed in Tehran Stock Exchange. The research method was descriptive and causal-comparative. The population was all the accepted companies in Tehran Stock Exchange (cars and car fragments, petrochemicals, petroleum products, cement, pharmaceutical, home and sugar appliances) between years of 2010 and 2014 that 82 companies were selected based on Morgan table as a sample. Data was analyzed using independent t-test. Results showed that the average ratio of gross profit to total assets (ROI) in companies after the application of corporate governance had no significant difference with an average ratio of gross profit to total assets (ROI) before the implementation of corporate governance. There was no significant difference between the average ratios of net income to equity (ROE) in companies after the application of corporate governance and net income to equity (ROE) in companies before the application of corporate governance. The average ratio of net profit to total assets (ROA) in companies after the application of corporate governance and average ratio of net profit to total assets (ROA) in companies before the application of corporate governance in companies did not significantly differ from each other. Other results showed that the average ratio of gross profit to total assets (ROI) in companies that used corporate governance had no statistically significant difference with an average ratio of gross profit to total assets (ROI) in companies that did not use corporate governance.

Keywords: Corporate Governance, Auditing, Profit.

INTRODUCTION

Corporate governance was arisen as mechanisms for dealing with the separation of ownership from control of the commercial unit as well as potential conflicts of representation theory. These mechanisms are assumed as reducing agent in the degree of much difference between the various stakeholders as well as the separation of ownership from controlling the commercial unit (Aghaie et al., 2008). Given the above as well as controlling daily important and key decisions of the commercial unit by professional managers and other regulatory factors, how to control managers by shareholders can be known as one of the main objectives of corporate governance. As well given that it would be expected to reflect the available information quickly in stock prices in efficient capital markets and also entrance of accounting data to the market caused the stock price changes in case that the information would be related to the stock value and has information content (Setayesh and Ebrahimi, 2012). Therefore, company executives are looking for showing financial statements as optimum using a variety of tools to change stock prices to show better performance and on the other hand investors are looking for increasing their wealth which would cause a conflict in revenues (Taghavi et al., 2010). The aim of this study was to compare profitability ratios in companies before and after the implementation of corporate governance in firms listed in the Tehran Stock Exchange.

METHODOLOGY

The research method was descriptive and causal-comparative. The population was all the accepted companies in Tehran Stock Exchange (cars and car fragments, petrochemicals, petroleum products, cement, pharmaceutical, home and sugar appliances) between years of 2010 and 2014. The companies with the following conditions were considered as the sample.

1. Those that their financial period conduces to the end of March.
2. Those that have been accepted in the Tehran Stock Exchange prior to 2013.
3. Those that are not among the mediation, financing, leasing and insurance companies.
4. Those that their needed financial information is available.
5. Those that are not among companies with the initial supply of the stock.

The number of 82 companies was selected as the sample through Morgan table. Following regression model was used to achieve the research goals.

$$Corporate\ governance_{it} = \alpha_0 + \alpha_1 ROI_{it} + \alpha_2 ROE_{it} + \alpha_3 ROA_{it} + \alpha_4 Lev_{it} + \alpha_5 P/E_{it} + \alpha_6 Size_{it} + \varepsilon_{it}$$

$Corporate\ governance_{it}$: Corporate governance of companies in the years studied
ROI_{it}: Return on investment (ROI) ratio in the years studied
ROE_{it}: Return on owners' equity (ROE) ratio in the years studied
ROA_{it}: Return on assets (ROA) ratio in the years studied
Lev_{it}: Financial leverage ratio in the years studied
P/E_{it}: Price to earnings per share ratio of companies in the years studied
$Size_{it}$: The size of the companies in the years studied
The research variables were measured as follows.

Profitability index: According to the study of Glen and Singh (2004), the criterion of profitability index may affect the relationship between capital structure and other variables. Profitability indices involve return on investment, return on owner's equity and return on assets that are calculated as follows.

A) Return on investment:

$$ROI_{i,t} = \frac{\text{Profit and loss before taxes (gross)}}{\text{Total assets}}$$

B) Return on equity

$$ROE_{i,t} = \frac{\text{Profit and loss after taxes (net profit)}}{\text{Equity}}$$

C) Return on total assets

$$ROA_{i,t} = \frac{\text{Profit and loss after taxes (net profit)}}{\text{Total assets}}$$

D) Financial leverage ratio:

To calculate the financial leverage ratio of firm i in year t, we have (Maquieira, Preve and Sarria-Allende, 2012):

$$Lev_{i,t} = \frac{\text{The book value of total debts}}{\text{The book value of total assets}}$$

E) Price to earnings per share ratio:

It will be proceeded to calculate the ratio of stock price to earnings per share of the firm i in year t as follows.

$$PEration_{i,t} = \frac{\text{Price per share}}{\text{Earnings per share}}$$

Off-balance sheet financing of the firm i in year t was measured using rental costs disclosed in the notes to the financial statements of companies listed in Tehran Stock Exchange (Faramarzi and Pormosa, 2014). And sale variable was considered as replaced variable for the size of the company as a controlling factor. Independent t-test was used to analyze the data. In all analyzes, the significant level was considered as $p < 0.05$.

RESULTS

Results of Kolmogorov-Smirnov test showed normal distribution of the data ($p > 0.05$). The average ratio of gross profit to total assets (ROI) in companies after the application of corporate governance was compared with an average ratio of gross profit to total assets (ROI) in companies before the application of corporate governance using independent t-test. Results are presented in Table 1. It can be said that the average ratio of gross profit to total assets (ROI) in companies after the application of corporate governance had no significant difference with an average ratio of gross profit to total assets (ROI) in companies before the implementation of corporate governance.

Table 1. Results of independent t-test.

ROI	N	Mean	t	df	Sig.	Mean	Std. Deviation	Lower limit	Upper limit
Before corporate governance	18	0.2126	0.209	17	0.625	0.00842	0.12659	-0.05259	0.069440
After corporate governance	18	0.2012							

The average ratio of net profit to equity (ROE) in companies after the application of corporate governance was compared with the average ratio of net profit to equity (ROE) in companies before applying the corporate governance. The results showed that there was no statistically significant difference between the average ratio of net profit to equity (ROE) in companies after the application of corporate governance and average ratio of net income to equity (ROE) in companies before the application of corporate governance (Table 2).

Table 2. Results of independent t-test.

ROE	N	Mean	t	df	sig	Mean	Std. Deviation	Lower limit	Upper limit
Before corporate governance	18	0.5116	0.208	17	0.732	0.15579	2.98071	-1.28087	1.59245
After corporate governance	18	0.5058							

The average ratio of net profit to total assets (ROA) in companies after the application of corporate governance was compared with average ratio of net profit to total assets (ROA) in companies before applying the corporate governance. It can be said that the average ratio of net profit to total assets (ROA) in companies after the application of corporate governance and average ratio of net profit to total assets (ROA) in companies before the application of corporate governance had no significant difference with each other (Table 3).

Table 3. Results of independent t-test.

ROA	N	Mean	t	df	sig	Mean	Std. Deviation	Lower limit	Upper limit
Before corporate governance	18	0.1819	-1.709	17	0.056	-0.05211	0.12017	-0.11002	0.00581
After corporate governance	18	0.1961							

The average ratio of gross profit to total assets (ROI) in companies that used corporate governance was compared with an average ratio of gross profit to total assets (ROI) in companies that did not use corporate governance. Results showed that the average ratio of gross profit to total assets (ROI) in companies using corporate governance had no significant difference with an average ratio of gross profit to total assets (ROI) in companies not using corporate governance (Table 4).

Table 4. Results of independent t-test.

t-test for Equality of Means						Levene's Test for Equality of Variances		ROI
%95 Confidence Interval of the Difference		Std. Error Difference	Mean Difference	Sig. (2-tailed)	t	Sig.	F	
Upper	Lower							
0.04288	-0.06487	0.02739	-0.01100	0.528	-0.399	0.128	1.988	Variance equality hypothesis
0.06168	0.08368	0.03672	-0.01100	0.635	0.300			Variance inequality hypothesis

DISCUSSION AND CONCLUSION

The aim of this study was to compare profitability ratios in companies before and after the implementation of corporate governance in firms listed in the Tehran Stock Exchange. Results showed that the average ratio of gross profit to total assets (ROI) in companies after the application of corporate governance had no significant difference with an average ratio of gross profit to total assets (ROI) in companies before the implementation of corporate governance. There was no significant difference between the average ratios of net profit to equity (ROE) in companies after the application of corporate governance and before the application of corporate governance. The average ratio of net profit to total assets (ROA) in companies after the application of corporate governance did not differ significantly with an average ratio of net income to total assets (ROA) in companies before the application of corporate governance. Other results showed that the average ratio of gross profit to total assets (ROI) in companies that used corporate governance had no significant difference with an average ratio of gross profit to total assets (ROI) in companies that didn't use corporate governance. Results of previous studies showed that the implementation of corporate governance involves a set of relationships between shareholders, directors, auditors and other stakeholders that ensure holding controlling system in order to respect the rights of shareholders as well as the proper implementation of the decisions of the assembly and prevention of possible abuses. Corporate governance is arisen as a mechanism for dealing with the separation of ownership from control of the commercial unit as well as potential conflicts of representation theory. These mechanisms are assumed as reducing agent in the degree of much difference between the various stakeholders as well as the separation of ownership from controlling the commercial unit. As discussed above, negative relationship between corporate governance and future stock returns that is caused due to inexperienced investors in the market and by the conducted examination in the sample studied, the use of corporate governance by the companies has been confirmed in the market and continually it has examined this issue that inexperienced investors demonstrate incorrect response to the application of corporate governance affected by what factor. The use of corporate governance is known as an incorrect reaction of investors, this factor was examined that suggesting that as more companies are adopting corporate governance, efficiency of financial ratios and profitability ratios does not significantly change. This may be due to not to desirable use of corporate governance tools by firms listed in the Tehran Stock Exchange, restrictions on the use of corporate governance tools, how to choose the statistical community and other factors such as the effects of hyperinflation in the economy of the country which increases the cost of rent in accordance with inflation faster and thus will reduce the profitability.

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