Reviewing Impact of Corporate Governance Ratings, Quality of Reporting on Value of Listed Companies in Tehran Stock Exchange

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ABSTRACT: This study examines the impact of corporate governance ratings, quality of reporting on Value of listed companies in Tehran Stock Exchange. The research methodology and research design is practical and the semi-experimental using post-events approach, respectively (via the past information). Temporal and space domain of the investigation is companies listed in Tehran Stock Exchange and since 2004 to 2009. The two hypotheses to evaluate the relationship between each of the variables have been developed. Hence the corporate governance ratings and the quality of reporting are defined as independent variables and value of the company as the dependent variable too. Also, three control variables: company size, company growth and financial leverage have been used. We used Ordinary Least Squares (OLS) method to test hypotheses using EVIEWS 7 software. The results showed that the corporate governance ratings and quality of reporting has a significant impact on the value of companies listed in Tehran Stock Exchange.

Keywords: Company’s value, Corporate governance ratings, Quality of reporting.

INTRODUCTION

Nowadays, by globalization of markets, competitive developments, the demand for new financial resources and increasing expectations of investors, small businesses are more concerned. Almost all financial decisions involve determining the added value, according on which the business decisions will be made (Borton & Vimor, 2004). Companies to create value are under pressure not only by the shareholders but also by other stakeholders. Small companies ought to try to compete with big companies effectively (Hu & Robinson, 2005). Small business owners should be aware that maximizing the created value is possible only in light of an effective and efficient use of resources, which requires careful planning and control companies’ operations (Romano, 1996). The term “value”, of course, includes the general concept which would be interpreted variously in terms of shareholders and other stakeholders’ viewpoint regarding interests of each of them (Mojtahedzad, Alavi Tabari & Shafiee, 2011). The company with a top rate of value creation can grow faster, access to capital markets easier, provide better conditions for their employees and are more capable for managing their resources (Bidel & Morey, 2009).

So the value creation could represent structures are grown. Customers’ sources are better provided within such structures, this is because the company can attract funds at lower costs. Being low the cost of capital in investment activities leads to customers’ expectations of prices on goods or services to be provided (Rahmani, 2007). Also main goal of the financial statements provides useful information about the financial and operational position of the company to make the right decision by investors and creditors. Financial statements would be appropriate quality when ensuring the goal (Abudi & Hogos, 2005). Reporting quality refers to how expressing and detecting a company's economic situation using the financial statements and its performance during the financial period by accurate and sincere manner. Managers would have no incentive to offer an unrealistic situation of the company to shareholders, if their incentives were in line with shareholders’ interests or there were not any conflicts between their interests (Petroski, Limpaphayom & Nagarajan, 2008). In financial reporting and disclosure, quality is a necessity.

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Financial reporting quality causes to better predict company’s future cash flows, investors’ votes and other users of financial statements. Given that the economy and accounting have interacted with each other, level of financial reporting quality has the economic effects (Nouravesh & Ebrahimi Kordlor, 2005). In this regard, results of the research by Hassasyeganeh and Alizadeh (2006) indicated that there is a positive relationship between institutional investors and firm value. Other researchers have found a positive and significant relationship between debt ratio and firm value, whilst no negative relationship between firm size and value of the business unit (Abbasi, 2003). The results of Khodadi and Tocker (2008) showed that the concentration of ownership and governmental ownership are significantly and positively related to performance and value of companies.

Also there has been strong positive relationship between corporate governance and financial reporting quality of Nigerian manufacturing firms (Baba, 2011). Eventually, the results of Chalak, Tan and Adams (2013) showed that there has not been any communications between corporate governance features (including institutional ownership, ownership indices, board independence, and size) and financial reporting quality.

METHODOLOGY

The research method

The research design of the study is semi-empirical and is done based on post-event approach (via past information). On the other hand, the present study is descriptive-correlational research. This investigation is a kind of quantitative research based on data natures and is regarded as practical research based on the goals. And in order to examine the research hypothesis and given nature of information, the research data is based on past quantitative and real information.

Research hypotheses

- Corporate governance ratings have a significant impact on the companies listed in Tehran Stock Exchange.
- Rating reporting has a significant impact on the companies listed in Tehran Stock Exchange.

Participants

The statistical population studied in this research is the companies listed in Tehran Stock Exchange during the years 2004 to 2009. Companies were selected for the sample was limited to the following three conditions:

1. The companies that have been listed before 2004 in Tehran stock exchange.
2. The companies that their end of financial year was February 29th.
3. The companies that their demand data are available.
4. The companies that are not a part of the banks and financial institutions (investment companies, financial intermediation, holding companies, banks and leasing companies).

In this survey, following relationship has been used for estimating the number of samples with regard to measure type of hypotheses variables in the research:

\[ n = \frac{N \left( Z_1 - \frac{a}{2} \right)^2 \sigma^2}{(N + 1)d^2 + \left( Z_1 - \frac{a}{2} \right)^2 \sigma^2} \]

- \( Z_1 \) = how confidence of 95% level
- \( N \) = population size
- \( d \) = error in sampling
- \( \sigma^2 \) = population variance

Based on the above formula, statistical sample in this research is 75 companies among the 331 companies given by the Tehran Stock Exchange.

Data collection

In this study, financial information has been provided of financial statement and explanatory notes related companies under investigation and with assistance of CDs regarding Tehran stock exchange, the organization of stock website and Tadbirpardaz and Rahavard novin software.

The research conceptual model concept

In this paper we use the following model:

\[ \text{FIRMVAL}_{t+1} = a_0 + a_1 \text{FQ}_{t+1} + a_2 \text{CGL}_{t+1} + a_3 \text{SIZE}_{t+1} + a_4 \text{LEVERAGE}_{t+1} + a_5 \text{GROWTH}_{t+1} + \varepsilon_{t+1} \]
FIRMVAL
FQ
CGI
SIZE
LEVERAGE
GROWTH

Operational definition of the research variables

Reporting Quality

Quality of working capital accruals is considered as a substitute for financial reporting quality. The quality of accruals is calculated based on the following model 1. This model has been presented by Emese Nickels (2002) and Dychaou and Dychou (2002).

\[ \text{ACC} = \beta_0 + \beta_1 \times \text{CFO}_{t-1} + \beta_2 \times \text{CFO}_t + \beta_3 \times \text{CFO}_{t+1} + \beta_4 \times \Delta S_t + \beta_5 \times \text{FA}_t + \epsilon_{\text{ACC}} \]

The theoretical basis of the model 1 persisted on the fact that working capital accruals (ACC) with cash flows (CF) in the previous, current and future periods be explained. Error values obtained from the regression of accruals and cash flows of the above three variables mean that accruals are unrelated to identifying cash flows. So whatever the size of the obtained error values \( |\epsilon_{\text{ACC}}| \) of this model to be lower, accruals quality and as a result, quality of financial reporting will be higher. As errors values provide an index to calculate poor quality of financial reporting. Obviously, it can be used as an indicator for calculating financial reporting quality by multiplying -1 with positive values of the errors. In other words, symmetry of bigger (smaller) error values quantity reflects the higher (lower) quality of financial reporting.

Corporate Governance Ratings

It is achieved with regard to four components: ownership, shareholder rights, transparency and effectiveness of the Board among the companies (Barzegar & Salehi, 2008).

Firm Value

We in this study will use BVPS standard (market value of the company’s common stock).

Control variables for research

It is a variable which is left constant ensuring whether it affects the relationships between independent and dependent variables or not.

<table>
<thead>
<tr>
<th>Table 1. Operational definition of the research control variables.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name of variable</td>
</tr>
<tr>
<td>Firm size</td>
</tr>
<tr>
<td>Firm growth</td>
</tr>
<tr>
<td>Financial leverage</td>
</tr>
</tbody>
</table>

Data analysis

This paper uses combined data to test the hypotheses. In this method, time series data (years under investigation) and cross-section (the surveyed companies) are combined to each other. Combined data is further used due to increasing number of observations, enhancing the degree of freedom, reducing variance heterogeneity and studying dynamic changes. In order to efficiently estimate a regression model using combined data, one of the common effects, fixed effects and random-effects models are selected using appropriate tests. Tests used to select one of the top models are F Limer test for choosing between models of common effects and fixed effects, if you select the fixed effects model, the Housman test will be used to choose between fixed effects and random effects models. Autocorrelation will be reviewed except disturbing the model, the heterogeneity of variance and normality of the data. To illustrate the explanatory power of the explanatory variables, coefficient of adjusted determination (Adjusted R²) will be used, to evaluate being significant variables, t-statistics and to assess the overall adequacy of the model, Fisher statistical. The statistical analysis will be performed using EXCEL and EVIEWS software.
RESULTS

Descriptive statistic

Table 2. Description of statistical data.

<table>
<thead>
<tr>
<th>Name of variable</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Average</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm value</td>
<td>9.27</td>
<td>17.12</td>
<td>12.66</td>
<td>4.25</td>
</tr>
<tr>
<td>Corporate governance ratings</td>
<td>0.81</td>
<td>3.31</td>
<td>2.34</td>
<td>0.74</td>
</tr>
<tr>
<td>Reporting quality</td>
<td>-0.35</td>
<td>0.06</td>
<td>-0.09</td>
<td>0.46</td>
</tr>
<tr>
<td>Firm size</td>
<td>7.42</td>
<td>25.62</td>
<td>13.02</td>
<td>0.69</td>
</tr>
<tr>
<td>Firm growth</td>
<td>0.06</td>
<td>0.23</td>
<td>0.11</td>
<td>0.19</td>
</tr>
<tr>
<td>Financial leverage</td>
<td>0.09</td>
<td>0.72</td>
<td>0.32</td>
<td>0.26</td>
</tr>
</tbody>
</table>

Evaluation of variance heterogeneity

To investigate the variance heterogeneity, disturbing statements of Arch test LM has been performed. Results of the variance heterogeneity of Arch test LM are as follows:

Table 3. Test results of Arch heterogeneity LM in the research model.

<table>
<thead>
<tr>
<th>Description</th>
<th>Statistics value</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>F-statistics</td>
<td>1.102296</td>
<td>0.095</td>
</tr>
<tr>
<td>Obs*R-squared</td>
<td>1.221087</td>
<td>0.095</td>
</tr>
</tbody>
</table>

Note that this test statistics is not significant at the 5% level, thus confirming the assumption of homogeneity of variance and rejecting variance heterogeneity of disturbing statements.

Test for significance of fixed effects method

F-statistics test

Table 4. Results of F-statistics test.

<table>
<thead>
<tr>
<th>Description</th>
<th>Statistics value</th>
<th>Freedom degree</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-section F</td>
<td>1.962154</td>
<td>74</td>
<td>0.005*</td>
</tr>
<tr>
<td>Cross-section Chi-square</td>
<td>139.102596</td>
<td>74</td>
<td>0.011*</td>
</tr>
</tbody>
</table>

\*5% error level

Housman test

Table 5. Housman test results.

<table>
<thead>
<tr>
<th>Description</th>
<th>Statistics value</th>
<th>Freedom degree</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-section F</td>
<td>6.326505</td>
<td>9</td>
<td>0.018*</td>
</tr>
</tbody>
</table>

\*5% error level

According to the results of two tests performed (F and Housman), the probability is less than 5 percent for both tests, and therefore it should use the fixed effects method in the relevant regression model.

Testing hypotheses

Table 6. Regression testing hypotheses.

<table>
<thead>
<tr>
<th>Name of variable</th>
<th>B</th>
<th>S.E</th>
<th>t</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed</td>
<td>0.335</td>
<td>0.147</td>
<td>2.136</td>
<td>0.009*</td>
</tr>
<tr>
<td>Corporate governance ratings</td>
<td>0.421</td>
<td>0.269</td>
<td>2.302</td>
<td>0.001*</td>
</tr>
<tr>
<td>Reporting quality</td>
<td>0.019</td>
<td>0.625</td>
<td>2.015</td>
<td>0.012*</td>
</tr>
<tr>
<td>Firm size</td>
<td>0.165</td>
<td>0.059</td>
<td>1.925</td>
<td>0.019*</td>
</tr>
<tr>
<td>Firm growth</td>
<td>0.251</td>
<td>0.421</td>
<td>2.248</td>
<td>0.003*</td>
</tr>
<tr>
<td>Financial leverage</td>
<td>-0.075</td>
<td>0.248</td>
<td>-1.266</td>
<td>0.066</td>
</tr>
</tbody>
</table>

\*5% error level
Table 7. Capability of explanation and significance of the entire model.

<table>
<thead>
<tr>
<th>R determination coefficient</th>
<th>Adjusted determination coefficient</th>
<th>DW</th>
<th>F</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.624</td>
<td>0.615</td>
<td>1.633</td>
<td>6.265</td>
<td>0.000&quot;</td>
</tr>
</tbody>
</table>

" 1% error level

According to Table 1-6, because the statistics value of the Watson-Camera test is interval from 1.5 to 2.5, the hypothesis for lack of correlation between the errors cannot be rejected and regression can be used. Given the significant amount of F-test (6.265) at the error level smaller than 0.01, we can conclude that the regression model combined of independent, dependent and control variables is an appropriate model and a total independent and control variables are able to explain changes in firm value. The coefficient of adjusted determination is equal to 0.615, suggesting that 61.5% of total changes in the research dependent variables is related to independent and control variables of the model. Considering the significant level of t-statistics, corporate governance ratings variables and the quality of reporting in 5% error level, it can be in 95% confidence level that corporate governance ratings and the quality of reporting impact on companies’ value listed in Tehran Stock Exchange.

CONCLUSION

The purpose of this study was to evaluate impact of the corporate governance ratings and the quality of reporting on the companies’ value listed in Tehran Stock Exchange. The results show that the corporate governance ratings and quality of reporting affect significantly on the companies’ value listed in Tehran Stock Exchange. This finding is consistent with finding of Hassasyeganeh and Alizadeh (2006), Mehrazin, Zendedel and Daman (2006) and Verchia, Firth, Gao, Oliver & Rui (2001). According to research findings, it is recommended to investors in the stock market to pay attention seriously to the quality of reporting or providing information when buying stocks of companies. According to the results, increasing the quality of reporting in companies could result in increasing value to the companies and thereby increasing shareholders’ returns.

REFERENCES


Nouravesh A, Ebrahimi Kordlor A, 2005. Investigating and explaining the relationship of shareholders with...


