The Impact of Corporate Governance Mechanisms on the Profit Timeliness

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Abstract

The aim of this study is to investigate the impact of corporate governance mechanisms on timeliness of profit in the listed companies in Tehran Stock Exchange. Timeliness of profit has been considered as a qualitative feature and a symbol of change in the stock market value and the ownership structure (concentration of ownership, type of ownership of the largest shareholders) and the independence of the board members have been considered as the corporate governance mechanism. Testing of the research hypotheses has been performed with the approach of analyzing the panel data using a sample including 80 companies listed in Tehran Stock Exchange between the years of 2006 and 2013. The results of the study indicate that there is a significant and positive relationship between concentration of ownership and timeliness of profit. In other words, as the concentration of ownership increases, the accounting profit of the companies is more timely; and also there is a negative significant relationship between the independence of the board members and the timeliness of profit and there was no relationship between the governmental ownership and the timeliness of profit.

Keywords: timeliness of profit, corporate governance, concentration of ownership, board independence, governmental ownership.
1. Introduction

The net profit is one of the most important items of accounting information and it has features such as timeliness in order to be useful in investors’ decision making (Ebrahimi Kordlor & Shahriari, 2009). In addition to the importance of the reported profit figure for the investors and its impact on their decisions, as one of the aspects of the profit information, the qualitative features of the profit are certainly paid attention to by the investors (Kordestani & Khalili, 2011). Timely disclosure of the profit information can lead to decrease in asymmetry of the information (Lang & Lundholm, 1999) and prevent from the possible opportunities of dealing using the confidential information and inappropriate allocation of the company’s assets by the manager (Leventis and Weetman, 2004); it can decrease the likelihood of the abuse of managers through certain accessing to the domestic information about the company’s activity (Scott, 1997) and finally it can decrease the capital cost of the company (Euromoney Institutional Investor PLC publication, 2001). Thus, the timely disclosure can decrease the large sums of profit in each period and in the contrary, decrease the management credit and decrease the volatility of the stock price.

Today, the modern stock companies have a various set of owners and the ownership duty and company control duty have been distinguished from each other in these companies and this has been delegated to the professional managers. The key issue in this condition is to ensure that the managers perform regarded to the interest of the stockholders (Jensen & Meckling, 1976). The corporate governance has been again posed as one of the discussions of business from the beginning of the twenty first century and after the collapse of great companies such as Enron (the largest company in the world’s energy section) and WorldCom (the greatest telecommunication company in the world). The basic principles of the corporate governance emphasized on the issue of the companies’ strategies and the shareholders’ rights; then, with newer views, this emphasis biased to paying serious attention to the stakeholders and society. In recent years, the matter of the corporate governance has been developed so much in the world and the pioneer countries in this field are still improving their corporate governance system and in this regard, they pay a certain attention to the participants in the corporate governance and fields including: the stockholders and their relationships, accountability, improvement of the board performance, auditors and the accounting systems and domestic control (Hasas Yegane, 2006). Regarded to the above, in this study, we will investigate the impact of the corporate governance mechanisms on the timeliness of reporting profit information (due to the delay in the reporting process and also the speed of exploring stock price). Also in this study we will investigate the characteristics of the major shareholders regarded to the fact that probably they have corporate purposes, power and different accessibility to the financial resources. In this regard the supposition is posed that the timeliness of profit information is different depend on who is the major stockholder of the
company. Thus, the current study is intended to find an answer to this question “do the corporate governance mechanisms influence the timeliness of the profit information?”

2. Theoretical Principles and Research Background

The board is from the internal mechanisms of corporate governance majorly influencing the performance of the company and observance of the rights of corporation stakeholders. The board of the companies plays a very crucial role in monitoring the way of managing the company in order to achieve the set goals and directing the executive management to the extent that in some cases, the appropriate corporate governance is measured by the composition and performance of the board. In addition to the strategic directing of the company, the board has an important responsibility in monitoring the managerial performance and achievement of the suitable income for the stockholders, observing the rules and also preventing from the conflicts in interests and balancing the conflicting demands from the company. The sixth principle of the corporate governance of the Organization for Economic Co-operation and Development (2004) necessitates the board to do the duty of trusteeship which includes two main elements of the carefulness duty and loyalty duty. The professional care duty requires the board to fulfill their obligations based on the full information and with good faith and enough diligent and care. Also the loyalty duty has a special significance due to the emphasis on the efficient implementation of the other principles of corporate governance about the similar behavior with the stockholders, monitoring the interactions of the dependent people and adjusting the wage policy of the main executive managers and the board members.

Ownership concentration lets the stockholders directly care about their interests, but the theories and results of the researches existing in this field evaluate the relationship between the ownership concentration and the performance of the institute positive, negative or with no statistical importance due to different attitudes or intellectual principles. In one hand, the ownership concentration can be positive because with the increase in ownership of the investor, more investors get interested in monitoring the managerial decisions. On the other hand, it can be negative because when there is a high level of concentration, it can refer to the less developed investment market and the control can be ineffective as a regulation mechanism. Moreover, the percentage of the ownership of some of the investors has been followed by the advantage of the reduction of the number of stockholders and perhaps it leads to the financial and commercial relationships which are in the interest of the main shareholders. Otherwise, it is in the contrary of the company which controls it (Minguez, Vera & Ugedo, 2007). The other subject in the impact of the ownership structure as a control mechanism is the feature of the main stockholder. There are many studies about the control role of the governmental, institutional and individual investors. Some of the studies in the field of the type of ownership indicate the improvement in the value of institutions which have changed the type of their ownership or attempted for
privatization. Difference in monitoring and managerial motivations, political goals and social commitments lead to expectation of the lower performance of these units compared to the similar institution (Boubakri & Gueshami, 2005). Shleifer & Vishny (1986) stated that the investors of a great organization positively influenced the value of company due to increase in efficient monitoring (Minguez, Vera and Ugedo, 2007). The following hypotheses have been posed and tested in order to achieve the main goal of this study:

H1: the corporate governance mechanisms influence the timeliness of the profit.

Regarded to the fact that the corporate governance mechanisms do not just include one item and this item includes three criteria of the ownership concentration, governmental ownership and the independence of the board, so, the main hypothesis of the study has been measured by the three following sub-hypotheses:

H11: ownership concentration influences the timeliness of the profit.
H12: governmental ownership influences the timeliness of the profit.
H13: the independence of board influences the timeliness of the profit.

2-1. A Review on the Research Background

Vafeas (2000) have investigated the relationship between the corporate governance and stock income. In this study, the proportion of the non-stipendiary managers of the board and the size of the board has been investigated as the corporate governance mechanisms. The results of the study indicated that the composition of the board is not usually in relationship with the helpfulness and awareness of the profit. Even the proportion of the independent managers of board did not have any relationship with the informational content of the profit. But investors consider the profit informational content of the companies with smaller board more. In a study, Anderson et al. (2003) found out that the profit informational content has a negative relationship with the dual-responsibility of the manger and a positive relationship with the board independence. Dey (2005) in a study found that the dual responsibility of the manager is negatively in relationship with the reliability of the reported profits. If the dual responsibility of the manger decreases monitoring of management, it can also reduce the profit informational content.

With examining 273 Chinese companies with personal and governmental ownership, Ding, Hua and Junxi (2007) got to the result that there is a U form (∪) nonlinear relationship between the profit management and the ownership structure in the way that the companies with personal ownership tend to maximize their accounting profit very much. On the other hand, pursuit of the self-interests by the major owners (the majority) or in other words, the impact of the ownership concentration on the profit management in the companies with personal ownership is lesser than the companies with governmental ownership. In a study, Wang (2010) investigated
the relationship between the timeliness of profit and the capital raise through the issuance of new shares. His study was based on the theory that the share price will drop when divestiture of shares and one of the reasons for this reduction was stated the informational asymmetry between the managers and investors. He got to the result that in companies with more timely profit, the share price lesser drops due to the lesser informational asymmetry. Arosa et al. (2010) did a study in the non-listed companies in Spain under the title of *the ownership structure and the company performance*; the results indicated that the ownership concentration did not directly influence the investors’ behavior. Their results for the family companies showed that depended on what generation manages the company the relationship between the ownership concentration and the company’s performance is different.

Dimitropoulos & Asteriou (2010) investigated the impact of the size and composition of the board on the profit’s informational content and quality. Data analysis indicated that the informational content of accounting profit is directly in relationship with the proportion of the non-stipendiary board members but it has no relationship with the size of board. Moreover, findings showed that the companies with more proportion of the non-stipendiary board members act more conservatively when reporting bad news but do not delay when identifying good news. In a study, Ruiz Mallorqui and Santana Martin (2011) analyzed the impact of controlling with the major institutional owners (banking organizations and investment mutual funds) on the company value. The results indicated that when a bank is the major stockholder, there is a negative relationship between the owner’s rights to vote with the company value. This relationship was positive for the investment mutual funds. Moreover, the results showed that when a major institutional ownership controls the company, the presence of the other major stockholders influences the company value.

In a study, Lim, Hu and Verhoeven (2013) analyzed the impact of the ownership concentration and the major shareholder’s personality on the timeliness of providing company’s profit which is calculated according to the timing criterion based on the share price and delay in reporting. They got to the result that there is a nonlinear relationship between the ownership concentration and delay in reporting; but this relationship is not observed for the timeliness of exploring the share price. In their study, Saeidi, Bazaz and Liu (2014) investigated the impact of government’s ownership and its institutional motivations on the companies’ profit quality using a sample company in China between the years of 1988 to 2005 on the governmental and nongovernmental listed companies. The results of this study indicate that the Chinese government uses ownership leverage as its control on the governmental companies and there is a negative and significant relationship between the governmental type ownership and the profit quality.
3. Research Methodology

This study is from the type of applicable researches. It is non-interventional in terms of implementation method. Since the current research investigates the relationship of the research’s variables in normal form without manipulation, it is from the type of correlation researches. Finally, it is a cross-sectional study in terms of time period of data collection due to the fact that it studies the subject of outsourcing in company in a certain time period. The statistical society of the current study is the listed company in Tehran Stock Exchange from the beginning of 1385 to the end of 1392 (solar year) (2006 to 2013) for eight years. Also in the current study, we have not used certain relationship or model for estimating sample volume and sampling to determine the statistical sample; but the systematic elimination method has been used which is used in most of the conventional accounting and financial management researches. With investigating the listed companies in Tehran Stock Exchange and applying conditions and restrictions, 80 companies were selected in order to estimate models and test the research’s hypotheses. The measuring way of each of the variables of the study and the model of testing the hypotheses are as follows:

Dependent variable

Timeliness of profit: as a qualitative feature, timeliness of profit is based on the idea that the accounting profit is intended to measure the economic profit which is defined as the change in stock market value. Also in this study is has been tried to use the following model of Francis et al. (2004) to assess the feature of timeliness of profit:

Model (1)

\[
\text{Timeliness}_{it} = \beta_{0,i} + \beta_{1,i} \text{NEG}_{it} + \beta_{2,i} \text{RET}_{it} + \beta_{3,i} \text{NEG}_{it} \times \text{RET}_{it} + \epsilon_{it}
\]

Which its components include:
- \(\text{Timeliness}_{it}\) = profit before the unusual items of the company \(i\) in the year \(t\)
- \(\text{RET}_{it}\) = average return of the company \(i\) in the year \(t\) (real return)

The real return of some periods before an investment is the geometric average of a few periods before it (the period is the same selected period).

\[
\text{Real return} = \left( \sqrt[n]{1 + \frac{r_1}{100}} \left( 1 + \frac{r_2}{100} \right) \left( 1 + \frac{r_3}{100} \right) \cdots \left( 1 + \frac{r_n}{100} \right) - 1 \right) \times 100
\]

\(\text{NEG}_{it}\) = negative return index equals to 1 if \(\text{RET} < 0\), otherwise it equals to 0.
Independent variable

The independent variables of this study are as following:
Largest Shareholding: ownership concentration: it is calculated regarded to the criterion of the largest shareholder and the percentage of his share.
Owner Type: it is the character of the largest shareholder which is equal to 1 if this shareholder is governmental and in case that he is nongovernmental it equals to 0.
OutDir: board’s independence: it is calculated by the proportion of the non-stipendiary embers to all board members.

Control variables

Size: the company size: the company size variable is calculated regarded to the normal logarithm of the company’s stock market value.
Leverage: the leverage variable is calculated by dividing the sum of debts in the sum of properties.
Bad News: in case that the change in annual earning of the company’s profit is negative, bad news has the value of 1; otherwise, it is equal to 0.
Growth Rate (Book-to-Mkt): it is the normal logarithm of the proportion of the current year sale to the last year sale.
Specific Risk (Volatility):
\[ \text{Risk} = \sqrt{\frac{1}{n-1} \sum_{i=0}^{n} (r_i - E(r))^2} \]
Nonsystematic risk is the risk of the drastically changes of the stock return in last periods which equals to its standard deviation.

Research Model

We will use regression model of the table of clustered impacts in the level of companies to predict the relationships between the independent variables and the information reporting timeliness. The model of this investigation is as following:

Model (2)
\[ \text{Timeliness}_{it} = \alpha + \beta_1 \text{LargestShareholding}_{it} + \beta_2 \text{OwnerType}_{it} + \beta_3 \text{OutDir}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{Leverage}_{it} + \beta_6 \text{BadNews}_{it} + \beta_7 \text{Book to Mkt}_{it} + \beta_8 \text{Volatility}_{it} + e_{it} \]
Which its components include:
\( \text{Timeliness}_{it} = \) profit before the unusual items of the company \( i \) in the year \( t \)
Largest Shareholding: ownership concentration
Owner Type
OutDir: board’s independence
Size: the company size
Leverage
BadNews: bad news
Book-to-Mkt: growth rate
Volatility: specific Risk

4. Research’s Findings
4-1. F Limer Test

First, we need to do the necessary statistical tests to determine the type of data. To this end, first we use F Limer test to determine if the data is cross-sectional or on panel. The results of F Limer test are shown in table (1) for each of the study’s models. The possibility value related to this statistic for the first model is lower than 0.05; thus, the null hypothesis based on the complication of data is rejected. Also the possibility value of statistic of F Limer test for the second model is lower than 0.05 and this indicates rejection of the hypothesis based on the data complication use and also is the indicator of panel data.

<table>
<thead>
<tr>
<th>Model</th>
<th>Statistic possibility</th>
<th>Statistic</th>
<th>Test type</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>0.0154</td>
<td>12.27</td>
<td>F Limer</td>
<td>Panel method</td>
</tr>
<tr>
<td>Second</td>
<td>0.0485</td>
<td>3.44</td>
<td>F Limer</td>
<td>Panel method</td>
</tr>
</tbody>
</table>

4-2. Hausman Test

Regarded to the F Limer test, Hausman test is required to be done to determine the type of panel data. As it is seen in table (2), the result of Hausman test for the first model indicates that it is panel data with constant effects. The possibility value related to this statistic is lower than 5 percent; so, the first model of research is estimated based on the panel data approach with constant effects. Also the result of Hausman test for the second model indicates that data is from the kind of constant effects; the possibility value related to the statistic of Hausman test has been indicated to two decimal digits which is lower than 5 percent.

<table>
<thead>
<tr>
<th>Model</th>
<th>Statistic possibility</th>
<th>Statistic</th>
<th>Test type</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>0.0168</td>
<td>17.08</td>
<td>Hausman</td>
<td>Panel method with fixed effects</td>
</tr>
<tr>
<td>Second</td>
<td>0.0106</td>
<td>18.31</td>
<td>Hausman</td>
<td>Panel method with fixed effects</td>
</tr>
</tbody>
</table>
4-3. The results of estimation of the first model of study

According to the results of F Limer and Hausman tests, the first model of the study was estimated based on panel data approach with constant effects. The results obtained from estimation of the first model of the study are shown in table (3). F value of regression which is the indicator of explanatory power of the model is lower than 0.01 for this model of statistic possibility; so, it can be said that this model is validated and significant in the confidence level of 99%. Also observing the statistic value of Durbin-Watson (2.4279) confirms that there is no disruption of self-correlation among the components, because this value locates between 1.5 and 2.5. Also, in table (3) the adjusted determination coefficient which indicates the percentage of total changes in the dependent variable explained by the regression equals to 0.82.

Table 3: results related to estimation of the first model

<table>
<thead>
<tr>
<th>Variable</th>
<th>P Value</th>
<th>T test</th>
<th>Standard error</th>
<th>Estimated coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>0.002</td>
<td>3.170</td>
<td>0.063</td>
<td>3.01</td>
</tr>
<tr>
<td>RET</td>
<td>0.283</td>
<td>1.075</td>
<td>0.057</td>
<td>9.158</td>
</tr>
<tr>
<td>NEG</td>
<td>0.453</td>
<td>0.751</td>
<td>0.041</td>
<td>3.300</td>
</tr>
<tr>
<td>RET*NEG</td>
<td>0.775</td>
<td>0.286</td>
<td>0.015</td>
<td>8.536</td>
</tr>
<tr>
<td>Number of observations</td>
<td>Durbin-Watson test</td>
<td>Significance of f statistic</td>
<td>Determination coefficient</td>
<td>Adjusted determination coefficient</td>
</tr>
<tr>
<td>80</td>
<td>2.4279</td>
<td>0.0000</td>
<td>0.83</td>
<td>0.82</td>
</tr>
</tbody>
</table>

4-4. The results of estimation of the second model of study

According to the results of F Limer and Hausman tests, the second model of the study was estimated based on panel data approach with fixed effects. The results obtained from estimation of the first model of the study are shown in table (4). F value of regression is the indicator of explanatory power of the model; regarded to the fact that the possibility of F statistic is lower than 0.01, so, it can be said that this model is validated and significant in the confidence level of 99%. Also observing the statistic value of Durbin-Watson (2.093) indicates that there is no disruption of self-correlation among the components (considering that this value locates between 1.5 and 2.5 which indicates the lack of self-correlation). Also, the adjusted determination coefficient is equal to 0.27.
Table 4: results related to estimation of the second model

<table>
<thead>
<tr>
<th>P Value</th>
<th>T test</th>
<th>Standard error</th>
<th>Adjusted coefficient</th>
<th>Variable name</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.005</td>
<td>-2.846</td>
<td>4.77</td>
<td>-13.572</td>
<td>Constant</td>
</tr>
<tr>
<td>0.006</td>
<td>2.774</td>
<td>0.12</td>
<td>0.032</td>
<td>The largest shareholder</td>
</tr>
<tr>
<td>0.860</td>
<td>-0.176</td>
<td>0.559</td>
<td>-0.099</td>
<td>Owner type</td>
</tr>
<tr>
<td>0.195</td>
<td>-1.299</td>
<td>1.213</td>
<td>-1.575</td>
<td>Board’s independence</td>
</tr>
<tr>
<td>0.000</td>
<td>3.607</td>
<td>0.391</td>
<td>1.410</td>
<td>Company size</td>
</tr>
<tr>
<td>0.000</td>
<td>-4.846</td>
<td>1.210</td>
<td>-5.856</td>
<td>Leverage</td>
</tr>
<tr>
<td>0.686</td>
<td>-0.404</td>
<td>0.522</td>
<td>-0.211</td>
<td>Bad News</td>
</tr>
<tr>
<td>0.677</td>
<td>0.416</td>
<td>2.016</td>
<td>0.839</td>
<td>Growth Rate</td>
</tr>
<tr>
<td>0.000</td>
<td>13.854</td>
<td>0.013</td>
<td>0.175</td>
<td>Systematic Risk</td>
</tr>
<tr>
<td>0.0000</td>
<td>Significance of f statistic</td>
<td>Determination coefficient: 0.28</td>
<td>Adjusted determination coefficient: 0.27</td>
<td></td>
</tr>
<tr>
<td>17.05</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>80</td>
<td>Number of observations</td>
<td>2.093</td>
<td></td>
<td>Durbin-Watson test</td>
</tr>
</tbody>
</table>

Discussion and Conclusion

The corporate governance mechanisms do not just include one item. It includes three criteria of the ownership concentration, governmental ownership and the independence of the board. We investigated the three sub-hypotheses. Given that the corporate governance is measured by the largest shareholder and ownership concentration and board independence, and the p value is lower than the error level of 5% in the estimation of the research’s model for ownership concentration but it is higher than 5% error level for the two other mechanisms, the main hypothesis of the study was not confirmed. In the first sub-hypothesis, the p value is lower than the significance level of 0.05 with the possibility of 95%. Hence, H0 is rejected and it can be concluded that there is a significant relationship between ownership concentration and timeliness of profit. Also the results indicate that there is a significant and positive relationship between the ownership concentration and timeliness of profit. In other words, as the ownership concentration increases, the accounting profit of the companies gets on-time. The coefficient of
the ownership concentration variable indicates that in the listed companies in stock exchange market, as the ownership is exclusively restricted to minimum number of shareholders the profit quality increases and the profit has timeliness feature. According to these results it can be said that one of the factors influencing profit quality or in other words profit timeliness is the ownership concentration for the company owners. The results of this hypothesis are consistent with the research of Sabz Ali Pour et al. (2012).

In the second sub-hypothesis, the p value is higher than the significance level of 0.05 with the possibility of 95%. Hence, H0 is not rejected and it can be concluded that there is no significant relationship between governmental ownership and profit timeliness. The results of this hypothesis are consistent with the second hypothesis of research of Sabz Ali Pour et al. (2012). In the third sub-hypothesis the p value is higher than the significance level of 0.05 with the possibility of 95%. Hence, H0 is not rejected and it can be concluded that there is no significant relationship between board’s independence and profit timeliness. The results of this hypothesis are consistent with the research of Sabz Ali Pour et al. (2012). In relation with the control variables of the study, the results showed that there is a significant relationship between the company size and profit timeliness. For the financial leverage, the p value is lower than the significance level of 0.05 with the possibility of 95%. Also the t test for this variable is 4.846 indicating the significant but negative relationship between the financial leverage and profit timeliness. For the variable of bad news, the p value is higher than the significance level of 0.05 with the possibility of 95%. Hence, the H0 is not rejected and it can be concluded that there is no significant relationship between bad news and profit timeliness. Also for the growth rate variable, the p value is higher than the significance level of 0.05 with the possibility of 95%. Hence, the H0 is not rejected and it can be concluded that there is no significant relationship between growth rate and profit timeliness. Finally, for the systematic risk variable, the p value is lower than the significance level of 0.05 with the possibility of 95%. Also the t test for this variable is 13.854 indicating the positive and significant relationship between the systematic risk and profit timeliness.
Research Suggestions

The results of the first hypothesis of the study indicated that ownership concentration is directly in relationship with the profit timeliness in listed companies in Tehran Stock Exchange; thus, it is suggested to the shareholders to pay attention to the ownership structure of the stock market companies and then by the shares of companies which their management and ownership have concentration in order to have timely united profit and will not lose their properties. The results of the second hypothesis indicated the lack of existence of significant relationship between the governmental ownership and profit timeliness in companies listed in Stock Exchange; thus, it is suggested to the stockholders that there is no need of paying attention to the governmental or nongovernmental ownership of the companies when buying their stocks, because it is indifferent to consider this element; instead, the can pay attention to the other corporate governance elements and mechanisms regarded to the results of the first and third hypotheses which are real samples of an experimental research including board’s independence and ownership concentration.
References


