Investigation of the Relationship between Corporate Governance and Information Disclosure of Risk Management in Banks Operating in the Capital Market in Iran

Matin Pirayesh Rad¹, Mahboubeh Jaffari²,*

¹Department of Accounting, Damghan Branch, Islamic Azad University, Damghan, Iran
²Department of Accounting, South Tehran Branch, Islamic Azad University, Tehran, Iran

ABSTRACT

Appropriate system of corporate governance provides the timely disclosure and reporting by companies. The objective of corporate governance system is to ensure the non-occurrence of opportunistic behavior realized by reducing representative problems and the potential asymmetric information between the agent (manager) and different stakeholders different (shareholders, creditors, etc.). This study examines the relationship between corporate governance indicators and risk management of disclosure of financial information on 18 private banks listed in the Tehran Stock Exchange from 2007 to 2013. To extract the risk management of disclosure of financial information, exploratory factor analysis was used, and to explain the relationship between corporate governance criteria and index of risk management of disclosure of financial information, panel data regression analysis (panel data) was used. Results of F-Limer and Hausman test results determine the estimation of fixed effects model. The estimation results indicate the positive and significant effect of managerial ownership, ownership of major shareholders and the internal auditor on the risk management of disclosure of financial information. In addition, the results of model estimation indicate a significant negative effect of the existence of state ownership and board composition on risk management of disclosure of financial information in the selected banks.

KEYWORDS
corporate governance, information disclosure, risk management, capital market

INTRODUCTION

The core of representative theory is that managers, as representatives of the shareholders, may act or make such decisions that necessarily would not maximize shareholder wealth. According to this theory, controlling or monitoring mechanism should be established to protect shareholders from conflict of interests. Transparency and voluntary disclosure of financial statements have been considered as a feasible solution. Disclosure of accounting information has long been considered as one of the most important issues by researchers, and it is considered as final product is an accounting system. In fact, the ultimate goal of accounting system is to provide information for beneficiaries in the form of internal and external reports. The terms disclosure suggests a various set of mandatory and voluntary information, including financial statements and notes, reports of board of directors, management analysis, management predictions, and presentation of analysis. Enhancing the information disclosure will improve transparency that is one of the best goals of global developments and major initiatives in the process of reforming the corporate governance in different countries. For many theorists in the field of accounting and economics, information is a key factor in the efficiency of resource allocation and economic growth of countries. Therefore, the governing role of accounting information means using reported information in controlling mechanisms that provide improvement conditions of corporate governance. Corporate governance also involves a set of relationships between shareholders, directors, auditors, and other beneficiaries ensuring the establishment of controlling or monitoring system to observe the rights of minority shareholders and correct implementation of the decisions of the assembly and preventing malicious uses. One of the main tasks of corporate governance is ensuring the quality of financial reporting process.

*Corresponding Author: Mahboubeh Jaffari
E-mail r:
Telephone Number r:
Fax. Number r:
**REVIEW OF LITERATURE**

**Corporate governance:**
To achieve a comprehensive definition of corporate governance system, it is required study the planning and development process of this concept. The literature review shows that there is no agreed definition of corporate governance. There are significant differences in definition, depending on the country being studied. Definitions of corporate governance are placed on a spectrum in which limited views and perspectives are placed on one side of spectrum and expanded views are on the other side. In limited views, corporate governance is limited to relationship between company and stakeholders. This is an old and traditional model expressed within a representative theory. At the other end of the spectrum, corporate governance can be seen not only as a network of relationships between companies and their owners (shareholders), but also between a company and a large number of beneficiaries, including employees, customers, dealers, bondholders, etc. Such a view is seen in the form of beneficiary theory (Hassas Yeghaneh, 2006, p. 101).

International Federation of Accountants (IFAC), 2004
- Corporate governance is a set of responsibilities and practices used by board and directors to determine strategic direction that guarantees the achievement of objectives, control risk appropriately, and use resources properly responsibly.

Parkinson, 1994
- Corporate governance is the process of monitoring and control to ensure that the company comply acts in accordance with the interests of shareholders.

Manual of corporate governance, Great Britain, 1996
- Relationship between shareholders and their companies and the method by which shareholders encourage the managers to the best performance (for example, by voting at general meetings and regular meetings with senior managers).

Keasyi and Right, 2014
- Corporate governance does not deal with management of the company's operations, but it deals with guiding the business enterprises, monitoring and controlling the company's executives actions, and their accountability to all beneficiaries (Hassas Yeghaneh, 2005, p. 32).

In general, the definitions of corporate governance in the scientific literature have certain common features that one of them is accountability. Limited definitions of corporate governance focus on the legal system of a country's ability to protect the rights of minority shareholders. These definitions are appropriate for comparison between countries and laws of each country has decisive role in the corporate governance system.

Empirical research (Salmon and Salmon, 2004) support the view that financial performance has a positive relationship with the exercise of right of their corporate ownership and better managers lead to better corporate governance and pay attention on their beneficiaries. In addition, better managers control and monitor companies better, and they produce higher financial efficiency. Critics of this view believe that corporate governance with a focus on beneficiaries is an ethical issue. In the real world, it is unlikely that traders and investors to be interested in ethical actions, unless they gain a good financial returns (Hassas Yeghaneh, 2005, p. 103).

**Representative Theory:**
Initiating of corporate governance through equity ownership has great impact on corporate control and thus owners delegate handling of company for managers. The separation of ownership from management led to known organizational problems, called as "representative problem". Berle and Means (1923), Ross (1973) and Prais (1976) studied and investigated this issue from different angles, and eventually Jensen and Mac Ling (1976) raised the foundations of the theory of representative. They defined managers of companies as brokers and stakeholders as server. In other words, the everyday decisions of company are delegated to managers who are brokers of stakeholders. The problem that arises here is that brokers do not necessarily decide in favor of the server. One of the main assumptions of representative theory is that the server and brokers have conflict interests. In financial theories, one underlying assumption is that the primary objective is to increase shareholder wealth, but it is not the case in practice. It is likely that managers prefer their own interests, such as obtaining the maximum reward. Managers are likely interested in personal profit. This leads into investments in projects that have short-term profits, especially in those cases that they are related with incomes, benefits, and rewards of managers. An important question is: how can shareholders control the company's management? One another underlying assumption of representative theory is that the confirmation of the brokers' actions is very difficult and costly for server.

There are several ways to coordinate and harmonize the interests of shareholders and managers. Experience has shown that one of the most effective ways is independent audit.

In short, some direct methods through which stakeholders can control managers and help to resolve conflicts are as follows:

- the right to vote by stakeholders in public assemblies has impact on handling and management of company. This voting right is an important part of financial assets of stakeholder. One use of this right is to vote to change managers. This issue is a disciplinary tool for managers.
- signing contracts between shareholders and managers is also one of the solutions. one final solution is withdrawal solution. It is clear that the withdrawal of main shareholder will be a great concern for actors of capital market, and investors are worried about a sharp drop in prices and...
by selling their shares, they will cause a sharp decline in the stock price, therefore, the interests of managers will be affected (ibid, p. 11). Therefore, if the market mechanism and the ability of shareholders to control the management and monitoring the behavior of managers are not enough, there will be a need to some sort of regulation or official guidelines. Indeed, if the markets are quite efficient in which companies can do financing, superficial measures aimed at reforming the corporate governance will be superfluous. However, evidence suggests that capital markets are not completely efficient. Therefore, to promote and enhance the corporate governance and increase the accountability of managers to shareholders, intervention is required. Representative problems between managers and shareholders are around the world and government intervenes in this issue by providing political documents and rules of corporate governance for the best performance (ibid, p. 11).

**Transaction cost theory:**

Transaction cost theory is an interdisciplinary combination of economics, law and organization (Williamson, 1996). The theory that was developed Cyert and March (1963) for the first time is known as behavioral theory, and it is one of the foundations of industrial economics and financial theory. In this theory, company is not only as a public entity, but it is as an organization, composed of people with different views and goals. Transaction cost theory is based on fact that companies have become so big and complex that they are leading and guiding the price fluctuations in market and balance the transactions market. Some transactions are eliminated within the companies and manager coordinates the production. It seems that the organizing of company (for example, vertical merging) determines some domains that beyond them company can regulate prices and production for domestic transactions (Hassas Yeghaneh, 2005, p. 107).

**Beneficiary theory:**

The beneficiary theory was developed gradually since 1970. One of the first explanations about this theory was presented by "Freeman" (1984) in management field. He presented a general theory of company and proposed company accountability to a wide range of beneficiaries. Since then, further literature has been raised on the subject (Hassas Yeghaneh, 1384, p. 13). Beneficiary theory is combination of organizational social theories. Beneficiary theory states that companies have become so large and their impact on society is so deep that in addition to the beneficiaries, we should consider greater parts of the society and they should be accountable. Not only beneficiaries are affected by companies, but they also affect companies. Beneficiaries include stakeholders, employees, vendors, customers, and creditors, nearby businesses and the public. The most radical supporters of the theory of beneficiaries believe that environment, animal species and future generations should be included among the beneficiaries. Beneficiary relationship has been described as an exchange (interaction) and beneficiaries groups have helped in the progress of companies, and is expected that their interests to be realized through encourage and creation of motivation. In Great Britain in 1975, corporate report proposed an accounting plan, showing that companies should be responsible for the effect that they impose on large group of stakeholders. The way to achieve this is to encourage companies to voluntary disclosure of reports for beneficiaries use, in addition to the traditional income statement and balance sheet. Additional statements such as value added statements, monetary transactions statements with the government, foreign exchange statement, futures goals statement, and future possible clients’ statement (ibid, p. 13).

**THE OBJECTIVES OF CORPORATE GOVERNANCE**

Companies believe that good corporate governance facilitates the effective management and control of business units. Therefore, companies are able to provide optimal efficiency for all beneficiaries. Corporate governance objectives are summarized as follows:

- increased shareholder value
- protecting of the interests of shareholders and other beneficiaries, including customers, employees, society, and public as a whole
- ensured transparency and integrity in the exchange of information and access to accurate and transparent information by all accurate and transparent
- ensured accountability regarding performance and achieve to advantages at all levels
- leading the company with the highest standards in order to compete with others (ibid, p. 5)

**Disclosure:**

Qualitative characteristics related to providing information

Some of the most important qualitative characteristics related to providing the information are as follows:

Understandability: in order that providing the financial information to be understandable, it is necessary that items to be merged and classified appropriately. In addition, the ability of users of financial statements should be at the reasonable knowledge of business and economic activities and accounting.

Comparability: to financial statements of a company should be compared with financial statements of previous years, as well as financial statements of similar units. For this purpose, observing the consistency in using the accounting methods and disclosure procedures accounting and comparative figures is required.

**Financial disclosure:**

Information disclosure is to analyze the management, explanatory notes and supplement of statements. It is more general concept of distribution, distribution, and presentation of information. Accountants tend to use narrow concept and they consider disclosure of financial
information about a company as annual financial reporting of these companies. Issues presented in information presented in the balance sheet, income statement and cash flow statements are identifiable and measurable in accordance with the instructions provided. Value of information that must be disclosed depends on the skill of users. Three concepts perceived from disclosure included enough, fair and complete disclosure. The term of disclosure is more than others referring the least amount of disclosed. Fair disclosure refers to moral purpose equal, equal dealing with all potential users regarding to provide all relevant information (Ahmadpur, 2007, 12).

Regarding the disclosure of information, some questions are raised that most important of them include:

- Information disclosed for whom?
- What is the purpose of disclosure?
- What amount of information should be disclosed?

In addition to the aforementioned questions, the questions of how and when financial information should be disclosed are also important, since timely disclose information prevents from ignorance of important events and thereby creates higher trust of financial reports by users. Financial statements are basically provided for the shareholders, other investors, and creditors, but employees, customers, government agencies and others are considered as users of annual reports and explanatory notes, and financial statements.

More investment decisions are related to buying, selling, or holding shares and creditors’ decisions are related to duration and the amount of credit granted to the entity. Shareholders decisions are usually related to employment, continuity or discontinuity management, and approving or rejecting their policies in major changes. The purpose of providing information to employees, customers and others are not specifically formulated, but it is often assumed that useful information for investors and creditors is also useful for others (Asghari, 280,2007- 279).

**REVIEW OF LITERATURE**

Kashani Pour et al. (1392) attempted to examine and test the relationship between voluntary disclosure and corporate governance. In the studied model, mechanisms of corporate governance include the ownership structure and board composition. Ownership structure has been determined by management ownership, major shareholders ownership and state ownership. Voluntary disclosure index is based on previous research conclusions. According to the results, a reduction in the level of managerial ownership and increasing the percentage ownership of major shareholders are associated with an increase in the level of voluntary disclosure. However, no relationship was found between government ownership by voluntary disclosure.

Rahimian et al (2009), in their study entitled “Corporate governance and information asymmetry in the capital market of Iran”, investigated the relationship between corporate governance and information asymmetry in 2004-2007. They concluded that there is negative relationship between mechanisms of corporate governance with bid and sale of shares, but positive relationship with the depth of the market. There is no relationship between internal auditing unit and the ratio of outside board managers and information asymmetry criteria. However, there is negative significant relationship between the percentage of institutional ownership and information asymmetry. Forker (2014) in an article entitled “The corporate governance and quality of disclosure,” argues that the presence of independent managers in the board of the company reduces the prohibiting of management information. Therefore, it provides an incentive to give more information. However, he does not find acceptable empirical evidence to his assumptions. Christopher F. New (2012) in a study called "voluntary disclosure and trading on secret information", showed that the potential information disclosure led to a decline in sales. Christopher F. Noe (2012) in a study entitled as “Voluntary disclosure and trading on the base of secret information”, showed that information disclosure reduces the final information sale. Eng and Mack (2009), in their study entitled “Corporate governance and voluntary disclosure” in Singapore, obtained experimental evidence in which increase in outside managers reduces the level of disclosure of company. In a study conducted by Patelli and Principe in 2007 as "the study of the relationship between the voluntary information disclosure and independent managers in terms of major shareholders in the population prepared from listed companies of Italy" was performed, the results showed positive relationship between independent managers and voluntary disclosure. Baker et al (2009) stated that companies with low levels of management ownership, there is negative relationship between level of management ownership and voluntary disclosure, while there is a negative relationship between ratio of outside of organizations managers and current information disclosure. However, the positive correlation between external Directors and disclosure of information is available.

The results of Miihkinen (2008) showed that the proportion of independent board members in companies increased recommended disclosure.

**First hypothesis:** there is negative relationship between corporate governance and information disclosure of risk management of banks operating in the capital market.

**The second hypothesis:** there is significant relationship between ownership of major shareholders and the disclosure of risk management in banks operating in the capital market of Iran.

**The third hypothesis:** there is significant relationship between state ownership and the disclosure of risk management in banks operating in the Iranian capital market.

**METHODOLOGY**

According to goal of research, the method of study is applied, and it is descriptive-correlational based on the methodology of study. In the correlational study, the main aim is to define the relationship between two or more variables, size, and value of that relationship. Research
hypotheses will be tested by statistical methods in the form of non-parametric correlation.

**POPULATION OF STUDY**

The population of study consists of banks operating in the capital market of Iran that have the following conditions:
1. They are listed in the Iranian capital market before 2009
2. Due to increased comparability, their fiscal period ended in March.
3. They are not among the losing companies in 2009 to 2014
4. During the fiscal years of 2009 to 2014, they don’t have change in activities financial period

**DATA COLLECTION METHOD**

Since the field and survey-based method of study deal with real data of banks and questionnaire, information of banks listed in the Tehran Stock Exchange is obtained from various sources. Domain of study consisted of banks listed on Tehran Stock Exchange since 2007 to 2013. Various sources, including: Capital Market Authority's CDs, Tadbir Pardaz Software, Stock Exchange site are used to collect data related to the independent variable of corporate governance, as well as a standard questionnaire of information disclosure of risk Management of Sheila et al. (2015) will be used to collect data on the dependent variable, the disclosure of risk management information.

**METHOD OF ANALYSIS**

Ratios used in this study, based on data collected, will be classified using Microsoft Excel, then SPSS and Eiviews software will be used to test the hypotheses. To test the hypotheses, the t-test and Mann-Whitney U test will be used to examine the initial test and main test of questionnaire data. Then, statistical regression models will be estimated. In order to test the significance of the model, F-statistic will be used, and to test the significance of the coefficients, t-statistic will be used.

**Dependent variable:**

Disclosure of Information of Risk Management: To measure this variable, eight components of this variable according to the standard questionnaire of Sheila were used, including disclosure of market risk, interest rate risk disclosure, disclosure of net assets value, liquidity risk, credit risk, operational risk, derivatives, and hedging strategies.

**Independent variables:**

Management ownership (MOWN): the percentage of common stock owned by executive manager.
Ownership of major shareholders (BLOCK): the percentage of asset or capital ownership in the hands of major shareholders (5% or more).
Government ownership (GLC): when dummy variable for the existence of state ownership is 20 percent or higher than common stock of the bank in the hands of companies and state organizations, number one; and otherwise, zero.

**Control variables:**

Financial leverage (LEV): long-term debt to total assets ratio
Firm size (SIZE): logarithm of total assets

**ANALYSIS OF THE RESULTS OF EXPERIMENTAL MODEL**

**Stationary:**

According to the econometric literature, it is necessary to examine the stationary of variables before we estimate the model. Using Dicky Fuller and Phillips-Pron tests are not recommended for panel data, because they have little power to detect stationary. To ensure the stronger stability tests in the panel models, it is suggested that data to be pooled and then stationary to be investigated (Anders, 2007).

<table>
<thead>
<tr>
<th>variable</th>
<th>Stationary test</th>
<th>Difference rank</th>
<th>Significance level</th>
<th>Test statistic</th>
<th>Stationary y / non-stationary y</th>
</tr>
</thead>
<tbody>
<tr>
<td>MOWN</td>
<td>Levin, lin &amp; chu</td>
<td>No difference</td>
<td>0.0000</td>
<td>-5.5934</td>
<td>Stationary y (0)</td>
</tr>
<tr>
<td>BLOCK</td>
<td>Levin, lin &amp; chu</td>
<td>No difference</td>
<td>0.0054</td>
<td>-2.5479</td>
<td>Stationary y (0)</td>
</tr>
<tr>
<td>GLC</td>
<td>Levin, lin &amp; chu</td>
<td>No difference</td>
<td>0.0000</td>
<td>0.0000</td>
<td>Stationary y (0)</td>
</tr>
<tr>
<td>SIZE</td>
<td>Levin, lin &amp; chu</td>
<td>No difference</td>
<td>0.0088</td>
<td>-8.4679</td>
<td>Stationary y (0)</td>
</tr>
<tr>
<td>LEV</td>
<td>Levin, lin &amp; chu</td>
<td>No difference</td>
<td>0.0009</td>
<td>0.0009</td>
<td>Stationary y (0)</td>
</tr>
</tbody>
</table>

Table above shows the unit root test results for research data. As it was said, Levin, Lin and Chu (LLC) test had more reliability and credit than other tests for panel data. According to the test, a significance level of less than 0.05 percent was reported which means that the null hypothesis is rejected and the opposite hypothesis is confirmed.

**The estimation of model and the answers to the research questions:**

Model mentioned in the previous section is estimated using panel data. To this aim, one test should be conducted to identify and choose among the least aggregated squares methods, fixed effects (FE) and random effects (RE) to determine which of these methods would have a better fit to the data. To do this, F-Limer, Breusch-Pagan (Lagrange multiplier (LM)) and Hausman tests were used.

To estimate the model, the considered model should be estimated as fixed effects form, using the least aggregated squares method, then we use F-Limer model. If H0 is rejected, the estimated model is panel and then we estimate the model by random effects and we use Hausman test to determine which of the fixed effects or random effects methods must be used.
The results: estimation of model using panel regression model with fixed effects model (dependent variable: information disclosure of risk management) show that the coefficient of determination of model is 0.75. It means that 75% of the change of dependent variable, information disclosure of risk management, is explained by significant variables in the model. In addition, the Durbin-Watson statistic index was 2.10 and as this value is within the range of 1.5 to 2.5, therefore, we conclude that the errors of the model are not correlated.

**The analysis of the above table:**

The results of the model estimation table indicate that the independent variable significant level of managerial ownership MOWN is 0.0000, which is smaller than 0.05. Therefore, the management ownership variable has impact on information disclosure of risk management. The coefficient of this variable is positive. It means that management ownership has direct and positive relationship with disclosure of risk management in the selected companies.

**CONCLUSION**

Therefore, first hypothesis of the study is confirmed, stating that that there is positive relationship between management ownership and information disclosure of risk management in accepted banks. Increase or decrease major shareholders ownership has a positive impact on the disclosure of information. In other words, per unit increase in BLOCK, the index of information disclosure increases 0.5 units in average. The first hypothesis is confirmed stating that that there is positive relationship between management ownership and information disclosure of risk management in accepted banks. Therefore, the second hypothesis is confirmed stating that that there is positive and significant relationship between major stakeholder ownership and information disclosure of risk management in accepted banks.

Therefore, the third hypothesis is confirmed stating that that there is negative and significant relationship between state ownership and information disclosure of risk management in accepted banks. As the significance level of this variable is higher than 0.05, the financial leverage changes (LEV) has no significant effect on information disclosure of risk management index.

Changes of Firm size variable (SIZE) have a significant positive impact on information disclosure of risk management index. AR (2) process were inserted to regression equation to remove the autocorrelation.

**RECOMMENDATION**

According to the results, the following recommendations are suggested.

1. Due to significant positive relationship between the percentage of ownership of major shareholders and the information disclosure of risk management, is it recommended for major shareholders that take action to disclose highly by exercising their powers.
2. For those banks that disclose beyond the requirements specified, appropriate incentive tools should be considered by relevant organizations.
3. It is recommended for banks and other creditors that they should consider the information disclosure of the
companies in their lending projects to be a factor in improving the reporting situation of the country.

4. The recent financial crisis and bankruptcy of big business companies in the last decade have been resulted from incompetence and poor management systems of corporate strategies. Since the higher level of information disclosure suggest the better and stronger governance disclosure, potential investors should pay special attention to the level of information disclosure because the disclosure of companies since disclosure of companies shows better image better than a company that is run by competent managers.

5. Managers of companies should consider this issue that their increased quality and quantity not only can increase the credit of the company managed by them, but also it can increase their reputation among the investors community, especially institutional investors, financial analysts, financial and credential institutions, and public people.

REFERENCES


