



## The impact of corporate governance on the performance index of banks members of Tehran stock exchange

Arash Ketab foroush Badri<sup>1\*</sup>, Karim Panahi<sup>2</sup>, Mostafa Cham<sup>3</sup>, Parsa Ketabforoush Badri<sup>4</sup>

<sup>1</sup> Department of Economic, Faculty of Management and Accounting, Qazvin Islamic Azad University, Qazvin, Iran

<sup>2</sup> Department of Management, College of Management, Economics and Accounting, Tabriz Branch, Islamic Azad University, Tabriz, Iran

<sup>3</sup> Faculty of Information Technology and Computer Engineering, Azarbaijan Shahid Madani University, Iran

<sup>4</sup> Faculty of Management, Tabriz University, Tabriz, Iran

### Abstract

Corporate governance is a set of relationships between shareholders, managers, and auditors of companies and institutions, which includes establishing a control system to ensure that shareholder rights are partially implemented and that the Board approves and properly abuses them. The law, which is based on the social responsibility and accountability system, is a set of duties and responsibilities that must be fulfilled by the pillars of the company to ensure accountability and transparency. Attempts to achieve this need to be undertaken by various studies and the impact of this important indicator on the performance of corporations and institutions should be tested. Banks are one of the institutions where corporate governance can be more effective and relevant. Therefore, it is necessary to examine this index on the performance of banks. With this in mind, this study attempts to investigate the impact of corporate governance on the performance index of banks affiliated to Tehran Stock Exchange from 2009 to 2016 using panel data method. The results show that the ratio of the number of non-performing directors to the total number of directors, the bank's capital and the position of CEO, and the head of the board of directors have a positive and significant effect, and the financial leverage index has a negative and significant effect. Banks' performance indexes are listed on the Tehran Stock Exchange.

**Keywords:** corporate governance, performance index, tehran stock exchange, panel data method

### 1. Introduction

Today, due to the expansion of economic activities, financial markets, and investment boom in capital markets, especially security and legal entities, access to accurate and timely information and accurate and realistic analysis are important. The most important tool for making the right decisions is to obtain the expected benefits and make the most efficient use of financial resources (Shourvarzi *et al.*, 2015) <sup>[18]</sup>. The basic concept of a broad range of governance elements is defined as a network of relationships that encompass not only a company and its owners but also all stakeholders, including employees, customers, people, society, etc. (Hashemi and Bekrani, 2010) <sup>[7]</sup>. Corporate governance also governs the manner in which a public corporation is governed and how the company is accountable to its shareholders as well as to its other stakeholders. Hence, it has become important in terms of the functioning of companies as well as the whole community and has attracted much attention in recent years (Osman and Malik, 2007). At the same time, however, corporate governance can be defined as the legal, cultural, and institutional arrangements that determine the direction and direction of corporate behavior (Nazmul and Tasneem, 2018) <sup>[12]</sup>. Elements present in the scene include shareholders and their ownership structure, board members and their constituents, company management led by a CEO or chief executive officer, and other stakeholders that may influence the move. Have the company (Nazemi *et al.* 2014) <sup>[14]</sup>. In other words, corporate governance is a set of relationships between shareholders, directors, and auditors of the company that ensures

that a control system is in place to ensure that shareholder rights are part of and properly enforce the board's approvals and prevent potential misuse. The law, which is based on the social responsibility and accountability system, is a set of duties and responsibilities that must be fulfilled by the pillars of the company to ensure accountability and transparency (Alam and Akhter, 2018) <sup>[3]</sup>. In other words, utilizing corporate governance indicators can properly define the relationship between shareholders, management and board members and affect how a company operates. At the elementary level, corporate governance faces issues arising from the separation of ownership and management of the company, but this concept goes beyond merely establishing a clear relationship between managers and shareholders. Corporate governance includes a set of relationships between company management, the board of directors, shareholders and other stakeholders. Besides, it provides a framework through which the goals of the company, the means of achieving it, the goals and monitoring of the performance of the company are determined (Saghafi and Najafabadi, 2016) <sup>[17]</sup>. Therefore, the proper establishment of corporate governance mechanisms, in order to enhance organizational status, is a key measure of optimal use of resources, promoting accountability (Hashemi and Bekrani, 2010) <sup>[7]</sup>. As a result, regulatory mechanisms must be put in place to bridge the gap between ownership and management. In this regard, one of the mechanisms for reducing agency problems and information asymmetry between managers and shareholders, and

consequently reducing the problems in managing cash and cash equivalents, is the existence of an effective board of directors as one of the internal mechanisms of corporate governance (Bushman and Smith, 2001) <sup>[6]</sup>. Considering the above and the importance of corporate governance, the present study aims to investigate the effects of corporate governance on the performance index of the banking system in member banks of Tehran Stock Exchange from 2009 to 2016 using panel data model.

## 2. Theoretical Foundations and Research Background

The basic concept of corporate governance is derived from the word *Gubernare*, which is commonly used to guide a ship, implying that the first definition of corporate governance focuses more on leadership than on control. There are several ways to define corporate governance ranging from limited and focused definitions of companies and their shareholders to comprehensive definitions that include corporate responsibility for all stakeholders and communities (Shourvarzi *et al.*, 2015) <sup>[18]</sup>. Existing definitions of corporate governance fall into one spectrum, with narrow perspectives on one side and broad perspectives on the other. In limited perspectives, corporate governance is limited to the relationship between the company and the shareholders. On the other hand, corporate governance can be seen as a network of relationships that not only between the company and the shareholders but also between the company and a large number of stakeholders including employees, customers, vendors, corporate bondholders and all. There are stakeholders in the company. Such a broad view can be seen in stakeholder theory. Opponents argue that corporate governance, focusing on stakeholder ethics, is ethical and in the real world it is unlikely that speculators and investors will be interested in doing ethics unless they have the appropriate financial returns to do so. In general, corporate governance definitions in scientific literature have certain commonalities, one of which is accountability (Nazemi *et al.*, 2014) <sup>[14]</sup>. However, corporate governance can be called a system by which companies are governed and controlled by a general definition. By reviewing the above definitions and analyzing them we can provide the following comprehensive definition: Corporate governance is the laws, regulations, structures, processes, cultures, and systems that achieve the goals of accountability, transparency, justice and respect for the rights of the stakeholders (Alam and Akhter, 2018) <sup>[3]</sup>. Institutional ownership and managerial ownership can be considered as basic mechanisms of corporate governance. The general argument is that the increase in managerial ownership is likely to be negatively correlated with the strength of management. This is because managers have a positive incentive to invest in projects with net expected value by owning the shares of the companies that run it (Nazemi *et al.* 2014) <sup>[14]</sup>. As a result, in this case, institutional owners, by taking an active role in overseeing management decisions, incur additional and unnecessary costs, while managerial ownership is likely to reduce agency costs. However, it may be argued that by increasing its stake in the company it can overcome other shareholders and pursue its own goals (Lasfer, 2007). If this is the case, then institutional owners are more likely to be involved in monitoring and control activities. In fact, the ultimate impact of the relationship between institutional ownership and

managerial ownership on inventory management is not as simple as it seems. Rather, this impact is likely to change not only in terms of industry and country space, but also in terms of cost, effectiveness, and availability of other corporate governance mechanisms. For example, in environments such as Egypt, where there is little investor support and family-owned companies are common, increased ownership is expected to lead to management robustness and control the interests of other stakeholders. Managers increase their stake to increase their voting power, implement decisions that optimize their personal interests, and reduce the regulatory oversight of other corporate governance mechanisms (Nazmul and Tasneem, 2018) <sup>[12]</sup>.

Rahman and Harun (2019) <sup>[15]</sup> examined the effects of corporate governance on Islamic Banks in Indonesia in the period 2012-2016. The results show that SSB features (SSB size, SSB cross-membership, SSB training, and SSB reputation) and board structures (page size and board independence) play a key role in improving IB performance. The findings suggest smaller-sized SSBs, a higher proportion of SSB cross-membership, fewer SSB doctoral degrees, fewer accredited scientists, more board members, and non-executive directors increase IB performance. Alam and Akhtar (2018) <sup>[3]</sup> studied the impact of corporate governance mechanisms on the performance of commercial banks in Bangladesh. Four hypotheses have been formulated for the study. To test the hypotheses, 140 observations were collected using 14 sample banks for 10 years from 2006 to 2015. In this paper, four corporate governance tools such as board size, board independence, internal audit committee, and capital adequacy ratio are considered as independent variables and the return on equity, stock returns and earnings per share are as dependent variables. Bank performance is considered. Correlation analysis and multiple regression were used in the present study. The results show that the size of the board of directors, the number of independent directors, and the number of internal audit committee members are inversely related to bank performance. The regression results also show that there is a linear relationship between capital adequacy ratio and return on assets, but there is a nonlinear relationship between CAR and the other two performance measures of stock returns and earnings per share.

Nazemi (2016) <sup>[16]</sup> has examined the impact of corporate governance and conservatism mechanisms on helping firms predict their financial disclosure and consequently their financial performance. The statistical population of the present study consists of manufacturing companies listed in Tehran Stock Exchange, which was tested by applying the necessary constraints on 90 firms (45 poor performances and 45 strong performance). Neural networks have been used to differentiate between weak and strong companies and forecasts. The results show that adding variables of corporate governance and conservatism have no effect on improving the accuracy of financial performance prediction in neural network-based models.

Asaadi (2016) <sup>[4]</sup> in a study, examined the effect of corporate governance components on the performance of holding companies (specialized mothers) and subsidiaries in Tehran Stock Exchange. This research is an applied research purpose because its results can be used by managers and participants of the capital market and it is classified as a post-event descriptive-

correlational research method. The components of corporate governance and market value-added are considered as research variables. The statistical sample of the study is Holding Companies and their subsidiaries in Tehran Stock Exchange, selected by applying criteria, which include 27 Holding Companies and 89 Subsidiaries during 2008-2009. The results of the testing of research hypotheses using combined data and multiple regressions show that the composition of the board of directors and the ownership structure of the holding companies have a significant effect on the performance of these companies, and the effect of the holding companies' performance on the performance of their subsidiaries is also significant.

Shourvarzi *et al.* (2015) <sup>[18]</sup> investigated the relationship between corporate governance and firm performance based on fuzzy regression among 151 firms. In this study, linear regression with fuzzy coefficients was used to fit the research model and reduce the error, also considering the fuzzy output values that are ambiguous and symmetric triangular fuzzy numbers using gravity center or COA method. Have made this output. Based on the results of this study, the hypothesis of the relationship between the existence of non-executive members in the board of directors and the existence of institutional owners with the firm's performance was confirmed. Therefore, according to the results of this study, special attention is paid to corporate governance mechanisms to improve corporate performance.

Tanani *et al.* (2015) <sup>[19]</sup> examined the role of corporate governance mechanisms in reducing the risk of falling stock prices of listed companies in Tehran Stock Exchange. In fact, the purpose of this study is to investigate the role of some corporate governance mechanisms in reducing the risk of falling stock prices of listed companies in Tehran Stock Exchange. Institutional shareholders, ratio of non-executive directors to board members, presence of internal auditor, and separation of CEO's vote have been used by CEO as variables of corporate governance. 163 companies were selected as a statistical sample during the period 2004-2009. The findings of the study indicate a significant negative relationship between institutional shareholders and stock prices risk and a positive and significant relationship between the ratio of non-performing members of the board of directors and stock prices risk.

Al-Amameh (2014) <sup>[2]</sup> in a paper examines the relationship between corporate governance, ownership structure and banking performance in Jordan between 2000 and 2012. The results of the study show that ownership concentration has a positive and significant relationship with banking system performance. However, foreign ownership has a positive effect on bank performance and also increases the size of the board of directors.

Nazemi *et al.* (2014) <sup>[14]</sup> examined the relationship between corporate governance mechanisms and product inventory management efficiency in listed companies in Tehran Stock Exchange. From the variables of ownership structure (corporate ownership, managerial ownership, institutional ownership and ownership concentration) and board composition (size of board, percentage of non-executive members, and duality of CEO role) as measures of corporate governance and average ratio Inventory of goods for sale has been used as a measure of inventory management efficiency. The statistical population of this study consists of 75 companies listed in Tehran Stock Exchange during 2005-2009. Multiple linear regression statistical analysis was

used to test the research hypotheses. The findings show that there is a direct and significant relationship between corporate ownership, managerial ownership and institutional ownership with product inventory management efficiency, but there is no significant relationship between ownership concentration and product inventory management efficiency. Also, the relationship between board size variables and direct inventory productivity efficiency was significant and the relationship between the duality of CEO role and percentage of non-executive directors with corporate inventory management efficiency was inverse and significant.

Saadati *et al.* (2013) by examining the power of corporate governance and conservatism variables in predicting financial performance, they find that conservatism indices along with financial ratios have significant correlations with firm performance and have a significant role in the separation of poor and strong performance firms while governance variables. A company does not have a significant impact on the separation of firms with weak and strong performance and cannot be used to improve the accuracy of a firm's performance forecasting model. Izadinia *et al.* (2012) <sup>[8]</sup> in a study entitled "Investigating the Relationship between Corporate Governance and Profitability and Stock Liquidity among Tehran Stock Exchange Companies" found that there was a positive and significant relationship between corporate governance and earnings smoothing, secondly between smoothing. There is a negative and significant relationship between earnings and stock liquidity. In this study, we used criteria of percentage of non-executive directors and the percentage of institutional shareholders for corporate governance mechanism.

Mashayekhi and Mohammad Abadi (2011) <sup>[10]</sup> have studied in a study the relationship between corporate governance mechanisms and accounting earnings quality. In the present study, the quality of accruals, earnings sustainability, and its predictive power as earnings quality measures and responsibilities, the ratio of non-performing directors to the board of directors, and the number of meetings as indicators of corporate governance were investigated. The findings of the study indicate that as the number of board meetings increases and the number of non-executive directors increases, the quality (sustainability and predictability) of accounting profits has increased. However, there is no significant relationship between the responsibilities of the CEO and the Chairman of the Board and the quality (sustainability and predictability) of earnings. The findings of the study indicate that there is no significant relationship between accrual quality as a measure of earnings quality and corporate governance mechanisms.

Zhizhong *et al.* (2011) <sup>[20]</sup> conducted a study on a sample of 1147 companies in China for the period 2002 to 2006 to answer the question of whether corporate governance affects financial reporting. They gave. In this study, they used the logistic regression model to examine the relationship between the synthetic variable of financial statements renewal with the equity structure and board of directors as well as the quality of auditors' independence. The results showed that the re-submission of financial statements is due to performance-related accounting errors that can be sustained by strong internal governance such as a board of directors consisting of a high percentage of non-executive directors and an efficient and independent audit

committee and external governance such as Major shareholder and strong independent audit, be inhibited. The findings also showed that the effect of the Audit Committee on controlling the re-presentation of financial statements relies on the influence of other factors of corporate governance.

Matt nor and Sulang (2010) <sup>[11]</sup> in a study entitled "Corporate Governance Mechanisms and Corporate Value" the impact of corporate governance mechanisms including dividends, concentration of ownership, institutional ownership, external ownership, percentage of board shares, dichotomy of CEO and The percentage of non-executive members of the Board of Directors surveyed the value of 403 companies active in the Malaysian Stock Exchange between 2002 and 2005. The results indicate that there is a significant and negative relationship between the duality of CEO duties and firm value.

Abdullah *et al.* (2010) <sup>[1]</sup> investigated the relationship between corporate governance and financial statements on a sample of 61 Malaysian firms between 2002 and 2005. The sample consisted of 17 firms that provided financial statement renewal firms and 17 firms that were selected by pair matching. They related the restatement of financial statements to the amount of ownership of major external shareholders and the independence of the Audit Committee, but the restatement of financial statements was found to be independent of the independence of the board of directors, management ownership, and dichotomy. Their results showed that firms with high levels of debt are more likely to commit financial misstatement.

### 3. Introducing data and estimation pattern

#### 3.1 Statistical population and research model

The data used in the model under study is panel data type. The study period is from 2009 to 2016. The statistical population of this research consisted of 10 banks affiliated to Tehran Stock Exchange, including Pasargad, Ansar, Tejarat, Khavarmiyaneh, Sina, Saderate Iran, Karafarin, Mellat, Egtesade Novin, and Parsian. Time series information is collected from Tehran Stock Exchange website. The model presented in this study, inspired by the article of Taghavi *et al.* (2013) and Elminter *et al.* (2012), is as follows:

$$ROE_i = \alpha_0 + \beta_1 NNMEM_i + \beta_2 CAPITAL_i + \beta_3 SPCEO_i + \beta_4 FINL_i + \varepsilon_i \quad (1)$$

Where ROE, Equity Return Model and Model Dependent Variable, NNMEM, Board of Directors to Total Board Ratio, CAPITAL, Bank Equity Rate, SPCEO, Separation of Managing Director and Chairman, FINL, Indicate Financial Leverage.

#### 3.2 Panel Data

The panel data model is one of the most used methods in Econometric for estimating equations and economic relations. This model is a combination of cross-sectional data and time series, that's mean we can see Information on cross-sectional data over time. Clearly, such data has two dimensions. One dimension is related to different units in any given time period and the other is related to time. Using panel data methods than the cross-sectional and time-series methods have two major advantages.

First, it allows the researcher to investigate the relationship between variables and even units (countries) to consider and review over time and the second advantage is the ability of the method to control individual effects related to countries (as of period). The larger number of observations and data, in Panel Data method compared with other models, more reliable estimates, and testing the enhanced model by researcher are the other features of panel data model (Ashrafzadeh and Mehrgan, 2010) <sup>[5]</sup>.

### 4. Model Estimation Results and Findings Analysis

The F test was used to determine the data method and data panel method and the Hausman test was used to evaluate the effect of fixed or random effects. The results of these tests can be found in Table 1.

**Table 1:** Results of F and Hausman tests for model estimation

Test	F	Hausman
Statistics	47/2781	13/0208
Prob	0/0000	0/0112

Reference: Research findings

According to Table 1, the probability value of the F test and Hausman's test indicates that it is appropriate to use the fixed effects method to estimate the model. Accordingly, the estimation results of the proposed model for determining the effects of corporate governance on banks' performance index using panel data fixed effects method are presented in Table 2.

**Table 2:** Results of estimating the effects of corporate governance on banks' performance index

Variables	Coefficient	T stat	Prob
NNMEM	0/6590	3/8624	0/0002
CAPITAL	0/8500	4/5596	0/0000
SPCEO	0/9079	4/9257	0/0000
FINL	-0/3466	-2/0219	0/0464
R <sup>2</sup> = 0/8835	R <sup>2</sup> <sub>bar</sub> = 0/8640	Prob(F)=0/0000	D-W=1/7078

Reference: Research findings

As can be seen from the results of the model estimation, all the variables used in the study were statistically significant. We then analyze the results of the model estimation.

The estimated coefficient for the ratio of the number of non-performing members of the board of directors to the total number of directors is 0.65 and positive. The t-statistic is 3.86 and the probability value is 0.0002. Therefore, there is a positive and significant relationship between the ratio of non-performing members of the board of directors to the whole board of directors and the performance index of banks. This means that the higher this ratio, the higher the banks' performance index. So that a 1-unit increase in the ratio of the number of non-performing members of the board of directors to the whole of the board of directors increases the performance index of banks by 0.65.

The estimated coefficient for the bank capital ratio is 0.85 and positive. The t-statistic of the bank's capital is 4.55 and its probability value is 0.0000.

Therefore, there is a positive and significant relationship between bank capital and bank performance index. That is, the higher the bank's capital, the higher the banks' performance index. So that a

1-unit increase in bank capital increases 0.85 units of banks' performance index.

The next variable to consider is the separation of the position of CEO and Chairman of the Board of Directors. The coefficient of the model estimation for this variable is 0.90. The t-statistic for the CEO and Chairman position is 4.92 and its probability value is 0.0000. Therefore, there is a positive and significant relationship between the level of separation of CEO and CEO and the performance index of banks. That is, the more the CEO and the CEO are separated, the better the performance index of banks. So as a result of the separation of this position and the necessary efforts, we can see a 0.90-unit increase in the banks' performance index.

The last variable examined is the financial leverage. Unlike other variables, this variable has a significant negative relationship with the performance index of banks. The estimated coefficient for the variable leverage ratio is -0.34 and is negative. The t-statistic of the number of non-members is -0.02 and its probability value is 0.0464. Therefore, there is a significant negative relationship between the variables of financial leverage and banks' performance index.

That is, the greater the financial leverage variable, the lower the performance index. So that a 1-unit increase in the financial leverage variable will result in banks' performance decreasing to 0.34 units. Therefore, the financial leverage and performance of banks have a negative and significant relationship.

Durbin-Watson's stat is 1.7078 which indicates that there are no errors in the autocorrelation model. The coefficient of determination of the estimated model is 0.88. Also, the adjusted coefficient of determination of the model under study is 0.86. Therefore, it can be concluded that in the regression equation, only 86% of the bank performance changes explained by these variables are explained. Since the absolute value of the statistic F is greater than 2 and its probability value is 0.0000, the regression equation is also significant.

## 5. Conclusion

In the present study, the effect of corporate governance on the performance index of banks affiliated to Tehran Stock Exchange from 2009 to 2016 was considered in the form of combined data. In the hybrid data model, the relationship between variables is evaluated and tested by combining cross-sectional and time series data. When using the combined data model, different tests must be performed to estimate the model. In this study, the F test was used to estimate the model. To determine the data currency or data panel. According to this test, the panel data method was used. Then the Hausman test was used to determine the fixed effects method and the random effects method. The results of the Hausman test indicated the use of the fixed effects method. Finally, the model was evaluated using fixed effects method. The results showed that the relationship between the number of non-performing members of the board of directors to the total number of members of the board of directors and the performance index of banks was significant so that by increasing 1 item in this variable, the performance index of banks was 0.65 units improved. The estimated coefficient for bank capital ratio was 0.85 and positive. This indicates that there is a significant positive relationship between bank capital and bank performance. The difference between the position of CEO and Chairman of the

Board of Directors was also a factor that can have a significant and positive impact on the performance of banks. The more efforts made to separate the two sides, the better the performance of the banks. So if banks want to see their organization improve, it is best to make the distinction between CEO and CEO positions. The financial leverage variable was used in this study. The results of the surveys showed that as the financial leverage increased, the performance index of banks declined. This is shown by the negative relationship and the coefficient of -0.34.

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