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The Impact Of Corporate Governance Mechanism On Performance In Emerging Market *(Evidence from Tehran Stock Exchange (TSE))*

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Abstract: The presence of corporate governance can result in the improved economical performance of the firms and consequently a desirable economical growth in country. However most of the researches regarding the relationship between corporate governance and the performance of the firms have been conducted in the industrial countries and the lack of this line of research in the emerging markets is completely observable. So we examine the relationship between corporate governance score and firm performance, and evaluate the relatively understudied governance practices in Iran. Also we construct a corporate governance score (CGS) in the firms listed on the Tehran stock exchange. Weak investor protection environment makes Iran a good setting to study how corporate governance practices affect firm value. Using a panel data of firms listed on the Tehran stock exchange from 2004 through 2007, we find that ownership and company-specificcharacteristics has a significant effect on corporate governance score and subsequent corporate performance. This study recommends that policy makers increase their awareness of the Importance of ownership structure to generate better corporate governance, since managers in weak investor protection environments could differentiate their firms adopting corporate policies to improve their governance structure, and also our measure of governance practices gives investors a quantitative tool to better assess Iranian firms.

Key words: corporate governance, emerging market performance, Stock Exchange

INTRODUCTION

Both accountants and financial economists and financial management have devoted considerable attention to the impact of governance structures. The accounting literature documents that these factors have a substantial impact on earnings management, while the finance literature shows that they likewise affect financial performance. In this paper we examine how governance structure influences firm performance. Although most of the researches regarding the relationship between corporate governance and the performance of the firms have been conducted in the industrial countries and the lack of this line of research in the emerging markets is completely observable. Given the recent importance of corporate governance in academic research and policy, which recently republished the first edition of corporate governance in Iran. we ask a very straightforward question: Do companies in emerging markets that practice better corporate governance receives better performance? That is, do investors care, via valuations, if a firm practices better governance? We are far from being the first to examine this question. Indeed, there is a large literature that has examined this question. For example, Mitton (2004), Brow *et al*, (2006), Teen & Lei (2007), Cornett *et al* (2008) , Siregar & utama (2008), Premuroso & Bhattacharya(2007), Epps & Cereola (2007), Garay & González (2008), among others, have examined this question in various emerging markets. This literature has generally found that better governance is indeed linked with higher market valuations and better performance.

However, a review of the former studies shows that the findings do not match with each other, as Black *et al*. (2006) in their research stated that: " The used criteria in calculating the rating of corporate governance is an important issue to be kept in mind, different indexes of corporate governance can lead to different results". For researchers, different criteria of corporate governance can be another reason for the disparity of previous studies. So we know relatively little about the potential impact that the adoption of corporate governance practices may have on company value and performance in Iran. Measuring this effect are important for the firms because the success or failure of implementing good corporate governance practices may be greater if the market rewards those companies that adopt them. In the case of the US, the empirical evidence shows either no effect or an economically small effect. Black (2001) argues that perhaps these weak results in the US arise because the variation in firm governance is small. Given that the minimum quality of corporate governance, which is set by law and by norms, is very high in that country. On the other hand, inter firm governance variation is found to be much larger in Iran. Although in this research investigate only the effect norm and law on corporate governance .This should not comes a surprise, as a country with weaker laws and norms offers a wider range for governance differences between firms.Consistent with past research, our paper is similar to Black (2001) and Garay & González (2008), who tested the relation between corporate governance and firm value in Russia and Venezuela as transition economies characterized by weak investor protection. Both papers have a small sample and Russia,

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like Iran, is also a country that scores low in terms of investor protection and exhibits a high inter firm variation in corporate governance practices. The evidence reported in this paper is important not only for Iran but also for other emerging markets in the process of attempting to improve their corporate governance practices. The evidence we show here adds to the growing literature worldwide that indicates that firms can differentiate themselves by adopting better corporate governance practices and policies. That is, even in a weak investor protection environment, firms can increase their market value by adopting good corporate governance measures. In general we present the data and conduct our econometric analysis testing the relation between TQ, MB, ROA, and our Gove-Score., we find a positive and strong relation between our index of corporate governance and MTB, TQ and ROA for firms in Iran.

The rest of paper is organized as follows: first, have presented: The target of CG rating project, Potential Contributions of Study, background of Tehran Stock Exchange (TSE) and corporate governance in Iran. Second, we review Theoretical background and hypotheses development and in the last section we present the conclusion and policy recommendations, as well as its potential practical application for future studies.

Background of Tehran Stock Exchange & The target of CG rating project:

The idea of having a well-organized stock market to speed up the process of industrialization of the country dates back to 1930's when Bank Melli Iran started a study about the subject. A report completed in 1936 worked out the details for the formation of a stock market and laid down the preliminary foundation to proceed with the plan. The outbreak of the World War II and subsequent economic and political events delayed the establishment of the stock exchange up to the year 1967 when the Stock Exchange Act was ratified. The Tehran Stock Exchange (TSE), opened in 1968 under the shah, all but died after Iran's Islamic revolution and the ensuing war with Iraq, re-emerging in fits and starts in the late 1980's. Though tiny compared with equity markets in New York, London or Tokyo, the Tehran exchange's market cap has increased from $17 billion in June 1999, when the current boom began, to $44 billion, with 400 listed companies, up from 220 a decade ago. The amount of money traded daily has quintupled in the last two years, to around $50 million in March, a rate comparable to that of the exchanges in other Middle East and North African countries, excluding Turkey. As many global equities markets have languished, the Tehran Stock Exchange has performed magnificently, topping world markets in the last few years and rewarding investors with 125 percent gains in the fiscal year ended March 21 and another 15 percent since. Managers of United States emerging market funds rarely even watch the exchange. Jonathan Asante, chief economist and manager of two emerging market funds worth $120 million for London-based Farmington Investment Management, the British partner of Maunder Capital Management in the United States, said markets in Iran and other oil-rich gulf countries were too pricey (Bernard, S., *et al*., 2006).

As stated above, investing in TSE has increased in current year. In the course of, Over rials 15 billion (US$1.5 million) in foreign investment has been made in the Tehran Stock Exchange (TSE) during the first quarter of current Iranian year (starting on March 21, 2008), a bourse official said. The caretaker of TSE noted some rials 388 billion in foreign investment had been made in the TSE during March 2007-March 2008. The target of CG rating project is:

1) To produce useful results of aggregated data for the relevant authorities (e.g. the Tehran Stock Exchange) and create an aggregate score for the Iranian listed companies participating, thus demonstrating strengths and weaknesses to be taken into account for policy making.

2) To provide an independent and reliable tool for all investors who believe that a thorough examination of CG practices will lead to increased long-term shareholder value. The importance of the tool increases in a framework of a small open capital market that aims to attract sophisticated international investors. 3. Form a basis for comparison with future exercises and offer a tool that will allow correlation of the results with stock value and profitability to check the extent to which investors pay a premium for companies with high ratings.

Potential Contributions of Study:

One of the main contributions of the project was the consensus that resulted from a very close collaboration between the TSE (which financed the study and had a vivid interest in practical results), an academic research centre (which could guarantee methodology and impartiality) and representatives of market participants (who provided thorough inputs and assured the practical value of the results). In order to achieve the highest possible consensus and obtain market-oriented outcomes, a Special Advisory Committee on Corporate Governance was convened consisting of members of all the relevant agents (the Tehran Stock Exchange, TSE Research and Development Center, Islamic Parliament Research Center) to advise the researchers on practical matters related to their work. Also, to provide a comprehensive and specific rating regarding all CG criteria for each company, enabling firms to use their individual results in order to measure themselves against several benchmarks. Furthermore the evidence reported in this paper is important not only for Iran but also for other emerging markets in the process of attempting to improve their corporate governance practices.

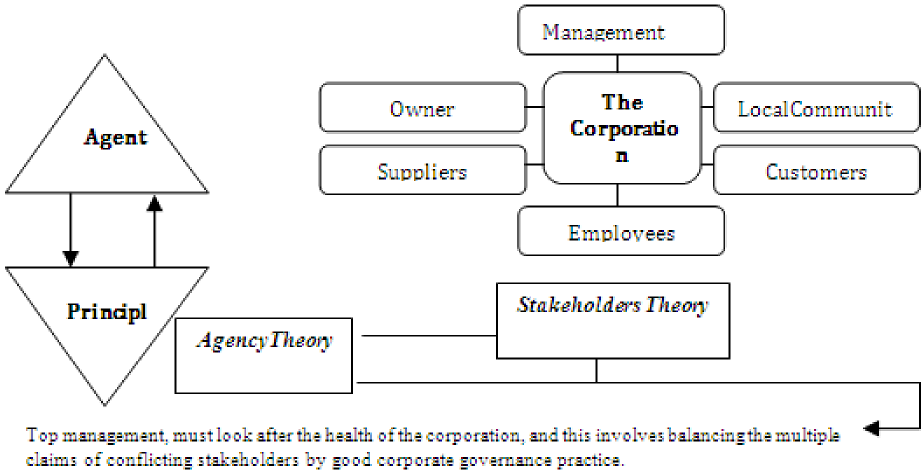


Fig. 3: Framework Conceptual Corporate Governance Theories

Corporate Governance in Iran:

A characteristic of corporate governance in Iran approximates internal governance structures - systems where all the listed companies in country are owned and controlled by a few, major shareholders. These shareholders are often divided into different groups: the foundation group, the creditor banks (which are a small group), other companies or the government. The major shareholder's supervision depends on certain activities such as buying controlling stock and the role of institutional investors. Minor shareholders have no supervisory role. However, auditing the financial statements of companies on the stock exchange is mandatory. But, there is no rating institution in Iran or any system for proper supervision of internal control mechanisms. Despite recent concerns in the field about boards of directors' and other issues related to executive management, such as dividing the responsibilities between executives and managers, the role of nonexecutive managers are very weak in Iran and there is seemingly no concern about supervising organizational morality. (Mashayekhi & Mashayekh, 2008)

Fortunately, in late 2004, the TSE Research and Development Center published the first edition of the Code of Corporate Governance in Iran. The 22 clauses contain some necessary definitions, management, board, and shareholder responsibilities, financial disclosures, accountability, and auditing concepts. This code was edited in 2005 based on the ownership structure, the capital market situation, and the Trade Law. The second edition of Code of Corporate Governance in Iran has 5 chapters and 37 clauses. This code was announced via media and implemented by many companies.

Theoretical Background And Hypotheses Development:

Agency theory explains how to best address the problems of goal congruency and information asymmetry between the principals (shareholders) and agents (managers). Effective corporate governance structures help to prevent agency conflicts by acting as a monitoring device designed to align management’s goals with those of the shareholder. The structure allows for compensation packages, which provide managers with an incentive to maximize the value of the firm. Hence, agency theory suggests better corporate performance established through measured corporate governance will lead to lower agency costs, higher stock prices and better long-term performance as managers are better supervised because a system of accountability, i.e. corporate governance, exists.

The agency model identifies number of governance mechanisms which realign the interests of agents and principals and so reduce agency costs (McKnight, Weir, 2008). The movement from exclusive ownership to collective ownership introduced a novel subject in the area of financial management, which was termed by Berl & Mins (1932) as the Agency problem. Jensen & Mc Ling (1976) while illustrating the fundamentals of agency theory stated that the managers of a company as the "agent" and the shareholder's as the "principle". In the other words, the shareholder, who is the owner, of the company, delegate day-to-day decision making in the company to the directors, who are shareholder's agents? The problem that arises as a result of this system of corporate ownership is that the agents do not necessarily make decision in the best interest of the principle (Solomon, J., 2007). This issue has caused a conflict of interest and brings about the agency costs which are the cost of agency produced from the stockholders attempts to control the managers. These attempts include the plans and contracts made between the manager(s) and the stockholders. Corporate governance systems comprise the techniques used to protect the interests of those that provide the resources essential to the operations of a business entity.

A basic assumption is that managers are likely to place personal goals ahead of corporate goals resulting in a conflict of interests between stockholders and the management itself. In general, agency costs also arise whenever there is an "information asymmetry" between the corporation and outsiders because insiders (the corporation) know more about a company and its future prospects than outsiders (investors) do. [21] If the market mechanism and shareholder's ability to express them are not enough to monitor and control managerial behavior, some sort of regulation or formal guidance is needed. Indeed, if markets are perfectly efficient and companies could compete in an efficient market for funds, artificial initiatives aimed at reforming corporate governance would be redundant. However, markets or not perfectly competitive and therefore intervention is necessary in other to improve corporate governance, help companies to raise finance and make companies more accountable to their shareholders and other stakeholders. Agency problems do exist between companies and their shareholders throughout the world, and governments are intervening by producing policy documents and codes of corporate governance best practice at and amazing rate (Solomon, J., 2007). Hence, the asymmetrically of the information and the presence of benefit contrasts derived from Agency Theory, so implementation of corporate governance rules is unavoidable.

As stated above, In Iran the stock exchange organization (SEO), in the process of internationalizing the stock exchange and developing the privatization process, which is a requirement of the World Bank and the international monetary fund, attempted to generalize the corporate governance regulation in 2007, which has not been executed up to now, although some firms have applied it voluntarily. Therefore, with regarding the weakness of leg structures in transparency of financial reports and public ownership (the report of parliament's center of researches) are the problems of the most emerging markets. It seems necessary that the required researches be carried out in the universities first and after evaluating the circumstances, the required mechanisms are provided for corporate governance to apply. Then With regarding the theoretical bases and the necessity of conducting this research, In Iran's emerging stock exchange, the main research question is:

"Is there a positive relationship between the firm's performance and corporate governance score in the firms accepted in the exchange market?"

As stated above, this study proceeds in two parts. The first part deals with determinants of corporate governance. In the second part, we explore the determinants of firm value. In the first part, we regress SCORE on a vector of x variables with and without ownership variables. In the second part, we test for a correlation between SCORE and performance measures indicated either by Tobin's q or by Return on Assets (ROA) and MTB. We add the variables found in part one to be associated with higher governance rankings as controls to filter out their effects on firm performance. Following what we have done in part one, we run regressions including and excluding ownership variables in part two.

Part (I):

Based on the theoretical considerations and on the empirical research previously described, we have developed several hypotheses that relate ownership and company-specific characteristics to corporate governance practices in Iran.

The Hypotheses And The Independent Variables:

- ***Inst:***

Institutional investors today are far more involved in all areas of corporate decision making and have been encouraged to take on a more active role by the recommendations in corporate governance codes of practice and policy documents. Institutional stockholders, which mostly possess a large share of the firms stock, have the necessary opportunities and capabilities to supervise the managers and in this way can influence the management decisions. In contrast to boards of directors, institutional investors have become increasingly willing to use their ownership rights to pressure managers to act in the best interest of the shareholders (Cornett *et al*. 2008). Based on agency theory, the management's fringe benefit is based on profit; the managers will be active in applying the regulations and rules and will try their best in the firms profit making.Institutional investors have two incentives for managing their portfolio of investments: 1) fiduciary responsibilities and 2) higher investment performance. To satisfy their fiduciary responsibilities, institutions develop a prudent/selective investment policy and continuously monitor performance. (Allhoff, F., A. Vaidya, 2005)

- ***Edum:***

Both agency and contingency theories lead us to think that the corporate governance structure of the company may be related to reporting practices, specifically to disclosure practices. So, board composition may be an interesting variable to consider because it will reflect the role of independent directors. More disclosure can be expected from companies with a higher proportion of independent directors. On the other hand, if the board has a high proportion of non-independent directors, less disclosure can be expected since they have access to inside information. As such, if the board includes representatives of shareholders, they do not have to rely extensively on public disclosure since they have access to internal information. (Lopes, P.T., L.L. Rodrigue, 2007)

- ***Inde:***

Boards of directors are a crucial part of the corporate structure. They are the link between people who provide capital (the shareholders) and the people who use that capital to create value (the managers). Hence the board's primary role is to monitor management on behalf the shareholders. Managers, especially top management, must look after the health of the corporation, and this involves balancing the multiple claims of conflicting stakeholders. Owner want higher financial returns, while costumers want more money spent on research and development. Employees want higher wages and better benefits (Allhoff, F., A. Vaidya, 2005). As stated, Board structure is an important corporate governance mechanism. The existing studies have suggested that board characteristic like size, power concentration, the existence of domination individual, the presence of audit committees with certain features, the proportion of non-executive and independent members have an influence on accounting information quality. (Marcia Millon Cornett, *et al*., 2008)

- ***Block:***

Kenneth *et al*. (1995) note the substitution effects between outside directors, block holders, and incentives to insiders using eighty one U.S. bank-holding companies in his study. Both Dedman and Elisabeth (2002) and Young (2000) investigate the board structure determinants before and after Cadbury Report. They either find managerial entrenchment is reduced or non executive directors are increased following the imposition of new standards of “best practice” regarding board structure. Lei& Teen (2004), show that insider shareholdings and block holdings are negative and significant, whereas institutional shareholdings are positive and significant with corporate governance practice.

As stated above, we examine the four mechanisms used in controlling agency problems: non-executives managers, block holdings, institutional shareholdings and disclosure. In addition, we also include a comprehensive measure of governance using a corporate governance scorecard and measuring governance over a longer time period.

- ***Fsize:***

There are several arguments that can be used to link size to disclosure as a corporate governance mechanism. As Watts and Zimmerman (1990) argue, political costs are higher in larger companies, and so larger companies are more likely to show higher levels of disclosure since it improves confidence and reduces political costs. Also, larger companies are supposed to have superior information systems, so additional disclosure is supposedly less costly in larger companies than in smaller ones. Moreover, proprietary costs related to competitive disadvantages of additional disclosure (Todd Mitton, 2004) are smaller as company size increases (Lopes, P.T., L.L. Rodrigue, 2007). Certainly the firm size determines the amount and range of firms' activities. Larger firms, because of their more contacts with the shareholders and the existence of more control mechanisms have a less amount of commercial risk, so we expect that large firms have a higher corporate governance score. To calculate the firm's size criteria is the same as the mean of sum of assets, the firm's stock exchange value and amount of sale. We use sales figures as proxy for size because regarding the high rate of inflation in Iran, the sale figures present more relevant information.

The Hypotheses And The Dependent Variables:

Corporate Governance Score (CGS):

Most studies on firm-level evidence on corporate governance practices gather their information using questionnaires filled by the companies themselves. This methodology presents various potential problems, among others: a low response rate, especially from those companies whose corporate governance practices are poor (self-selection bias); and, for the firms that do respond to the questionnaire, there is a tendency to present themselves not as they are at the moment when the questionnaire is being completed, but as they want to see themselves in the future (self-report bias). In our paper we follow a different route to construct our CGS. In the same spirit of Garay & González (2008), we answer the questions ourselves using publicly available information. The Corporate Governance Score (CGS) was constructed based on 21 questions pertaining to different corporate governance practices. We answered these questions for each of the 125 Iranian firms that were listed in the TSE. The answer to each question is either “Yes” or “No.” If the answer is “Yes,” we add 1 and if the answer is “No,” we add 0. All answers are based on publicly available information. These 21 Questions were answered after reviewing each firm’s financial statements, bylaws, minutes of the boards of directors and shareholders’ meetings, and annual reports available at WWW.rdis.com.

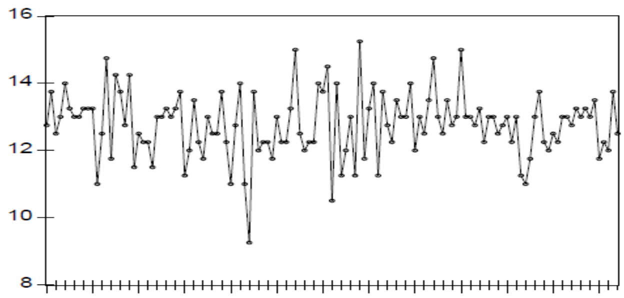


Fig. 2: Average CGS 125 Firms

To summarize, in part one, the model is specified as:

$$\boldsymbol{SCORE_{it} = \alpha_i + \beta_1 INST_{it} + \beta_2 INDE_{it} + \beta_3 EDUM_{it} + \beta_4 BLOCK_{it} + \mu_{it}} \quad (1)$$

$$\mathrm{SCORE}_{it} = \alpha_i + \beta_5 \mathrm{FSIZE}_{it} + \beta_6 \left(\frac{K}{S}\right)_{it} + \beta_7 \left(\frac{Y}{S}\right)_{it} + \mu_{it} \quad (2)$$

$$\boldsymbol{SCORE_{it} = \alpha_i + \beta_5 FSIZE_{it} + \beta_6 \left(\frac{K}{S}\right)_{it} + \beta_7 \left(\frac{Y}{S}\right)_{it} + \beta_1 INST_{it} + \beta_8 DDUM_{it} + \beta_2 INDE_{it} + \beta_4 BLOCK_{it} + \mu_{it}} \quad (3)$$

Where:

SCORE: The corporate government score
INDE: The percentage of outsider managers
INST: The percentage of institutional stockholders
FSIZE: Natural Logarithm Sale:
K/S: The ration of property, plant and equipment to sale
Y/S: The ratio of operational profit (loss) to sale
BLOCK: the percentage of block stockholders
INST: The percentage of Institutional stockholders
INDE: The percentage of the outsider managers
EDUM: Is a dummy variable meaning that if there is no related- parties transition it equals to one and zero otherwise.
DDUM: Is a dummy variable meaning that if the numbers of outsider managers are more than the insider managers it equals to one and zero otherwise.

Control Variables:

We use the following three variables as controls: company size (FSIZE), measured as the natural logarithm of the sale, The ration of property, plant and equipment to sale (K/S) and The ratio of operational profit (loss) to sale(Y/S). Information regarding each one of these variables was obtained from the financial statement.

Hypotheses Part (I):

A: corporate governance practice has relationship with **ownership characteristics** in companies listed on the Tehran stock exchange.

- Corporate governance practice has positive relationship with institutional stockholders.
- Corporate governance practice has positive relationship with Non-executive managers.
- Corporate governance practice has negative relationship with related party transactions.
- Corporate governance practice has positive relationship with block holders.

B: corporate governance practice has relationship with **company-specific characteristics** in companies listed on the Tehran stock exchange.

Part (II):

Empirical research on corporate governance use either market-based measures or accounting-based measures to assess firm performance. Epps& Cereola (2007) use ROA as an operating performance indicator. Lei & Teen (2004), Brown & Caylor (2004), Brown & Caylor (2006), Garay & Gonzales (2008), use Tobin's q as an operating performance indicator.

According to the Agency Theory which states that good corporate governance leads to a decrease in the expected return rate and consequently leads to a more proper evaluation of the stock price in long run. The firm's performance arises from executing the rules and methods created by the board. The separation of executive duties and monitoring duties in economic entities and implementing the same procedure in the board structure is truly one of the main achievements of scientific view to the issue of corporate governance. Today the presence of dependent and outsider members along with insider members in the board is exactly in the direction of this critical principle, namely, the separation of supervision from execution. The presence of responsible but outsider individuals in the board arranges the affairs in a way that the main responsibility of these persons becomes the supervision of the insider directors, and in this direction the necessary monitoring tools like the reward committee and accounting committee have been forecasted to apply monitor duties.

Also firms with an independent board and higher ROE, have more marginal net profit and stock profit (Berle, A. & G. Means, 1932). Therefore, it is expected that the firm performance has a significant relationship with corporate governance score which has been explained based on the different management and governance criteria according to what has been mentioned in the introduction part of article, some dummy variables have been used for this purpose to be achieved. After discovering the relationship between the factors affecting corporate governance, we attempted to test the main hypothesis, namely: " There is a positive relationship between the firm performance and the corporate governance score in the firms' accepted in the exchange market "

We use three alternative dependent variables to test our hypothesis. First, we use the Tobin’s q; this variable was computed as the market value of the firm’s assets ([(No. of common shares ×Price of shares at calendar year end) + Book value of Preferred Capital + Book value of total liabilities]/ Book value of total assets) divided by the book value of assets. Tobin’s q can be considered the classic valuation measure and has been used extensively in the corporate governance literature. Tobin’s q reflects growth opportunities (and, more generally, expectations of the firm’s prospects in future years) through the impact of these factors on market value.

The second dependent variable is the price-to-book ratio (price-to-book value or PBV), measured as the quotient between per share market price and book value. The price to book is a valuation measure that has been used in corporate governance studies by authors such as Garay & González (2008) for Venezuela. Finally, we use the ROA as the third of our dependent variables, Return on assets is a measure of operating performance, which shows an investor what earnings a firm has generated from its invested capital assets. ROA in the current study is defined as income before extraordinary items for the fiscal period divided by total assets for that same period. Managers are directly responsible for the operations of the business and therefore the utilization of the firms’ assets. Thus, ROA allows users to assess how well a firms’ corporate governance system is in securing and motivating efficient management of the firm (Klapper, L.F. and I. Love, 2004).

As stated above, the following models are for part two analysis.

$$\mathbf{Q_{it}} = \boldsymbol{\alpha}_i + \boldsymbol{\beta}_9\,\mathbf{SCORE_{it}} + \boldsymbol{\beta_5 FSIZE_{it}} + \boldsymbol{\beta_6}\left(\frac{\boldsymbol{K}}{\boldsymbol{S}}\right)_{it} + \boldsymbol{\beta_7}\left(\frac{\boldsymbol{Y}}{\boldsymbol{S}}\right)_{it} + \boldsymbol{\beta}_8\,\mathbf{DDUM_{it}} + \boldsymbol{\beta_1 INST_{it}} + \boldsymbol{\beta_2 INDE_{it}} + \boldsymbol{\beta_3}\mathbf{EDUM_{it}} + \boldsymbol{\mu_{it}} \tag{4}$$

Since the percentage of the block stockholders affects corporate governance score and finally performance, we imported the block stockholders as control variable in the final model.

$$\mathbf{Q_{it}} = \boldsymbol{\alpha}_i + \boldsymbol{\beta}_9\,\mathbf{SCORE_{it}} + \boldsymbol{\beta_5 FSIZE_{it}} + \boldsymbol{\beta_6}\left(\frac{\boldsymbol{K}}{\boldsymbol{S}}\right)_{it} + \boldsymbol{\beta_7}\left(\frac{\boldsymbol{Y}}{\boldsymbol{S}}\right)_{it} + \boldsymbol{\beta}_8\,\mathbf{DDUM_{it}} + \boldsymbol{\beta_1 INST_{it}} + \boldsymbol{\beta_2 INDE_{it}} + \boldsymbol{\beta_3}\mathbf{EDUM_{it}} + \boldsymbol{\beta_4 BLOCK_{it}} + \boldsymbol{\mu_{it}} \tag{5}$$

Where:

Q: [(No. of common shares ×Price of shares at calendar year end) + Book value of Preferred Capital + Book value of total liabilities]/ Book value of total assets. Other variables are the same as previously defined.

$$\mathbf{Q_t} = \left(\frac{\boldsymbol{PS + CS + DEBT}}{\boldsymbol{TA}}\right)$$

Whether or not on the relevant literatures and theories of corporate governance and corporate value, the paper proposes a theoretical framework shown in figure 1. Under the conceptual framework this study will verify the following hypotheses:

Main Hypothesis :Better Corporate Governance Practices Will Be Positively Related To Firm Valuation In Iran.

Econometric Analysis:

In order to perform the statistical tests and the multivariate regressions, a preliminary analysis of the information available was carried out following a procedure similar to that used by Garay&González (2008);

companies without any market transaction during the year were deleted from the sample. In Table 1 we report the descriptive statistics for the variables used in the analysis that follows. In our sample has a price-to-book multiple equal to 2.61 and a Tobin's q equal to 2.77. Also average ROA as a performance measurement was 0.91 show that, is in proportion to low score. In terms of our CGS, the reduced sample of 125 firms shows an average value equal to 12.77 over a maximum of 21 points (one point for each question answered as "yes"), or 59 percent in percentage terms. Low level for companies listed on the Tehran stock exchange, this is consistent with the fact that owner structure is governmental also information disclosure and other legal requirements are weak.

Table 1: Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Std	Skewness	Cross	Obs
Q	2.77	1.25	147.53	-79.32	11.24	6.75	125	500
MB	2.61	1.46	89.53	-59.17	9.38	1.5	125	500
ROA	0.91	0.86	3.35	-0.34	0.45	1.32	125	500
SCORE	12.77	13	17	8	1.59	-0.15	125	500
FSIZE	12.17	12.13	17.77	5.54	1.47	0.05	125	500
BLOCK	51.09	56.50	98.00	1.00	31.2	-0.18	125	500
INST	55.21	65.50	100.00	1.00	32.08	-0.26	125	500
INDE	52.48	50	90.00	20	24.65	0.05	125	500

In Table 2 we report a pair-wise correlation matrix for the variables used in this study. It shows that the CGS is positively correlated to the three alternative dependent variables previously defined (MB, ROA and TQ). With respect to the firm's size (FSIZE), unlike the findings obtained by Garay & González (2008), we obtain a negative and significant coefficient for our sample. In other words, larger firms tend to exhibit better corporate governance practices. But, owner structure in big company is governmental in Iran, as weak corporate governance practice is normal.

Table 2: Correlation Matrix

	SCORE	FSIZE	KS	YS	DDUM	INST	EDUM	BLOCK	INDE	Q	MB	ROA
SCORE												
FSIZE	-0.005											
KS	-0.038	-0.227										
YS	0.0005	-0.018	-0.045									
DDUM	0.0072	0.1132	0.018	0.0216								
INST	0.0285	0.1208	0.0342	-0.027	0.126							
EDUM	-0.063	-0.037	-0.099	0.0146	0.022	0.096						
BLOCK	0.006	0.0854	0.0402	0.0095	0.126	0.977	-0.097					
INDE	0.0244	0.1293	-0.022	0.026	0.843	0.175	0.0274	0.1708				
Q	0.114	0.2194	-0.01	0.003	0.101	0.099	-0.014	0.0817	0.104			
MB	0.2462	0.1285	-0.078	0.0078	0.036	0.066	0.0187	-0.081	0.021	0.0953		
ROA	0.0517	0.2401	-0.275	0.0381	0.005	0.035	-0.02	-0.04	0.021	0.0602	0.146	

Result Of First Part's Models:

As shown in Table 3, To test first hypothesis, we estimate regression (1) setting $Score_{it}$ equals to corporate governance score in period t. the results of regression indicate that There is a significant positive relationship between the percentage of institutional stockholders and the corporate governance score. The coefficient on INST is positive (0.03) and significant at the 1% level (t = 2.77). Recursive partitioning analysis yields somewhat stronger explanatory power (R^2 = 38 percent). Durbin-Watson test also shows lack of autocorrelation (the 5th row of result in Table3).then we inter INDE as a control variable because, outsider managers can affect corporate governance mechanism, but we have not found significant relationship between it with SCORE (see Table 3). Therefore the percentage of institutional stockholders as a factor with positive effect, affects on corporate governance score. Also there is a significant negative relationship between the percentage of block holders (BLOCK) and the corporate governance score. The coefficient on BLOCK is negative (-0.03) and significant at the 1% level (t = -3.56). In other words, block holders have not given view for firm directing.

Next, we replace ownership with firm characteristics as explanatory variables. Hence we estimate regression (2) setting $Score_{it}$ equals to corporate governance score in period t. the results of regression indicate that There is a significant negative relationship between the firm's size and the corporate governance score. The coefficient on FSIZE is negative (0.62) and significant at the 1% level (t = -3.63). Recursive partitioning analysis yields somewhat stronger explanatory power (R^2 = 38 percent).Durbin-Watson test also show lack of autocorrelation (see the last row of result in Table3).Finally, our model specifications in the four columns of Table 3 include ownership in combination with firm characteristics (the combined model). As shown in Table 3, the results reemphasize the negative relationship between the firm size and the corporate governance score. The control variables, the percentage of institutional stockholders have a positive significant relationship with corporate governance score. However, the control variables, the ratio of operational profit or loss to sale, the percentage of outsider managers and the dummy variable DDUM did not have a significant relationship with corporate governance. Durbin-Watson test also approves the significance of this model. Hence, corporate governance practice has relationship with **ownership and company-specific characteristics** in companies listed on the Tehran stock exchange.

Table 3: Result of Regression

Variable	MODEL(1)	MODEL(2)	MODEL(3)
FSIZE	-	-0.62**(-03.63)	-0.61**(-03.54)
(K/S)	-	-0.14†(-1.89)	-0.12(-1.59)
(Y/S)	-	-0.003*(-2.231)	0.00(0.08)
INST	0.03**(2.77)	-	0.02**(2.38)
INDE	-0.03(-0.93)	-	-0.03(-0.86)
EDUM	0.30(1.46)	-	0.34(1.59)
BLOCK	-0.03**(-3.56)	-	-0.03**(-3.42)
Obs	4×125	4×125	4×125
R^2(overall)	38%	38%	39%
Adj. R^2	17%	18%	19%
F	76.15**	116**	60**
Durbin- W	2.09	2.12	2.14

Result of second part's models (Firm performance):

Tables 4 present regression results of firm operating & economic performance as a function of corporate governance variables. In Table 4, we treat reported performance, Tobin's q, MB, ROA, as the dependent variables. We also include firm size (log of sale) as a control variable for operating performance in these regressions.

- ***Tobin's q:***

The results of regression (4) indicate that there is a significant positive relationship between the corporate governance score and performance. The coefficient on SCORE is positive (1.12) and significant at the 1% level (t = 3.48). Recursive partitioning analysis yields somewhat stronger explanatory power (R^2 = 45 percent). Durbin-Watson test also shows lack of autocorrelation (the last row of result in Table4). Model 5 includes all the control variables considered together (t = 3.40, p < .01).

	Tobin's q		MB		ROA	
Variable	MODEL(4)	MODEL(5)	MODEL(4)	MODEL(5)	MODEL(4)	MODEL(5)
SCORE	1.12**	1.13**	1.59**	1.57**	0.02*	0.02*
	(3.48)	(3.40)	(6.16)	(6.10)	(1.87)	(2.00)
FSIZE	2.82*	2.82*	0.30	0.33	0.02	0.02
	(2.21)	(2.20)	(0.29)	(0.31)	(0.47)	(0.65)
(K/S)	0.23	0.23	0.01	0.02	-0.01	-0.01
	(0.89)	(0.88)	(0.07)	(0.13)	(-1.44)	(0.12)
(Y/S)	0.009	0.008	0.005	0.01†	-.003	-0.007
	(1.20)	(0.92)	(1.38)	(1.65)	(-0.48)	(0.16)
INST	0.02	0.01	0.06	0.11†	0.002	-0.007
	(0.34)	(0.20)	(1.39)	(1.70)	(1.17)	(0.73)
INDE	0.11**	0.11**	0.02	0.03	0.005	0.005
	(3.08)	(3.09)	(0.36)	(0.39)	(0.41)	(0.78)
EDUM	-0.93	-0.21	-0.17	-0.22	-0.02	-0.02
	(-0.08)	(-0.08)	(-0.19)	(-0.25)	(-0.74)	(-0.65)
BLOCK	-	0.006	-	-0.05	-	0.03†
		(0.14)		(-1.01)		(1.66)
Obs	500	500	500	500	500	500
R^2(overall)	45%	45%	52%	52%	66%	67%
Adj. R^2	25%	25%	35%	34%	55%	55%
F	42.96	42.95	57.02	50.13	124.15	106
Durbin- W	2.49	2.49	1.51	1.51	1.82	1.83

- ***MB:***

The results of regression (4) indicate that there is a significant positive relationship between the corporate governance score and performance. The coefficient on SCORE is positive (1.12) and significant at the 1% level (t = 6.16). Recursive partitioning analysis yields somewhat stronger explanatory power (R^2 = 52 percent). Durbin-Watson test also shows lack of autocorrelation (the last row of result in Table4). Model 5 includes all the control variables considered together (t = 6.10, p < .01).

- ***ROA:***

The results of regression (4) indicate that there is a significant positive relationship between the corporate governance score and performance. The coefficient on SCORE is positive (0.02) and significant at the 5% level (t = 1.87). Recursive partitioning analysis yields somewhat stronger explanatory power (R^2 = 66 percent). Durbin-Watson test also shows lack of autocorrelation (the last row of result in Table4). Model 5 includes all the control variables considered together (t = 2.00, p < .05).

Correlation is significant at the 0.10 level (two-tailed),

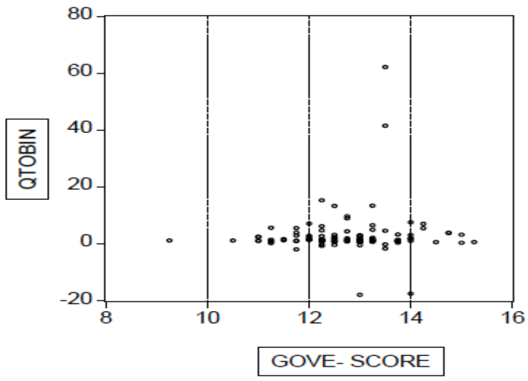
* Correlation is significant at the 0.05 level (two-tailed) and

**Correlation is significant at the 0.01 level (two-tailed). The t- statistics are reported in parentheses bellow coefficient estimates.

Overall, we find a positive and significant relation between firm valuation (MB, Tobin's q and ROA) and our CGS. Firms with a better CGI are more valuable for investors in terms of their MB multiple and their Tobin's q. Results also suggest that in a weak investor protection environment such as Iran, firms are able to send strong signals to the market by voluntarily improving their corporate governance practices, something that allows them to differentiate from the rest.

Discussion and Conclusion:

The results of hypothesis testing, using the information from 125 accepted firms in the firms listed on the Tehran stock exchange, during 2004-2006 shows that there is a relationship between a firm performance and the corporate governance score (See Figure 1).



The result of first group hypothesis testing showed that there is a significant positive relationship between the institutional stockholders (like banks, insurance companies, and Islamic Revolution Institutional etc.) and the corporate governance score. But the variables of institutional stockholders are able to explain a good percentage of the change in corporate governance score, and it is due to this high effect that institutional stockholders can exert in implementing their desired managerial policies. The findings of the current research were complied with Lee & Teans findings (Lee & Tean, 2007) who found out that there is a positive relationship between the institutional stockholders and the corporate governance score. And in contrast to Cornett *et al*'s findings (cornet et.al, 2008) we believe that institutional stockholders require more information disclosure and more transparency. Also our findings shoe that, there is a significant negative relationship between the block holders and the corporate governance score. Perhaps, one of the reasons of this significant negative relationship is the governmental nature of block holders and minority of other stockholder in ownership structure; it's led to less accountability which is a bench market for the governmental managers.

Our Finding affirms the presence of a negative relationship between the firm size and the corporate governance score, too. In other words, larger firms tend to exhibit better corporate governance practices. But, owner structure in big company is governmental in Iran, as weak corporate governance practice is normal. Although the findings are in contrast to Clopper & Low (2004) and Aggraval *et al*. (2006). However, Lee (2007) concluded that there is a nonlinear relationship between the firm size and the corporate governance score. Other findings show the presence of a positive relationship between corporate governance score and the firm's performance. By entrance of the variables related to the characteristics of the owners, the model's predicting power decreased, due to the fact that the institutional stockholders and block stockholders intervention prevent the firm's favorable performance. The findings were complied with Mc Cannel & Servas (1990), Lee & Tean (2007), Black (2001), and Brown & killer (2004). Also the findings are in contrast to Theodoral (1998) and Epps & Creola (2007).

Generally, the results of this study are in compliance with Mashayekhi & Mashayekh(2008) findings, who state that, " role of non-executive managers is very weak in Iran and there is seemingly no concern about supervising organizational morality " (Mashayekhi & Mashayekh, 2008). The institutional stockholders have not been able to use their power utility and facilities to improve the governance indexes. Nevertheless, the exchange market's requirementsto establish the regulations which firms have to perform corporate governance mechanism cause to decrease the monitoring problem of company. Because of the inaccessibility of the firm's reports after announcing the corporate governance regulations in 2007, it was not possible to investigate the effects of its execution. Although, the findings showed that we can rely on the corporate governance score and declare it as one of the important factors of the stock exchange in the future of Iran's exchange market. As the findings showed, the information about corporate governance score can be, considered the ***'' relevant information''***, thus it suggests Iranian markets & other emerging markets that: Some pieces of information relating to the corporate governance score are provided by SEO or any other related accounting organization which is offered through management notes and reports to the market & investors. Also, we think these findings are able to help the investors for determination of their portfolio regarding corporate governance score and the selection of a strategy based on corporate governance score in choosing portfolio. Finally, keep in mind that, the 125-sample firms of the present study were chosen according to the access to data. Hence scientific caution must be exercised in generalizing its findings to other firms. One of the main obstacles in this study was the lack of organizations which would provide corporate governance rating of Iranian company. We hope that with the economic growth and the development of stock exchange in Iran, we will have such organization for the future researches, though in a limited scale. In this orientation we sure expect the contribution of international organizations such as IOSCO and OECD which are highly essential. Also there was no access to the information about R&D in Iranian firms, and, since this variable affects the SCORE, we were not able to determine its effect on the models. Therefore, its intervention may have had some impact on the results.

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