

Relationship between the board structure and earnings response coefficient with Grade of Disclosures Information

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Abstract: *The aim of this study is to investigate the effect of board structure on earnings response coefficient (ERC) and Grade of Disclosures Information of companies accepted in Tehran Stock Exchange. The present study is an applied research in terms of its purpose. Also, a correlational research method has been used in this study. The statistical population includes all the companies accepted in Tehran Stock Exchange which have been continuously active from the beginning of 2007 to the end of 2012. 117 companies listed on the Tehran Stock Exchange were selected as the statistical sample. The research results showed that there is a negative and significant relationship between the board's tenure and the independence of the board with the Grade of Disclosures Information. Also, a direct and significant relationship was discovered between the size of the board of directors and the Grade of Disclosures Information. The size of the company had a positive and significant relationship with the disclosure rate, while the ratio of book value to market value and coefficient β had a negative and significant relationship with the quality of disclosures information and also, according to the information gained, there was no significant relationship between long term debt to assets ratio and voluntary disclosure rate. Also, board tenure and director independence have a reverse and significant relationship with the earnings response coefficient, while the board size has a direct and significant relationship with the earnings response coefficient. Except β coefficient which has no significant relationship with earnings response coefficient, long term debt to assets ratio has a negative and significant relationship with earnings reaction coefficient and the size of the company and the ratio of book value to market value have a positive and significant relationship with the earnings response coefficient.*

Keywords: *board structure, earnings response coefficient (ERC), grade of disclosures information*

INTRODUCTION

The dynamics of the capital market depend on the trust of investors, and investors make decisions using reliable financial information. Therefore, effective monitoring of the ability to rely on financial reporting plays an important role in the life of the capital market (Chang and etal,2009).

Evidence indicates that corporate governance is one of the most commonly used phrases in the world trade vocabulary at the start of the new millennium. The collapse of large corporations like Enron and World com in the United States in recent years has drawn everyone's attention to the important role of corporate governance and management structures and professional associations, universities, and legislative institutions have shown a widespread perception to this issue (Yeganeh,2006).

Accordingly, one of the controversial issues in accounting is the structure of the board of directors in companies [3]. While members of the board undoubtedly play a vital role in the organization (Fama and etal, 1983), however, the structure of the board has positive and negative consequences for the organization (Brown et al, 2006; Erickson et al, 2005; Klein,2002).

On the other hand, by those who use financial reports to make investment decisions and conclude various contracts are interested in earnings response coefficient and, more generally, the quality of profit. From the view point of investment, low earnings response coefficient is not favorable since it indicates the existence of risk in allocating resources to that sector and will reduce economic growth through inappropriate allocation of capitals. On the other hand, low earnings response coefficient leads to diversion of resources from plans with actual returns to projects with unrealistic returns which results in a decline in economic growth (Asadi et al, 2013).

As a result, investors and other users of financial statements treat with more doubt about information released by companies that have lower earnings response coefficient. Also, one way of transferring information is to expose it through financial statements. Effective transfer of information to individuals outside the organization in a credible and timely manner is the main role of financial reporting. But if managers do not properly disclose their knowledge about the company's business activities, mislead investors in their decisions.

Considering the above mentioned issues, in this research, we will try to investigate the impact of some of the characteristics of the structure of the company's board of directors (including independence, tenure and number of board members) on the Grade of Disclosures Information and earnings response coefficient of companies accepted in The Tehran Stock Exchange and we want to find the answer of this question that does the independence of board members affects the grade of disclosures information (disclosure quality) and earnings response coefficient? Does the tenure of board members affect the grade of disclosures information (disclosure quality) and earnings response coefficient? Does the number of board members affect the grade of disclosures information (disclosure quality) and earnings response coefficient?

Theoretical fundamentals and an overview of the research background

The board of directors is one of the pillars of governance in today's companies that are often known as the executive leverage of corporate's governance principles and are responsible for overseeing and policy-making in companies (Huse, 2007). Boards are often a group of people who have the right to supervise, control, and make great policies and governance over a particular company.

The general belief is that the board applies a more effective supervision of executives when it has more independence. For instance, Beasley, 1996, in an empirical study, found that the presence of non-executive members of the board has reduced the likelihood of fraud in the presentation of financial statements (Beasley, 1996). Clay also provided some evidence in conjunction with the independence of board members and manipulation of profits suggesting that companies with independent board members have had less unusual accruals (Klein, 2002).

The independence of the board depends on its size, because a board with a small number of members may be more easily controlled by the highest executive officer and based on the field of social cohesion while the influence of the highest executive officer on a board with more number of members is more difficult. The managing director can control the smaller members in different ways. For example, it may use political strategies such as specially channelized information in order to influence and manage (Roodushti et al, 2006).

On the other hand, the level of independence of the board is usually measured in either of the following ways: a: tenure or lack of tenure of two organizational posts at the same time by the chief executive officer (CEO) which means that whether the posts of the president of the board of directors and the highest executive officer (CEO) are occupied by the same person or not, and b: the number of board members.

Profit figures are influenced by the choices of managers and accountants between the accepted accounting principles and individual judgment of executives about the procedures used to record accounting

information. Sometimes, the management of the business uses accounting choices to manipulate profits and mislead users. Moreover, managers may manipulate the elements of profits to reflect a better outlook, and by doing this, they minimize the reported quality of profit. Because those who rely on the mentioned benefits in their decisions will make mistakes and financial analysts cannot present an appropriate prediction about the profitability of the business in the future.

Siegal (Siegal,1 979), believes that profit figures should be honest, reliable and predictable. Honesty means that they must be far from any kind of prejudice and planned manipulation to show a suitable condition for the business and also reliability means that the reported earnings figures should provide an accurate assessment of the company's profitability and the procedure of future profitability should also be predict through them.

Higher sustainability of profit means that the company has more power to maintain current profits and the company's profit quality is also assumed to be higher. The levels of accruals have also an inverse relationship with the quality of profits because the higher the accruals of profit, the lower the profitability of the company. Also, as the accounting profit reported reflects the actual economic transactions; the quality of profit will also increase to the same extent (Nichals , 2002).

Scott announced some reasons for the different market response to the reported profit based on the historical costs

Table 1: Effective factors on earnings reaction coefficient (Scott,2003)

Row	Effective factors	Description
1	Beta	The higher the beta, the lower the earnings reaction coefficient and vice versa
2	Capital structure	The higher the financial leverage, the lower the company's earnings reaction coefficient and vice versa
3	Quality of profit	The higher the quality of profit the higher the earnings reaction coefficient and vice versa
4	Investors' expectations	As the investors' expectations are more various, the earnings reaction coefficient is lower and vice versa
5	Continuing the profitability process	As the expectation of the continuity of profitability is higher, the earnings reaction coefficient will be higher and vice versa
6	Growth opportunity	As the company's future growth is expected to be higher, the earnings reaction coefficient will be higher and vice versa
7	Power of price awareness	The higher the power of the price awareness the lower the company's earnings reaction coefficient and vice versa

High quality disclosure can reduce the lack of information symmetry and the issue of inappropriate selection and increase liquidity. This impression has two parts: firstly, the existence of more public information makes it more difficult and costly for traders to access confidential and private information. As a result, investors are less likely to have private information, which this reduces the possibility of exchanging information with a better investor; secondly, higher quality disclosure reduces uncertainty about company value, which in turn reduces the potential information advantage of an informed investor. Both effects reduce the extent to which uninformed investors need to be protected in the prices and therefore, increases the market's liquidity(Liu,2006).

In Disclosure of financial information, the needs and desires of major investors, investment firms and financial analysts should be addressed. This fact that all investors need financial information to assess the

relative risks of investing in each business unit should also be considered in disclosing the desired information.

Although, creditors and government agencies often have adequate power and facilities to access additional information to meet their needs, they should also be considered as groups that use financial statements in relation to the disclosure of financial information (Alivar,1984).

Although financial statements are required to be presented in full, they should not contain excessive information and include insignificant content, since it can draw the users' attention to detailed and negligible information and in consequence important events and operations might be ignored(Hendriksen, 1992).

Mohammad Hossein Setayesh and Fahimeh Ebrahimi in a paper entitled "Investigating the Effect of Corporate Governance Mechanisms on the Information Content of the Profits of Companies Accepted in Tehran Stock Exchange" have examined the effects of ownership concentration variables management ownership, institutional ownership, corporate ownership, board composition and board size on the earnings reaction coefficient with the aim of investigating the effect of corporate governance mechanisms on the information content of profits. The statistical sample of the research consists of 70 companies during the period of 2002 to 2008 and combined data has been used as the statistical method by the researchers. The results of this research show that the information content of profits has a positive and significant relationship with concentration of ownership and institutional ownership. Also, there was no evidence indicating a meaningful relationship between management ownership variables, corporate ownership, board composition and board size with information content of profit.

In 2006, Mohsen Mehraara and Ghahraman Abdoli, in a study entitled "The Role of Good and bad News on Stock Fluctuations in Iran" reviewed the type of news on stock returns in Iran's stock market. In this research, the relationship between return shares with stock prices and conditional fluctuations and the hypothesis of asymmetry of fluctuations were tested, which empirical evidence from the use of fluctuation models for Tehran's securities showed that the effect of negative and positive price pieces on future fluctuations of prices is not statistically different. The most important reasons of this result can be attributed to the young Tehran Stock Exchange, the slowness of flow of information and institutional and organizational constraints.

1. Research Hypotheses

The first hypothesis

The structure of the board of directors is effective on the grade of disclosure (disclosure quality) of listed companies in Tehran Stock Exchange.

The second hypothesis

The structure of board of directors affects the earnings reaction coefficient of companies listed in Tehran Stock Exchange

2. Research Methodology

This study is an applied research in terms of its purpose. Also, this research has been done in a correlational manner. The research is conducted within the framework of deductive- inductive arguments. The statistical population consists of all companies accepted in Tehran Stock Exchange which had continuous activity from the beginning of 2007 to the end of 2012. More transparency of information, monitoring the financial statements as well as a stronger information environment of stock exchange companies compared to other companies are among the characteristics of this statistical society. The

systematic elimination sampling method has been used in the present study and selected companies as examples of research should have the following criteria:

1. The end of their fiscal year must end on March 20th.
2. They should be continuously active in Tehran Stock Exchange throughout the study period and their financial information has been published (companies that did not have access to their financial information during the research period, or have not been fully active in Tehran's securities market in these years have been removed from the statistical community of the research).
3. Manufacturing and industrial companies have been considered and financial services and insurance companies have been removed from the statistical community. 117 companies listed in Tehran Stock Exchange were selected after the necessary investigations and removal of companies with no information. Eviews has been used in this study to examine the hypotheses.

3. Research variables and the method of measuring them

According to the assumptions of the research, the dependent variables of the research are as follows:

1- Grade of Disclosures Information

The Securities and Exchange Organization publishes the ranking of companies accepted in Tehran Stock Exchange on the basis of publishers' informing score. In this research, the ranking report of all companies has been used at the end of the years 2007 to 2011 and companies that had more than 50 points have been classified at a good level and those with less than 50 points at a weak level.

A virtual variable is used in the research model for measuring the level of disclosure:

Number 1 is considered for companies with a disclosure score of higher than 50 (good disclosure level) and number zero is assigned for other companies with a disclosure score of less than 50 (an undesirable level of disclosure).

2. The earnings response coefficient (ERC)

The dependent variable of the research is the earnings response coefficient (ERC). In this study the amount of changes in the company's stock market returns is used to measure the earnings response coefficient of the company. The following procedure has been conducted in order to measure it:

$$RET_{it} = \frac{RI_{it} - RI_{it-1}}{RI_{it-1}}$$

In which:

RET_{i, t}: Percentage of changes in company's efficiency

RI_{i, t}: Total efficiency of the Company.

i: Company

t: Represents the 12-month period leading to three months after the end of the fiscal year

We will review and assess the information related to the price and stock returns in three months after the end of the fiscal year in order to consider the reaction of investors to published accounting and financial information (according to the multi-month interruption in the dissemination of information).

The earnings response coefficient reflects the market's reaction to profit information so that an earnings response coefficient measures the unexpected returns of the market in response to unexpected components of the profits reported by the company that issued the bonds. After the earnings response coefficient, we must define the variable of abnormal return.

How to analyze the RET_{i,t} variable: The response rate of the stock price to the market information can be estimated by the RET_{i,t} coefficient. This variable represents the growth rate of the company's returns. For instance, for a share with a high reaction rate to market information the value of RET_{i,t} is significantly different from zero.

To this end we draw your attention to the following example:

For the Absal company, the annual yield of 2011 is 41.780 and is 7.790 for 2010, so we have:

$$RET_{i,t} = \frac{41.780 - 7.790}{7.790} = 4.363$$

Or, for Pars Daru Company, the Stock return was -2.610 for one year and was 25,060 at the beginning of that year Therefore, we have:

$$RET_{i,t} = \frac{-2.610 - 25.060}{25.060} = -1.104$$

In the first company, in the target year (2011), the earnings reaction coefficient is positive while in the second company this coefficient is negative.

For analyzing the above model, we compare each of the above coefficients with the median industry earnings reaction coefficient in the desired year. If the coefficient of the company is higher than the median industry coefficient then the company will be recognized as a company with a high earnings reaction coefficient and if the coefficient of the company is lower than the median industry coefficient, then it will be recognized as a company with a low earnings reaction coefficient.

For example, if the company's factor is 4.363 and the median industry coefficient is 3.252, then the company will be recognized as a company with a high earnings reaction coefficient. So the earnings response coefficient is a virtual variable which is one in companies with high earnings reaction coefficient otherwise, zero should be assigned to it.

Independent variable

The independent variable of this research is some of the features of the board of directors of listed companies in Tehran Stock Exchange. In this research, three features are considered:

A) Board size

This variable will be measured based on the number of members in the structure of the board of directors of the company.

B) The board tenure

This variable will be calculated by the average period of board members' tenure.

C) Board Independence

Non-executive managers will be used to measure this variable. Non-executive managers are members of the board who do not have executive responsibility.

Control Variables of the Research

We have used several control variables to investigate the effect of the characteristics of the board structure that may affect the earnings reaction coefficient and voluntary disclosure which is as follows:

Size: is the size of a company that derives from the natural logarithm of the total assets.

VOL: represents the company's fluctuating returns, which the company's beta coefficient is used to measure it.

Leverage: Represents the financial leverage of the company. In this study, we used the long-term debt to accumulate end-of-period assets ratio to control the effect of the above variable.

BKMK: Indicates the company's book value to the market value of the company.

4. Research findings

Figure 1: Descriptive statistics of the research variables during the period of 2012-2007

	PD	RET	VOL	BKMK	LEV	SIZE	BIND	BSIZE	BTENUR
Mean	0.524	-0.5571	-5.251	3.093	0.852	5.840	0.563	5.284	3.461
Median	1.000	-0.9752	-4.534	2.094	1.000	5.755	0.600	5.000	3.000
Maximum	1.000	310.89	22.36	36.42	1.00	8.007	0.857	9.00	7.00
Minimum	0.000	-110.0	-17.06	0.171	0.000	4.265	0.000	5.000	1.000
Std. Dev.	0.499	18.48	4.379	3.697	0.339	0.600	0.171	0.696	1.838
Skewness	-0.096	8.546	0.063	4.456	-1.895	0.665	-1.161	3.296	0.443
Kurtosis	1.009	140.2	4.166	2.954	4.640	3.845	5.348	1.737	2.090
Jarque-Bera	1.15	1.575	1.33	1.149	2.807	1.956	2.409	1.254	0.250
Probability	0.254	0.188	0.636	0.254	0.024	0.542	0.098	0.078	0.098

Figure 1 refers to the statistical description of the research variables. As can be seen, the mean statistic, median, minimum, maximum, standard deviation, inclination, and elongation are displayed. Also, JB statistic and its Prob value are also shown in the table above. The value of J.B (Normality of data) for variables is not significant at the alpha level of 5%. Therefore, it can be said that the data related to this variable follow the normal distribution.

Test of normality for the distribution of dependent variables of the research

Since OLS method is used in conducting this research to estimate model parameters and this method is based on the assumption that the dependent variable of the research has a normal distribution and the abnormal distribution of the sample leads to a violation in the assumptions of this method for estimating the parameters. Therefore, it is necessary to test the normality of the distribution of the dependent variable of the study. In this study, the normality of the data was investigated through Jarque -Bera test. The zero assumption and the opposite assumption in this test are as follows:

H0 = Data follow a normal distribution

H1 = Data does not follow a normal distribution

Figure 2: Related to the normality of the dependent variable

Variable	Jarque -Bera	prob
PD	1.57506	0.25445
RET	1.15769	0.18801

Given that the level of significance (prob) of the Jarque -Bera statistic for dependent variables is greater than 0.05, therefore, the opposite hypothesis based on non-normalization of the distribution of variables is rejected at the confidence level of 0.95 which indicates that the variables have a normal distribution.

Analysis of the first hypothesis:

The following regression model was fitted to test the first hypothesis.

$$PD\ Score = a_0 + a_1 B_Size + a_2 B_Tenure + a_3 B_Ind + a_4 VOL + a_5 Size + a_6 LEV + a_7 BKMK + a_8 Industry + \mu$$

Figure 3: related to Chow test

Test	statistics	The amount of statistics	Degree of freedom	P-Value
Chow (effective F)	F	2.45	5-672	0.032

According to the results of Chow test and P-value, F statistics (2.45) is significant at the alpha level of 5 hundredth and the zero hypotheses based on the equality of intercepts at the confidence level of 0.95 is rejected. Therefore, the model is presented as a panel. Now the model of constant effects must be compared with the model of random effects. For this purpose, Husmon test is used.

Figure 4: related to Hausman test, second hypothesis

Test	statistics	The amount of statistics	Degree of freedom	P-Value
Hausman	Chi-sq	3.039	5	0.694

The results of the Husman test showed that Husman test and the P-value test are not significant at the alpha level of 5 hundredth, and the zero hypotheses was not rejected, therefore, the random effects method should be used to estimate the model.

Figure 5: Model test (1) by panel method

Dependent variable: Voluntary disclosure of information Method: Panel Least Squares with Random Effects					
Year: 2007-20012		Number of observations: 685			
Variable	Coefficient	Standard Error	t-test	prob	Relationship
Constant coefficient	-0.434	0.322	-1.34	0.000	Negative and meaningful
B-Tenure	-0.082	0.01	-8.27	0.008	Negative and meaningful
B- Size	0.085	0.03	2.52	0.000	Positive and meaningful
B-ind	-0.636	0.141	-4.51	0.001	Negative and meaningful
BKMK	-0.059	0.006	-9.82	0.000	Negative and meaningful

SIZE	0.172	0.041	4.24	0.001	Positive and meaningful
VOL	-0.063	0.636	-15.94	0.000	Negative and meaningful
LEV	-0.434	0.053	1.05	0.178	Not meaningful
Coefficient of determination (R2)					0.077
Adjusted Coefficient (R2aj)					0.067
Durbin Watson	F test				3.74
1.74					0.001

According to the results presented in the above Figure, since the probability of t statistics for all coefficients is significant at the alpha level of 5%, as a result, the existence of the significant relationship of the structure of the board on the voluntary disclosure of companies is accepted at 95% confidence level. Therefore, the above hypothesis is accepted and it can be said that there is a meaningful relationship between the structure of the board and voluntary disclosure.

Also, the adjusted R2 is equal to 0.067. This value indicates that 6.7 percent of changes related to the voluntary disclosure of the company's information can be explained by the structure of the board which this level of prediction is significant at the alpha level of 5% according to the f function (3.74). Meanwhile, the Durbin-Watson statistic is also equal to 1.74 which indicates the lack of self-correlation in the model.

Analysis of the second hypothesis:

The model used to test the above hypothesis is as follows:

$$ERC = a_0 + a_1 B_Size + a_2 B_Ternure + a_3 B_Ind + a_4 VOL + a_5 Size + a_6 LEV + a_7 BKMK + a_8 Industry + \mu$$

Figure 6: related to Chow test

Test	statistics	The amount of statistics	Degree of freedom	P-Value
Chow (effective F)	F	2.27	5-672	0.045

According to the results of Chow test and P-value, F statistics (2.27) is significant at the alpha level of 0.05 and the zero hypotheses based on the equality of intercept is rejected at the confidence level of 0.95, so the model is presented as a panel. Now the model of constant effects must be compared with the model of random effects. For this purpose, Husmon test is used.

Figure 7: related to Hausman test, the second hypothesis

Test	statistics	The amount of statistics	Degree of freedom	P-Value
Hausman	Chi-sq	6.39	5	0.269

The results of the Husman test showed that Husman test and the P-value test are not significant at the alpha level of 0.05, and the zero hypotheses was not rejected, therefore, the random effects method should be used to estimate the model.

Figure 8: Model (1) based on panel method

Dependent variable: Earnings response coefficient		Method: Panel Least Squares with Random Effects			
Year: 2007-20012		Number of observations: 59			
Variable	Coefficient	Standard Error	t-test	prob	Relationship
Constant coefficient	14.34	0.922	-15.54	0.000	Negative and meaningful
B-Tenure	-0.294	0.043	23.42	0.000	Negative and meaningful
B- Size	0.662	0.126	5.23	0.000	Positive and meaningful
B-ind	-0.49	0.112	-4.45	0.000	Negative and meaningful
BKMK	-0.045	0.018	-2.52	0.018	Negative and meaningful
SIZE	-0.177	0.025	-6.68	0.000	Negative and meaningful
VOL	-0.059	0.164	-0.360	0.719	Not meaningful
LEV	0.874	0.134	6.69	0.000	Positive and meaningful
Coefficient of determination (R ²)					0.091
Adjusted Coefficient (R ² _{aj})					0.082
Durbin Watson	F test				4.49
2.16					0.000

According to the results presented in the above table, since the probability of t statistics for all coefficients, except the company size, is significant at alpha level of 0.05% with 95% confidence, therefore, the existence of a significant relationship between the structure of the board and the earnings response coefficient of companies accepted in the stock exchange is approved at 95% confidence level. Therefore, the above hypothesis is accepted and it can be said that there is a significant relationship between the structure of the board and the earnings response coefficient.

Also, the adjusted R² is equal to 0.082. This value indicates that 8.2 percent of changes related to the earnings response coefficient of companies can be explained by the structure of the board which this level of prediction is significant at the alpha level of 5% according to the f function (4.49). Meanwhile, the Durbin-Watson statistic is also equal to 2.16 which indicates the lack of self-correlation in the model.

5. Conclusion and discussion

As mentioned in the discussion of the representation theory, corporate and governance (board structure) characteristics, as the internal control mechanisms along with full disclosure are used as an external control mechanism to reduce the company's information asymmetry. It seems that the following results can be deduced from the results:

When the percentage of managers' ownership in companies is at a low level, representation issues will increase. On the other hand, the presence of external stakeholders and, in particular, the presence of major shareholders in companies, due to their significant influence on the company, can increase the control and supervision of managers' behavior to reduce the problems of representation. About the management ownership, it is inferred that managers who own a significant portion of the company's stock are less willing to deliberately release and disclose financial information and deprive the capital market of

disclosing additional financial information. In contrast, the existence and influence of major shareholders as a control mechanism facilitates the dissemination of corporate financial information. The results obtained in this study tell the same story (Borgatti et al, 2003).

Companies listed in the stock exchange which a significant percentage of their shares are in the hands of the government, governmental and quasi-governmental organizations and institutions may have defined organizational goals that are different from other private sector companies accepted in the stock exchange. Due to the support and influence of the public sector, these companies are obliged to run commands and directives adopted in accordance with the Executive Instructions and this can have complex and contradictory effects on the consequences.

However, non-executive directors (independent) do not have executive positions in the manufacturing companies but in some cases they may have certain relationships with the directors who are in charge and present in the board or as representative of the legal members on the board. All these issues and similar issues are a major and threatening problem for non-executive directors that can affect their independence.

It is suggested that investors, shareholders and managers become more familiar with the concept of earnings response coefficient and pay attention to it while they are making decision. If we take a look at the successful companies and organizations listed in the stock exchange or outside the stock exchange, it turns out that these companies have strong and capable board members who put companies on the path of progress and success with their proper guidance and leadership. The presence of capable and successful people in companies is of great importance that transferring board members is very effective in the company's stock values and these changes are very important for the investor and the shareholders' decision making so that changing one of the members the board of directors caused a sharp drop in the value of the company's shares in the exchange and vice versa. Therefore, when buying a stock it is recommended that investors chose companies that do not have a non-executive board and pay attention to other characteristics of the board, creating more control over the managing director's activities, coordinating and unifying the managing director's policies with shareholders, helping to improve the company's decision-making process and making optimal and appropriate decisions, providing expertise and different experiences in the company's policy making and guidance process and attracting expert and elite people.

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