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The impact of ethical views on the corporate governance of the firms listed on the Tehran Stock Exchange

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Abstract: The present study seeks to investigate the impact of ethics on the corporate governance. The research variables include ethics and corporate governance. The ethics of justice and the ethics of care are considered as the ethical mechanisms; whereas the board size, the ownership percentage of institutional investors, ownership concentration of the institutional investors, board independence, CEO influence, CEO duality and CEO tenure are regarded as the corporate governance mechanisms. The sample is composed of 74 firms listed on the Tehran Stock Exchange over the years from 2007 to 2011 which have been selected based on filtering technique. The required data is collected through the questionnaire. The research hypotheses are developed according to a specific regression model. The findings reveal that the ethics of care only impacts the board size. However, the ethics of justice is found to impact the board size, board independence, and the ownership percentage of institutional investors and the ownership concentration of the institutional investors.

Key words: *Ethics of justice; Ethics of Care; Corporate governance*

1. Introduction

By separating ownership and management in the corporations, a potential conflict of interests has emerged between the managers and shareholders. This conflict is referred to as agency problem. The information asymmetry is identified as one of the consequences of agency problem of the shareholders and managers. The shareholders are less likely to oversee the operations of the managers continually; this asymmetry causes the firms to encounter two special problems of ethical risk and biased selection (Kashani Pour et al, 2010). New business scandals have provided the chance to pay more careful attention to the ethical principles; furthermore, theyhave helped in establishing business, professional and industrial communities to develop and suggest ethical principles. In addition, the companies intend to determine policies and guidance by which they could follow the ethical principles (Salehi, 2010).

The organizations are required to follow the organizational rules and a set of ethical guidance to accomplish their tasks in the most effective and efficient manner. These rules and guidance should be designed in a way that it becomes possible to facilitate the move to the desirable situation of the organization. Following business ethics and social responsibility impacts the competitive advantage and profitability through increasing legitimation of the organizational performance (Rahman Seresht et al., 2009).

It must be mentioned that the desirable and efficient governance does not guarantee a business; however, it is considered as one of the factors which might help in long-term achievement of the business goals. Corporate governance leads to transparency which results in increasing customers' satisfaction and eliminating rent opportunities. These items increase the chance for using the opportunities by the stakeholders. The corporate governance principles are the boundaries between professional and legal ethics which might make a difference in working process and enhance the organizational culture (Golpayegani, 2013). Given the above mentioned points, the present study aims to examine the impact of different ethical dimensions on the selected measures of corporate governance.

2. Theoretical bases and hypotheses development

2.1. Ethics of justice

Strike (2003) identified a twofold tension between maximizing profit and respecting the individuals' rights in ethics of justice. Begley (2006) considers the ethics of justice as the basis for the real contracts decisions. He reminds that the ethics increases the profits in addition to the respect it brings for the individual rights. The ethics of justice evolves around thoughts such as rationality, legal rights and justice; in terms of justice and fairness, it is defined as the fair allocation of the resources and

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following the rules. Noddings' approach to ethics of care considers two requirements for caring. These include one-caring and cared-for concepts. The one-caring means one individual cares another one; wheares the cared-for refers to a wisdom leading us to a more public field which might be the basis of justice (Trong Tuan, 2012).Plot (2009) argues that in comparison with the ethics of justice which evoloves around rationality, rights and justice, the ethics of care deals with consideration, feelings and responsibilities.

2.2. Ethics of care

French and Weis (2000) suggest that the conservative ethics is the concentration on the ethics resulted from the individuals' rights for the communication requirements. Given the prediction of one's identity based on the caring relationships with the others, it is used as the basis for the ethical conservatism. The ethical conservatism is a method for higher concentration on the individuals rather than on the policies (Begley, 2006). Ethical conservatism refers to the intrinsic values and dignity of the individuals and it seeks to see whether a person enjoys the human life. The ethical conservatism focuses on communicational demands in terms of love and absolute attention rather than contractual or legal points of views. The ethical conservatism deals with considerations, feelings and responsibilities (Trong Tuan, 2012).

There are three distinctions between the ethics of care and ethics of justice. First, the ethics of care is more concentrated on the communications and responsibilities. Second, the ethics of care is not focused on subjective, formal and pervasive situations, but it deals with specific situations. Third, ethics of care is not described as a set of principles, but it is considered as a caring activity (Trong Tuan, 2012).

2.3. Corporate governance and its elements

Given the different perspectives on corporate governance, there are various definitions provided for this concept. The corporate governance has been defined in terms of the visions and scientific backgrounds of the individuals. Laporta, for example, defines corporate governance as a system for leading and controlling the firms (Mashayekhi and Jalali, 2012). Pronsit and Yixi (2008) argue that the corporate governance is an instrument for creating a balance between the managers and the shareholders and for mitigating the agency problems. They also declare that the corporate governance reduces the possibility that the managers select an undesirable dividend policy (Fakhari and YousefaliTabar, 2010).

Scheifer and Vishny (1997) introduce corporate governance as a way by which the financial suppliers of the firms make sure of the return on their investment. John and Senbet (1998) suggest that the corporate governance includes those mechanisms by which the shareholders execute control over the organizational members and managers in order to protect their interests. Cadbury (2000) identifies corporate governance as a system which forms and controls the companies (Jamali, 2008).

Corporate governance is a set of mechanisms of internal and external controls which gives the owners the opportunity to control the corporate and managerial operations. The internal mechanisms of corporate governance are very significant in the behavior and performance of the corporations. To be effective, these mechanisms should be supported by the external factors and mechanisms of the corporate governance (Malekian and Daryayi, 2011). Given the theoretical bases, the first hypothesis is developed as follows:

H1: Ethics has a significant impact on the corporate governance.

Based on the twofold dimensions of the ethics, the first hypothesis is formed in terms of two subsidiary hypothesis:

H11: Ethics of care has a significant impact on the corporate governance.

H12: Ethics of justice has a significant impact on the corporate governance.

Some of the internal and external mechanisms of corporate governance will be discussed in the next section.

2.3.1. Board size

A board of directors is considered as a body of appointed members who have the responsibility of leadership and direction of the company with the primary goal of protecting the interests of the shareholders. The number of the board members is one of the factors which might impact the performance of the board and the monitoring level of the executives (Khanchel, 2007). From the agency perspective, it can be concluded that a larger board of directors is more conscious about the agency conflicts because more individuals oversee the operations of the managers.

2.3.2. Board Independence

The balance between the executive and non-executive members of the board might be more effective in the monitoring and controlling the directors. The prior studies found that the independent directors play more effective roles in preparing financial reports and the conservative companies have more external directors in their board composition (Anwer and Duellman, 2007).

2.3.3. CEO duality

CEO duality occurs when the CEO is also appointed as the chairman of the board. In this situation, the CEO has potential powers. The dual structure also allows CEO to effectively control the information available to the other board members (Aghayi et al, 2009).

2.3.4. CEO influence

CEO influence refers to the situation in which the chairman of the board is the executive member. The corporate governance regulators have found that CEO influences on the board of directors (Deman, 2000). The chairman of the board monitors the CEO. The influence of CEO creates problems when the interests of CEO conflict with the interests of the shareholders (Aghayi et al., 2009).

2.3.5. CEO tenure

Hermalin and Weisbach (1998) argue that the CEO might control the board combination and reduce the monitoring ability of the board. They also suggest that the CEO who has been previously appointed as a board member, has greater relative powers in comparison with the new CEO and might have more constant and powerful position by increasing the tenure (Aghayi et al, 2009).

2.3.6. Institutional investors

The emergence of the institutional investors is one of the significant external mechanisms of corporate governance. Based on Gillan and Starks (2003), the institutional shareholders play the key roles in some evolutions of the corporate governance. Since the institutional owners constitute the largest group of the shareholders, it is expected that they have effective impacts on the corporation trends (Mehrani et al, 2010).

2.3.7. Ownership concentration of the institutional investors

The concentration of the institutional ownership is resulted from the absolute control of the institutional shareholders over the corporation. Increasing the ownership concentration of large shareholders provides sufficient incentives for monitoring the managers. The empirical evidences confirm that the institutional shareholders have more incentives to accept the costs of collecting information and interference in monitoring the management (BadavarNahandi et al, 2011).

Given the elements of corporate governance and the above mentioned views, the subsidiary hypotheses are developed as follows:

H111: Ethics of care has a significant impact on the board size.

H112: Ethics of care has a significant impact on the board independence.

H113: Ethics of care has a significant impact on the CEO duality.

H114: Ethics of care has a significant impact on the CEO influence.

H115: Ethics of care has a significant impact on the CEO tenure.

H116: Ethics of care has a significant impact on the percentage of institutional owners.

H117: Ethics of care has a significant impact on the concentration of the institutional ownership.

H121: Ethics of justice has a significant impact on board size.

H122: Ethics of justice has a significant impact on board independence.

H123: Ethics of justice has a significant impact on CEO duality.

H124: Ethics of justice has a significant impact on CEO influence.

H125: Ethics of justice has a significant impact on CEO tenure.

H126: Ethics of justice has a significant impact on the percentage of institutional owners.

H127: Ethics of justice has a significant impact on the concentration of the institutional ownership.

2.4. Literature review

Chie et al (2008) revealed that the firms with more effective corporate governance mechanisms and higher constraints in external finance pay less dividends; whereas the firms with weaker corporate governance and lower constraints in external finance pay more dividends. In a study by Adeyemi (2010), audit costs were found to be directly associated with the corporate governance mechanisms. Belak et al (2010) examined the relationship between corporate governance and market value of the Korean firms. They concluded that the firms with better corporate governance are confronted with lower growth of sales and higher capital expenditures; however, the investment is found to be more sensitive to the profitability. Using 746 non-financial firms in Japan as the sample, Al-Najjar (2010) demonstrated that there is no significant relationship between dividend policy and institutional investors. Ammann et al (2011) explored 64 characteristics of corporate governance in terms of six groups (board accountability, financial disclosure and internal control, shareholders' rights, compensation, market control, corporate behavior) in 22 developed countries over the years from 2003 to 2007. They found that there is a strong positive association between corporate governance characteristics and firm value.

Valenti et al (2011) investigated the impact of firm performance on the governance structures and components of the board. Their results indicated that the primary negative changes in the firm performance have a significant relationship with reducing the number of board members and the number of non-executive members. Malekian and Daryayei (2011) argue that the firms might have better positions by selecting policies and corporate governance mechanisms. That is, even in an environment with weak corporate governance, the corporations might improve their market position by selecting corporate governance mechanisms. Ghaemi and Shahriyari (2009) examined the performance and components of corporate governance. Their findings revealed that there is no significant association between the board combination and performance and also between performance and ownership structure. Testing the impact of the type of institutional ownership on the performance, Ebrahimi and Kordlor (2010) concluded that the type of ownership impacts the performance improvement.

The findings of Nikoomaram and Mohammad Zadeh (2010) showed that the efficiency of corporate governance has a significant association with the earnings quality. VakiliFard and Bavand Pour (2010) argued that the institutional shareholding and firm performance are positively associated. In addition, they found no significant impact on the performance by the presence of the institutional shareholders. In examining the relationship between dividend policy and corporate governance, Fakhari and YousefaliTabar (2010) disclosed that the listed firms use dividends for gaining more reputation and credit. Mahdavi and Ali Pour (2010) demonstrated that the CFOs of the firms listed on the Tehran Stock Exchange believe in interest-oriented, religious and conscientious decision-making approaches; however, they do not believe in unethical, commentary and practical decision-making approaches. The findings of Malekian and Daryaei (2011) confirm that the institutional shareholders were not successful in using their power, ability and facilities to improve the monitoring proxies. In terms of the relationship between corporate governance mechanisms and conservatism, BadavarNahandi et al (2012) examined the impact of ownership and corporate characteristics on good corporate governance and increasing firm value. Their conclusions also confirmed this issue. Mashayekhi and Jalali (2012) found that there is a significant inverse relationship between male-orientation and the ownership percentage of the non-exective members of the board. They documented a significant direct association between individualism and ownership percentage of the institutional shareholders; however, they found an inverse relationship between the proxy of vagueness avoidance and the ownership percentage of the institutional shareholders.

3. Methodology

The present study is based on the real information and is classified as a semi-empirical study in fields of positive accounting studies. This is also an applied study because the findings might be useful for the users of the financial statements. From another perspective, this is a descriptive-analytical study using the collected information to describe and analyze the relationship between the variables. The population of the study is composed of the whole firms listed on the Tehran Stock Exchange over five years from the beginning of 2007 to the end of 2011. To conduct this study, a specific sample is selected based on filtering technique to mitigate the potential biases. The sample firms should have all four following criteria:

1. The firm should not be classified as the financial intermediaries or investment firms.
2. The end of the fiscal years should be consistent with the calendar year and there should be no changes in the fiscal years over the selected period.
3. There should be no interruption in their trading.
4. The firms should not have incurred losses for the research period.

Considering all above criteria, 197 firms are selected as the sample. The questionnaires are distributed and 74 questionnaires are returned back. That is, the present study includes 370 firm-year observations from 74 firms.

The required data is collected by different methods. Using previous studies published in expert journals and books, the information about the theoretical bases of the study is collected. The data about the variable of ethics is collected by the standard questionnaires. The ethical views of the CFOs are measured by using the questionnaire of Myers-Briggs including 24 questions. The variables of ethics of justice and care are examined by the questionnaire of Measures of Moral Orientations (MMO) introduced by Liddel et al (1992). This questionnaire includes 36 questions described in terms of five-point Likert scale. In this questionnaire, 18 questions are related to the ethics of justice and 18 other questions are about the ethics of care.

Before testing the research hypotheses, it is necessary to calculate the Chronbach's Alphas of the questionnaires to verify the reliability. The calculated coefficients are higher than 0.7 which confirms the reliability of the questionnaire. It must be mentioned that using international standard questionnaire is another reason of the reliability.

Table1: The coefficients of Chronbach's Alpha

No.	Description	Chronbach's Alpha
1	MMO	0.726
2	Mayers	0.71

4. Findings

Before representing the results of testing the hypotheses, the input variables of the regression models and their abbreviations are provided in Table 2.

Based on the results of the regression models for all hypotheses and according to Durbin-Watson statistics, it can be concluded that there is no autocorrelation between the errors. In addition, the F-statistics and its related level (0.000) confirm the significance of the regression models.

The coefficients of the related variables should be examined in order to test the research hypotheses; that is, if a p-value is found to be less than 0.1, then the result is statistically significant at 90 percent.

When the dependent variable has only two possible results and it might take only one of the values of 1 or 0, the logistic (or logit) regression is used. The occurrence of the events takes value of 1 and 0, otherwise.

Table 2: Research Variables and Abbreviations

Description	abbreviation	Description	abbreviation
CEO Duality	CEOD	Ethics of care	CARE
CEO tenure	TENURE	Ethics of justice	J
Institutional Ownership	INSOWN	Board size	BRDSZE
Concentration of institutional	OWNSON	Board independence	BRDIND
		CEO duality	DUAL

In the logit regressions, the chi-square is used to test the significance of the total model and the significance statistic of the independent variable is the Wald statistic. Accordingly, the statistics related to the significance of the models and the significance of the individual independent and dependent variables are represented in Table 3.

Table3. A summary of testing hypotheses

Hypothesis	f Chi-square	Significance of the model	Significance of the independent variable	t Wald	Results of testing hypotheses	Significance level
H1	Ethics and corporate governance					
H11	CARE	(BRDSZE ‹BRDIND ‹DUAL ‹CEOD ‹TENURE ‹INSOWN ‹OWNSON)				
H111	0.72	0.002	0.081	1.34	confirmed	90%
H112	5.65	0.04	0.71	0.38	Rejected	-
H113	92.7	0.023	0.76	0.31	Rejected	-
H114	90.1	0.016	0.7	-0.39	Rejected	-
H115	4.45	0.000	0.86	-0.17	Rejected	-
H116	5.3	0.000	0.77	-0.3	Rejected	-
H117	8.62	0.000	0.76	-0.3	Rejected	-
H12	J	(BRDSZE ‹BRDIND ‹DUAL ‹CEOD ‹TENURE ‹INSOWN ‹OWNSON)				
H121	10.86	0.000	0.098	0.92	confirmed	90%
H122	8.62	0.000	0.002	0.11	confirmed	99%
H123	80.87	0.002	0.866	0.17	Rejected	-
H124	91.89	0.023	0.994	-0.007	Rejected	-
H125	2.35	0.04	0.85	0.19	Rejected	-
H126	9.87	0.000	0.042	0.6	confirmed	95%
H127	10.9	0.000	0.001	0.09	confirmed	99%

5. Discussion and conclusion

The results of examining the effect of ethics on the corporate governance reveals that the ethics of care only impacts the board size and the ethics of justice impacts the board size, board independence, ownership percentage of the institutional investors and ownership concentration of the institutional investors. The finding about the significant relationship between the ethics and corporate governance is consistent with the results of Jamali et al (2008). Based on the fact that the individual characteristics emerge in a hierarchy form and the efficient and moral individuals can enhance the ethical situations of the society, the corporations are suggested to create effective corporate governance mechanisms to be used in increasing the social responsibilities and act in the best interest of shareholders. It is clear that considering the interests of the society has many advantages for the corporations.

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