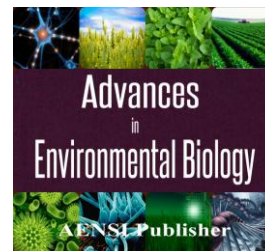




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Evaluating the impact of Corporate Governance Laws and Regulations on Market Participants' Reactions

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ABSTRACT

Effective corporate governance may reduce the risk sheer required by investors and thus lowers the cost of capital and increase firm value. Evaluation of direct effect of corporate governance on the market value and find a positive relationship between them shows that assumption of good corporate governance policies can help to increase value of shares. Our study examines the indirect effect of corporate governance on firm value and whether the market toward violation of corporate governance laws and regulations in listed companies on the stock exchange reacts or not. One of the sources of information that investors can use to assess the governance and the possibility of violation of that in the future, is attention to the background of the company in violation of rules and regulations in the past. We mention the companies with more violation in the past as "Bad Company" and the companies with less violation in the past as "good companies". We expect that declaration of the violation by good companies to investors is more surprising and lead to further reactions of market, in contrast to the bad companies, a violation is in line with previous expectations. Results indicate that between the breakdown in corporate governance laws and regulations in "good companies" and the reaction of investors, there is a positive relationship and also between the breakdown in corporate governance laws and regulations in "Bad Company" and the reaction of investors, there is no relation.

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INTRODUCTION

Nowadays, information is a key tool in economic decision-making and without doubt, the quality of the decision depends on the completeness, accuracy and timeliness of information that at the time of decision is in the hands of individuals. In the capital market, the information as signs, symptoms, news and predictions form from inside or outside the company can be reflected, and made available to shareholders, and cause to reaction and, consequently, change in the stock price. [11]

Efficient practices of corporate governance are critical to the proper functioning of capital markets and the overall economy of the country, it is essential to attract and retain public confidence. Poor corporate governance may lead to loss of confidence in the market, which in turn could lead to the withdrawal of resources or liquidity crisis and falling stock prices. In fact, the company not only has a responsibility against shareholders, but also against their investors and other members is responsible.

The market supervisor, the Securities and Exchange tend to have good corporate governance because it is an essential element in the desirable and correct functioning of the company and If it is not effectively implemented, may lead to the risk. Efficient monitoring and supervising the activities and responsibilities of stock by executives and senior management in maintaining an affordable and efficient monitoring system is involved. In addition to this correct corporate governance in support of investors and observers has a role and allows observers to rely more on internal company processes. The codification of corporate governance is in order to increase the efficiency and effectiveness of the executives and senior management in the development and deployment of efficient monitoring system. In addition, the draft regulations corporate governance in listed companies in Tehran Stock Exchange is also taken into consideration. It is expected that the establishment of

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effective corporate governance system helps to the performance of the duties of the board of directors and legality. [3]

Corporate governance mechanisms in order to encourage managers to make effective use of company resources and accountability to shareholders who put their resources at the disposal of managers have been designed. [13]. Appropriate corporate governance systems can help corporate to gaining the confidence of investors and encourage them to invest can help. According to empirical studies conducted, applying the correct principles of this system in the company cause to improve the company's financial performance and increasing the value of the company [20]. Perhaps no issue in the recent finance literature is more controversial than the question of whether investors behave rationally in determining the price of stock or not? Capital market efficiency theory focuses on two crucial assumptions. First, investors in their decisions at the market have rational behavior. Second, based on the latest information and news buy and sell securities and to determine the fairness of the price of securities, have enough tact. Assuming that being logical investors, have been criticized by many researchers [11]. The market reaction to the study of corporate governance rules are important and worthy of attention.

Literature study:

Many definitions of corporate governance are presented. Sloan, has defined corporate governance as follows: the mechanism that has been created to reduce the problems caused by the separation of ownership from management of business units [20]. Corporate governance refers to the mechanisms that companies work are controlled with that [16]. After corporate scandals such as Enron, WordCom and Parmalat, ensure the independence and credibility of the auditing and accounting profession and financial institutions decreased corporate governance has attracted more attention [18]. Also, in recent decades, especially following the collapse of the economic and financial crisis in many developed and developing countries, the need for focus on corporate governance increased. [14]. Corporate governance is procedures or practices that companies are run through it and thereby accountable to shareholders, employees and society. Recent scandals of Enron and WordCom and other companies create the impression that the profits as an opportunist are managed for their personal interests, not for the interests of the shareholders. What reinforces the negative public vision about earnings management is the fact that lawgiver recently have developed legislation to combat earnings management. For example Sarbynz Oxley law, is the continued efforts of Congress of United States of America in to reduce earnings management. So it seems that the opportunistic nature of profits, is clear issue [2]. Corporate governance is primarily intended to protect the interests of shareholders against management of the organizations [1]. The importance of corporate governance is to the extent that governments in developing countries to strengthen corporate governance mechanisms to pursue extensive political and economic grounds. The reason of the emphasis of Governments in this regard is that establishing good corporate governance at the corporate level can be an important factor in achieving competitive advantage to raise funds in the business world. Corporate Governance above all, targets the firm's life in long-term and seeks to protect the interests of shareholders against the management of organizations [19]. The complexity related to conflict of interest managers and owners on the one hand, and the importance of the effects of the company's performance over other groups of beneficiary on the other hand, has attracted attention of everyone and finding a suitable pattern for many people is a serious concern. Today, experts believe that the best solution to this problem is improving corporate governance [10]. Publishing company news by the directors is also very important as a corporate governance policy and can be caused different reaction by investors. The stock market's reactions to news and advertisements are different and in some cases the people's reactions are not rational and cause the abnormalities including increased too much or is less than the prices. Excessive reaction and much less reaction that occurs when people according to new information, determine the prices more or less than its actual value. Although the market over time realizes its mistake and returns to equilibrium, however, such behavior is a kind of non-rational behavior on the market that can be a logical response to the perceived uncertainty by investors. People's expectations are a function of their prediction, and sometimes they are inefficiency. Understanding the source of these inefficiencies could have important applications for the study in the rational investors and market efficiency fields [7].

Considering that the market reaction to violations of laws and regulations, corporate governance is of particular importance and corporate executives using the methods and mechanisms of corporate governance, have a significant impact on the reaction, the main question in this research is that are there any relationship between violation of the laws and regulations of corporate governance and market reactions?

Literature:

Foreign background research:

Nousheen and Ali Shah (2014) studied the effect of implementation of corporate governance mechanisms on investors' reactions. The results show that corporate governance mechanisms have no effect on the reaction

of investors and the relationship between them is negative. This represents the inefficiency of financial and capital markets and most trades are done on sentiment. [21]

Daneshfar, Saei and Zygal (2005) investigated on "The Effect of Stock Market Cycles on investors' reaction to the sudden changes in accruals". In this study New York stock market since the beginning of July 1997 to 29 January 2001 to tricycle optimistic, pessimistic stability is divided. The results show that in the optimistic period (ie the period during which the stock price of companies surveyed increased) increasing accruals are positively correlated with unexpected increased efficiency. This relationship in pessimistic period (ie the period in which the stock price had been decreased) is negative and in period of price stability, a significant association between increasing accruals and unexpected revenue increasing has not been observed. [15]

Bali (2003) found evidence that reduction in dividend causes more reaction from the increasing it in the market. In fact, they concluded that "the good news is not considered to be major news." which means that the market does not respond to changes in dividends, which is good news. Although this result was obtained that the bad news, including the elimination or reduction of the dividend will have a significant negative reaction. Bauman, in managerial optimism and market reaction to changes in dividends article concluded that changes in dividends cause abnormal reactions in the market and provides quantitative information on the company's future earnings. [12]

Internal background research:

Fadaee nzhad and Kamel nia (1392) in their paper entitled the market reaction to quarterly earnings declarations in Tehran Stock Exchange, from traditional method of event studies use for assessing the information content of quarterly dividend announcements in Tehran Stock Exchange as a small market and low transaction. In this paper, the quarterly dividend declarations in the period between the begining of 1384 until the end of 1391 is used as the original data. The innovation of this study is using three methods: the same stacked, business lead to lead to fill efficiency of the days when stock has not been traded.

The results show that earnings declarations contain information related to the stock market. When the real quarterly benefit is more than the company's forecast (good news), five days later earning declaration a significant positive abnormal return is observed. Persistence of abnormal returns during the first few days after the declaration of the dividend represents that the speed of adjustment of the prices in this exchange is small. In the statement of profit that actual profit less than expected (bad news), abnormal returns were not observed. Tehran Stock Exchange may have the ability to discover bad news than good news. Also the negative relationship between information content and index data were obtained before the disclosure is consistent with the results of large markets. [5]

Mahmoudi and research (1390) in their study investigate the market response to changes in dividend's division with respect to its payment process. In other words, this paper investigates how investors react to each of three trends: increasing, decreasing or unchanged trends and also the overall CAPM triple factor model. This sets the using Fama and French model are evaluated. Following the obtained results of the increasing process, substantial positive deviations cause positive market reaction, and deviation with the constant procedure causes slightly negative reaction, and substantial reduction deviations can lead to a similar trend. In constant process, substantial increase, causes a positive reaction, and continues to constant procedure significant slight negative reaction and substantial reduction causes significant negative reaction from the market. In decreasing trends, substantial reduction and substantial increase face with slight negative reaction of market and continuing constant process face with positive reaction. The results of evaluation show that market by following a specific procedure, a positive response shows to increasing taken by that process. As long as the firm does not deviate from its previous trend, the market does not react unexpectedly. According to this that the market reaction to positive substantial deviations from the negative trends, has been negative reaction, it can be concluded that the positive news, against negative trend don't face with an appropriate reaction of the market and the market follows trends in these deviations. [8]

Mahmoudi et al (1390) studied the response of investors to changes in dividend listed companies on the Stock Exchange. The present study investigates the response of shareholders to receive, both positive and negative information and news about the dividends of the listed companies on the stock exchange. The research population in this study consists of active companies in Tehran Stock Exchange from 1382 to 1388. In this study to measure the reaction of investors were used the average abnormal return of aggregation. The results represent the reaction of investors to received information about the benefit changes that for companies that have reported positive change in their profits, the reaction was observed less than positive confine and for companies that have reported negative change in their profits, the reaction was observed less than negative confine. [7]

A study about market reaction to dividend changes by the Saghafi and Kordestani (1382) was performed.

The aim of this study was to investigate the relationship between earnings quality and the cumulative abnormal return of stock in firms that cash dividend increase (decrease). Earnings quality based on earnings persistence, earnings predictability and the relationship between earnings and operating cash flow is measured.

Market reaction to cash dividend changes and changes in unexpected benefit is positive and statistically significant. Thus it can be said that Cash dividend provides information about the company value. [4]

Moradi et al (1387) studied the effect of stock market cycles on investors' reaction to the sudden changes in accruals. The aim of this study was to investigate the effect of stock market cycles on investors' reaction to the sudden changes in accruals. For this purpose the Iran's stock market between the years 1380-83 divided into three cycles consist of when the stock price has increased substantially, when the price increase is small and when stock prices rise moderately and investor reactions in the sample 66 accepted company on the Tehran Stock Exchange in this three periods were tested. The results indicate that companies profit management cannot be a deterrent in the way of investment of people, and also the conditions of the market and the existence of professional and amateur investors have no effect on this issue. [9]

Research hypothesis:

Effective corporate governance may reduce the risk sheer required by investors and thus lowers the cost of capital and increase firm value. Numerous studies have been done on this issue, including Lu and Klapyr (2014) and Kim and Durnev (2005). Evaluation of direct effect of corporate governance on the market value and find a positive relationship between them shows that assumption of good corporate governance policies can help to increase value of shares. Our study examines the indirect effect of corporate governance on firm value and does the market toward violation of governance laws and regulations in listed companies on the stock exchange reacts?

To provide answers to these questions, the following research hypotheses were formulated:

Hypothesis 1: Between the violation of the corporate governance laws and regulations in good companies and investors' reaction there is a positive relationship.

Hypothesis 2: Between the violation of the corporate governance laws and regulations in bad companies and investors' reaction there is a positive relationship.

One of the sources of information that investors can use to assess the governance and the possibility of violation of that in the future, is attention to the background of the company in violation of rules and regulations in the past.

For ease of explanation, we mention the companies with more violation in the past as "Bad Company" and the companies with less violation in the past as "good companies".

We expect that declaration of the violation by good companies to investors is more surprising and lead to further reactions of market, also a good history of the company is declining. In contrast to the bad companies, a violation is in line with previous expectations.

If the investors use the company's history as an additional source of information about the mode of governance, we expect that the market will react to violations, especially in companies with good governance and a good track record. For the companies with bad history and history of poor governance, in the future, the market may have a violation expectance however for companies that are managed well or have a good history, violation is unexpected. In other words, there is reciprocity between good governance and good experience.

Method of data collection:

The theoretical implications of this research was collected through surveys and library studies. Also, the implementation of the research and data collection has been developed via compilation and distributions the questioners. The questions of these questionnaires are organized on a Likert scale with five items (very high, high, medium, low, low, high). The questionnaire consists of two main sections, the first section includes a personal profile that people have asked about information relating to gender, age, level of education, field of study, their work history and organizational title and the second part is formed of 20 questions that according to the purpose of the study has been developed.

Research methodology:

In this study simple random sampling is used. In this method, the members of the target population have equal chance of being selected as the subjects. The reason for using this method is the least biased and most of generalization and the comments of target population are homogeneous. Also it is possible that in this sampling, distribution patterns and characteristic that we are interested in this research in the same way in the elements that we select to the sample is distributed.

Determination sample size:

To determine sample size when the population size is known, the Cochran formula was used as follows:

$$n = \frac{Nz^2pq}{Nd^2 + z^2pq}$$

$$Z=1.96$$

$$P=Q=.5$$

N= sample size

d= Factor of safety and the error value

Methods of data analysis:

To analyze the data, was used from descriptive statistics indices such as tables, the calculation of central indices such as mean and distribution indices like standard deviation.

To determine the significance of relationships between variables in the research hypotheses Pearson correlation test is used and for comparison of the mean, the Student t-test at an alpha level of 5% in other words 95% confidence level is used and by using spss software will be analyzed.

The results and the analysis of them:

The results of the two separately phases are discussed below.

A - Results of personal information and its analysis

In this section that is related to the descriptive statistics, describes data related to each of the demographic variables including gender, age, education and work history and organizational title are discussed.

B - Results of testing research hypotheses.

The research findings:

After determining by sample size formula samples, 160 people were selected as sample members and designed questionnaire was distributed among the 160 people, 10 people returned the questionnaire blank.

In this study, we first describe the data (frequency, frequency distribution, mean, etc.) then we will analyze the data with the Pearson test.

Table 1: frequency distribution of gender.

	abundance	Percent abundance	Cumulative frequency
man	121	80.7	80.7
woman	29	19.3	100
total	150	100	

From total sample of respondents was carried out on 150 people, 121 people (80.7%) of the them were men and 29 people (19.3%) of the them were women. This indicates the presence of more men than women in the work area.

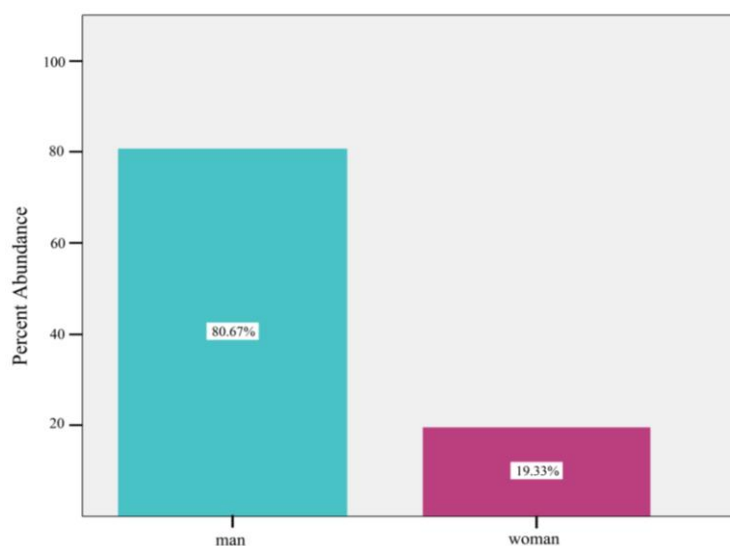


Chart 1: Sex Column Chart.

Table 2: Frequency distribution of education level.

	abundance	Percent Abundance	Cumulative Frequency
diploma	7	4.7	4.7
Associate's degree	27	18	22.7
Bachelor degree	50	33.3	56
MA	51	34	90
PhD	15	10	100
Total	150	100	

In Table 2, in total of 150 people, 7.4 percent of diploma, associate degree, 18%, 33.3% bachelor degree, 34% Master degree, 10% of the PhD reported and master degree is more than the others.

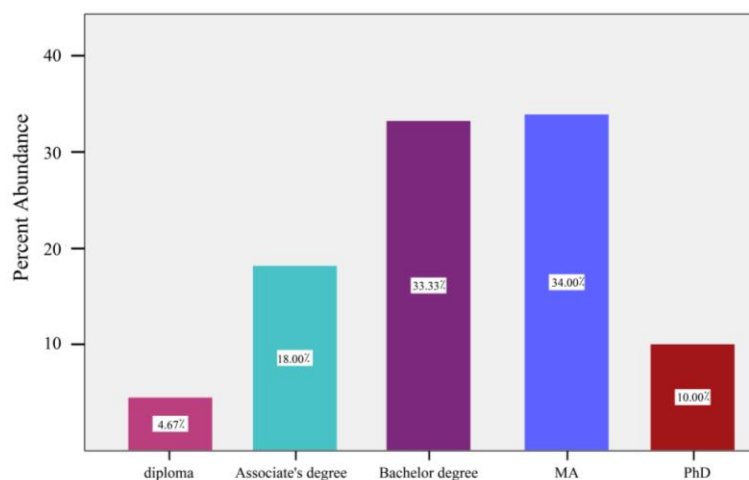


Chart 2: Column Chart education level

Table 3: The age distribution.

	abundance	Percent abundance	Cumulative frequency
Younger than 23 years old	8	5.3	5.3
23-28	20	13.3	18.8
28-33	37	24.7	43.3
33-38	38	25.3	68.7
Older than 38	47	31.3	100
total	150	100	

In the above table, 3.5% of 150 people are younger than 23 years old, 13.3% of them are 23-28 years old, 24.7 percent of them 28-33 years old, 25.3 percent of those 33-38 years old and 31.3 percent of them older than 38 years old have been reported and the age group of older than 38 years have highest percentage of frequent than other age groups and this indicates appropriate age group in the work area.

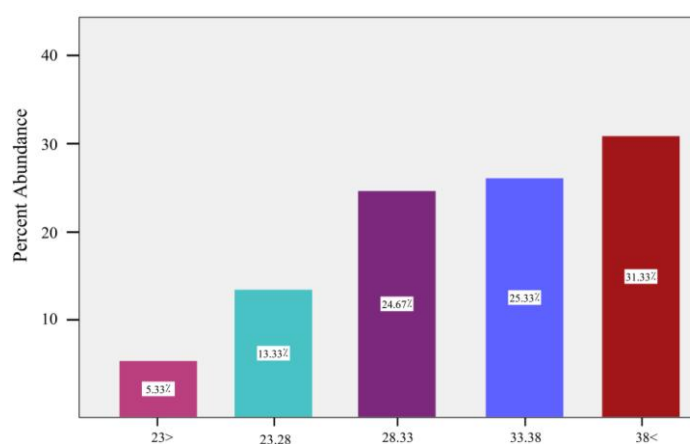
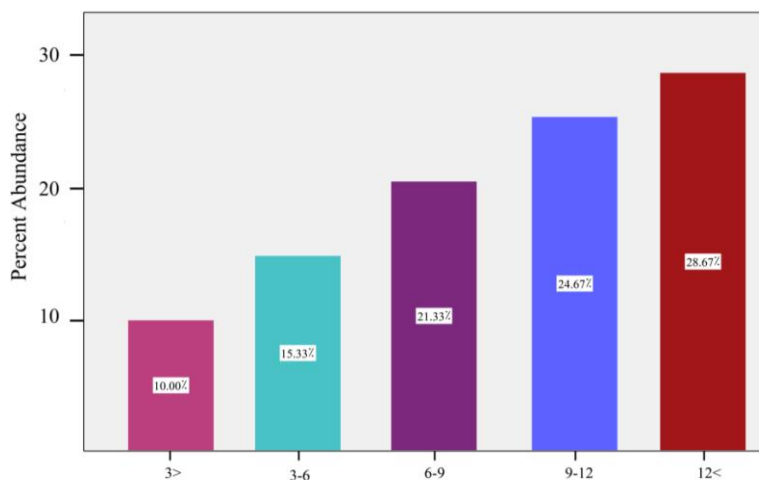


Chart 3: Column chart age groups of people.

Table 4: Frequency distribution of work history of people.

	abundance	Percent abundance	Cumulative frequency
3<	15	10	10
3-6	23	15/3	25/3
6-9	32	21/3	46/7
9-12	37	24/7	71/3
12>	43	28/7	100
Total	150	100	

In work history table of people between 150 people, 10% within 3 years, 15.3% with 3-6 years, 21.3 percent with 6-9 years, 24.7 percent with 12-9 years and 28.7 percent of those more than 12 years experience are reported. And work experience of over 12 years had the highest abundance.



In the general evaluation of the results of the demographic variables can be expression that the observation of Laws and Regulations and the reaction of investors in companies have suitable characteristics for such activities. Because it also has fit education for this type of jobs and also has a fit work history and fit has age that overall from these individuals, have provided capabilities for such jobs.

Explanatory indicators of research variables:

The following table shows the minimum value, maximum value, mean and standard deviation for each ancillary variable.

Table 5: Explanatory indicator of research variables.

	min	max	mean	Standard deviation	variance	skewness	elongation
Sex	1	2	1.19	0.39	0.15	1.5	0.46
age	1	5	3.64	1.20	1.4	-0/4	-0/74
Education	1	5	3.27	1.02	1.04	-0/25	-0/46
work history	1	5	3.47	1.31	1.7	-0/41	-0/97
Organizational position	1	5	3.07	1.58	2.5	-0/11	-1/5

Reliability and Propagation of the questionnaire:

Cronbach's alpha coefficient is a number between zero and one. The coefficient greater than 0.5 and closer to one indicates the reliability of questions which is calculated by the following formula.

$$r_{\alpha} = \frac{k}{k-1} \left(1 - \frac{\sum_{i=1}^k S_k^2}{S_t^2} \right)$$

K : Number of questions

S_k^2 : Variance of the answered of all subjects to K-th question

S_t^2 : Variance of the total score for each respondent

Obtained Alpha value for questions on the questionnaire been reported 0.941 and this shows that questions have high reliability.

Table 6: Cronbach's alpha test.

Number of Cronbach's alpha	Number of questions
0.941	20

Analysis of data:

In this study, to be significant the relationship between the variables in each hypothesis will be analyzed using Pearson statistical test and SPSS software.

Hypothesis 1: There is a positive relationship between the violation of corporate governance laws and regulations in good companies and investors reaction.

The output results in the table showed that between the violation of corporate governance laws and regulations in good companies and investors reaction that its type attention to Pearson's correlation coefficient is

positive and the correlation coefficient between two variables is 0.525 that shows the high relatively. Also output of scatter plot indicates that the correlation intensity is relatively high between these two variables.

Table 7: Relationship between the violation of good companies and investors reaction.

variant	quantity
Pearson correlation coefficient	525**
Significance level	0/000
Accept or reject	Existence of Relationship

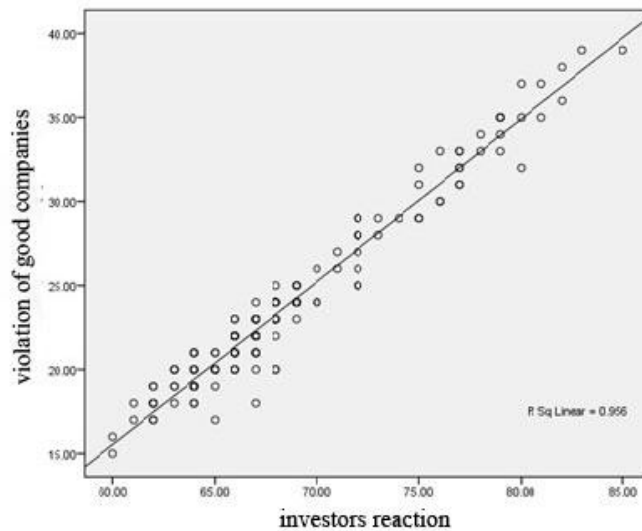


Fig. 1: The scatter plot between the violation of good companies and investors reaction.

Hypothesis 2: Between the violation of the corporate governance laws and regulations in bad companies and investors' reaction there is a positive relationship.

The output results of the table show that there is a correlation between the violation of the laws and regulations in the bad company and investors reaction and the amount of coefficient of correlation of two variables is 0.150 and significant levels reported 0.067 which is greater than alpha 0.05. Thus, between the violation of the corporate governance laws and regulations in bad companies and investors' reaction there is a relationship.

Table 8: The relationship between the violation of the laws in bad companies and the reaction of investors

variant	quantity
Pearson correlation coefficient	0/ 150**
Significance level	0/067
Accept or reject	Lack of Relationship

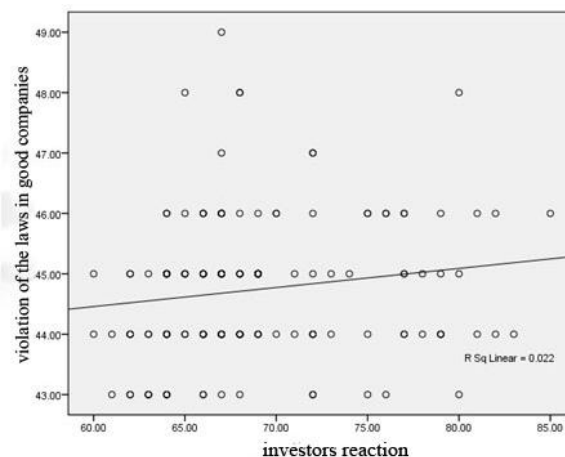


Chart 2: The scatter plot between the violation of the laws in good companies and the reaction of investors

Conclusions and recommendations:

In this study we investigated the relationship between the violations of the corporate governance laws and regulations and investors reaction. One of the sources of information that we have used to assess the corporate governance laws and regulations and the possibility of violation of that, was attention to the background of the company in violation of laws and regulations in the past. We mentioned the companies with more violation in the past as "bad company" and the companies with less violation in the past as "good companies". According to the first hypothesis test, the hypothesis is confirmed it means that between the violation of the corporate governance laws and regulations in good companies and investors' reaction there is a positive relationship. Also, as a test was performed to the second hypothesis, between the violation of the corporate governance laws and regulations in bad companies and investors' reaction, it was found that there is no relationship between the investors' reaction and corporate governance laws and regulations in bad companies.

To comply with the corporate governance laws and regulations for the companies offered the following titles:

1. Legislation relating to corporate governance in business law and apply them in sub-collections such as the Securities and Exchange and etc.
2. Preparation for the creation and start the activities of ranking agencies and forcing listed companies to provide the ranking of corporate governance and its subsidiaries.

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