

Investigating the effect of stock returns synchronicity on the relationship between the characteristics of the board of directors and the financial information transparency in companies listed on the Tehran stock exchange

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ABSTRACT

One of the important issues that has been considered in recent years following widespread financial scandals is the issue of financial transparency and the characteristics of the board of directors, which addresses the necessity of monitoring the management of the company and separating the economic unit from its ownership, and finally protecting the rights of investors and stakeholders. In this research, the relationship between the characteristics of the board of directors and the financial information transparency was investigated with emphasis on the synchronicity role of stock returns in the Tehran Stock Exchange. To achieve this goal, in this research, hypotheses were tested using a statistical sample of 104 companies listed on the Tehran Stock Exchange, which includes 644 observations between 2010 and 2015. In order to measure the characteristics of the board of directors, three criteria (size of the board of directors, independence of the board of directors, separation of duties of the chairman of the board of directors and the managing director) have been used and to measure the information transparency, the score provided by the Tehran Stock Exchange was used. The obtained results showed that the stock returns synchronicity does not affect the relationship between the characteristics of the board of directors and the information transparency.

Keywords: Characteristics of the Board of Directors, Financial Information Transparency, and Stock Returns Synchronicity

Introduction

Full disclosure along with financial reporting transparency can create safe conditions that increases investors' confidence. Transparency has a positive effect on the performance of companies and can protect the interests of shareholders. Increasing shareholders' confidence and decreasing risk exposure reduces the expected return and increases the value of the company (Kurdistani and Alavi, 2010).

On the other hand, in the current business structure, separating ownership from management is inevitable, and the absence of monitoring mechanism affecting management in such companies increases the likelihood of inefficient allocation of resources, reduces performance level and increases the spread of organizational problems (Johari et al., 2008). Trying in order to create an effective monitoring mechanism in companies in Iran has led to the compilation of corporate governance system regulations in the Tehran Stock Exchange. The characteristics of the board of directors including non-executive members of the

board of directors, appropriateness of the size of the board of directors and the presence of the audit committee in the companies are among the cases that have been emphasized in this regulation (Moradi et al., 2012). The structure of the board of directors includes the organization of the board of directors, the role of the affiliated boards of directors in the holding companies, the boards of directors committees, the formal independence of the one-rank and two-rank boards of directors, the leadership of the board of directors and the flow of information between the structures of the board of directors. The board of directors process reflects the decision-making activities, the styles of the board of directors, number and duration of the board of directors sessions, compliance with the ceremonies of the programs of the board of directors, and compliance with the ceremonies of the programs of the board of directors and the culture of the board of directors regarding the performance evaluation of members (managers) (Salmon, 2004).

On the other hand, the stock returns synchronicity can affect this relationship. Currently, the most important criterion for evaluating the performance of institutions is the stock return rate. Synchronicity means the movement of stocks in the direction of market movement. This movement can be in the up or down direction depending on the market trend. Stock returns synchronicity is as a criterion for stock price information value, which is calculated as a regression below the annual returns of each company, on market and industry returns as follows (Mingyang et al., 2014, p. 91). This criterion alone has information content for investors and is used to evaluate performance. When this criterion is reduced, it is an alarm for the company and does not show the performance of the company proper. This criterion has a lot of information content, because performance evaluation based on market value reflects the information of investors well. Stocks returns is a driving force in the process of investors that creates motivation and is considered as a reward for investors. Since stock returns are one of the most important criteria that play a greater role in evaluating the performance of the company, any company can increase its earnings per share by investing in low-yield projects. As long as the return on investment of a new project exceeds the cost of long-term debt cost after its tax, it will increase earnings per share. But if the return on the project is not high enough to give shareholders a proper return on their capital, it will reduce the stock price and the stock price coefficient and the price-to-earnings coefficient (Khoshtinat and Ismaili, 2005).

Since the existence of a proper governance system can help companies attract the investors' confidence and encourage them to invest, and on the other hand, the implementation of these principles at the company level, according to the conducted empirical researches, also improves financial reporting in the company, in this research, the effect of stock returns synchronicity on the relationship between the characteristics of the board of directors and the financial information transparency in companies listed on the Tehran Stock Exchange will be investigated.

Research Theoretical Foundations

Characteristics of the Board of Directors

A company with good corporate governance mechanisms, such as the separation of roles or optimal balance between executive and non-executive members, shows greater effectiveness in monitoring and controlling management (Salmon, 2005). If the managing director (CEO) is also the chairman of the board of directors, this situation is referred as the dual role of the CEO, and in this state the CEO has potentially more authority. The dual structure also allows the CEO to effectively control the information available to other members of the board of directors, and thus it might prevent effective monitoring.

The beginning of corporate ownership through the stock ownership had a significant impact on the methods to control companies, and thus, the owners delegated the management of the companies to the managers. Separation of management from ownership (control) led to a well-known organizational problem, called the "Agency Problem". Berle and Means (1932), Ross (1973), and Price (1976) addressed this issue from various angles, and finally Jensen and Meckling (1976) proposed the foundations of agency theory. They defined the managers of companies as "brokers" and shareholders as "work assigners".

In financial theories, a basic assumption is that the primary goal of companies is to increase the wealth of shareholders, but in practice this may not be the case. It is possible for managers to prefer their own

interests over the interests of shareholders. Managers are probably inclined to increase personal interest (Hasas Yeganeh and Jafari, 2005, 105).

The Board of Directors Size

Regarding the effect of the company size, prominent research by Kiel and Nicholson (2003) shows that as the company size increases, the composition size of the board of directors increases; multiple membership become more common, and independent members of the board of directors become more. Chizma and Kim (2010) also believe that as the company size increases, the number of independent members of the board of directors increases. However, Ning et al. (2008) consider the factor of company size as the most effective factor in the board of directors size. On the other hand, Shaw and Lin (2007) and Chizma and Kim (2010) believe that the investment structure affects the composition of the board of directors; in a way that in companies that have joint ventures, more independent members have entered into the composition of the board of directors. Researches show that with ownership in the hands of a small group of people such as the managers of company, shareholders, founders and institutional investors, the board of directors size will decrease. Kong et al. (2007) in the dimension of affecting the ratio of concentration on stock ownership also believe that in companies where stock ownership is concentrated, the composition of the board of directors will have fewer female members and less members will be independent. Ning et al. (2008) also believe that internal ownership (ownership by company members) negatively affects the board of directors size. Wideby (1997), on the other hand, believes that with the concentration of ownership in the hands of institutional investors, the number of independent members of the board of directors increases.

The Board of Directors Independence

Independence is defined in relation to the financial interests of the member, however, considering the concept of independence alone in terms of financial benefits cannot be enough. What is needed is a thorough understanding of the fundamental and basic reasons for the independence criterion and its related perspectives.

In some countries, independence exclusively means not having financial benefits other than incomes due to the membership in the board of directors. Such a definition not only makes it difficult to align the interests of the board of directors members and shareholders, but is not necessary in relation to the concept of independence. Zahra and Pierce (1989) and Daily et al. (2003) provide a comprehensive and concise image of the board of directors roles; they have divided these roles into four roles: supervisory, strategic, service (consulting/information) and resource provision (acquisition of resources/communicating).

Marlin and Geiger (2011) also emphasize the important role of law in the composition of the board of directors, by referring to the legal requirements for the composition of the board of directors, especially in terms of the expertise of members and their independence. Fitch and Shivodasani (2006) believe that the multiple membership of the board of directors has a negative effect on playing their supervision role. Mies (1986) believes that the board of directors members who are the members of several boards of directors can play their service role better than others. Carpenter and Westphal (2001) from another perspective also believe that the existence of diversity of professional and experienced members in the board of directors can be effective in playing their service role.

Wafi Thani (2009) states in a research that there is a negative and significant relationship between the percentage of non-executive members of the board of directors and also the percentage of institutional investors ownership and agency costs. On the other hand, the results of the research have not corresponded to the assumption that there is a relationship between the debt ratio of companies and agency costs.

Separation of the Duties of the Chairman of the Board of Directors and the Managing Director

In the governance factors section, components such as separation of the two positions of CEO and chairman of the board of directors, alignment of the goals of shareholders and managers, the CEO's

activity period and the existence of governance requirements in relation to the composition of the board of directors can affect the mentioned composition and its aspects. In this regard, Wordcars et al. (2007) point out that if the CEO has also the responsibility of the chairman of the board of directors, this issue has a negative effect on the number of independent members present in the composition of the board of directors. However, according to Ning et al. (2008), if the CEO has been activating in his position for a long time, this issue can affect the composition of the board of directors. Jasquise and Klein (2007) claim that the closer the goals of the managers and stock owners are to each other, the board of directors size and the number of its independent members decrease.

Rasaian (2010) examined the effect of the characteristics of the board of directors on the capital structure of the company. The research results showed that in companies where the duties of chairman of the board of directors and the CEO are not separated from each other and also in companies with a smaller number of the members of the board of directors, the ratio of debt utilization increases. While no significant relationship was found between the ratio of non-executive managers of the board of directors and the capital structure. Iliati and Hajiha (2013) in a research concluded that there is a positive and significant relationship between the structure of the board of directors and the quality of financial reporting and there is a negative and significant relationship between the percentage of the ownership of the board of directors and the quality of financial reporting. And there is no significant relationship between the other pillars of corporate governance which in this research includes the proportion of the members of the board of directors, ownership structure, and institutional ownership and the quality of financial reporting.

Financial Information Transparency

Investors' behavior is affected by many factors, that one of the main factors of these behavioral ambiguities is the issue of uncertainty and the lack of transparency of information. Information transparency is to increase on time and reliable flow of economic, financial, social and political information that is available to all stakeholders (Foroughi et al., 2011). It can almost be said that the occurrence of financial crises in the stock markets during the last decade has been mainly due to insufficient transparency of financial information. Recently, the accounting fraud in the companies, incorrect financial reports and poor management and control of companies have widely become popular in the world (Calzic, 2004). Vishwanath and Kaufmann (1999) have defined the lack of transparency as "deliberate obstruction of access to information, the presentation of incorrect information, or the inability of the market to ensure the adequacy of the relevance and the quality of information provided".

In Flourini's (1999) definition of transparency, accountability has become more prominent. He defined transparency as "the disclosure of information by companies that is relevant to their evaluation". In his view, transparency is a tool to facilitate the process of evaluating the performance of companies. Emphasis on the right of access to information (taking into account the privacy of both parties of producer and user) and the possibility of evaluating the performance of companies using this information has become more prominent in these definitions. In fact, transparency is closely related to accountability, and the reason for the demand for transparency is that the market considers companies responsible for the policies adopted and their performance (Blour and Kaufmann, 2005).

Information accessibility is among the important dimensions of achieving transparency. Companies can facilitate the flow of access to information. According to signaling theory, if companies refuse to provide information about their performance, the market interprets such an action as "bad" news and reduces that company's stock price. Therefore, companies have enough motivation to publish information. On the other hand, if delay in providing information or restricting access to useful information have financial benefits, companies will have an incentive to hide information, and according to Vishwanath and Kaufmann (1999), "access" to information is retained as a hostage to gain financial benefits.

Foroughi et al. (2011) in a research show that there is a direct relationship between the financial information lack of transparency and the risk of future stock price fall. The results of this research also show that in conditions that there is information asymmetry between managers and investors, the effect of financial information lack of transparency on increasing the risk of future stock price fall is greater.

Abzari and Derakhshandeh (2013) showed that all three dimensions of transparency, that are the disclosure of financial information, the transparency of the the board of directors structure and the transparency of the ownership structure have affected the behavior of investors in the Isfahan Stock Exchange and investors' understanding of the dimensions of transparency according to their demographics variables is different. Hsio (2006) showed that there is a positive and significant relationship in the perception of stock market investors of the dimensions of financial information transparency and their behavior, and among the dimensions of transparency, the transparency of ownership structure has the greatest impact.

Stock Returns Synchronicity

One of the basic criteria for decision making in the stock exchange is stock returns; stock returns alone have information content and most actual and potential investors use them in financial analysis and predicting. One of the most important and the most widespread researches in financial markets is to describe the behavior of stock returns. Identifying the factors affecting stock returns has always allocated many researches to itself. In the stock market, return means the set of benefits that accrue to a share during the year.

Chong and Jing (2014) in a research investigated the effect of free cash flow problems on the stock returns synchronicity. The results of their research showed that high free cash flow has a higher stock return synchronicity. They stated that such companies reduce the quality of disclosure by using earnings management.

Synchronicity means the movement of stocks towards the direction of market movement. This movement can be up or down depending on the market trend. Stock returns synchronicity is as a criterion for stock price information value, which is calculated as the following regression of the annual returns of each company on market and industry returns (Mingyang et al., 2014):

$$R_{itw} = \alpha_{0i} + \beta_{1i}R_{mtw} + \beta_{1i}R_{mtw-1} + \gamma_{1i}R_{jtw} + \gamma_{2i}R_{jtw-1} + \varepsilon_{itw}$$

Research Method

The present research is applied in terms of purpose, and the results obtained from it can be useful for a wide range including company managers, shareholders, investors, creditors, researchers and standards compilers. The statistical population is all companies listed on the Tehran Stock Exchange in various industries and groups. In this research, the systematic removal method for sampling is used, that the criteria applied for sample selection are as follows:

1. Companies should be among the companies listed on the Tehran Stock Exchange.
2. Companies should have been listed on the Tehran Stock Exchange before 2010.
3. The required information from 2010 to 2015 should be available.
4. In order to comply with the homogeneity of reporting date and to eliminate seasonal effects, their financial period should lead to the end of the solar year.
5. Companies should not be among the banks and financial institutions (investment companies, financial intermediation, holding and leasings).

It should be mentioned that in this research, the following model has been used to test the hypotheses.

$$\text{Transparence} = \alpha_{it} + \beta_1 BC_{it} + \beta_2 SRSY_{it} + \beta_3 CG_{it} * SPSY_{it} + \beta_4 size_{it} + \beta_5 lev_{it} + \beta_6 bm_{it} + \varepsilon$$

Which in the above equation:

Transparence: Financial information transparency

BC_{it} : The characteristics of the board of directors

SRSY: Stock returns synchronicity

size: Company size

lev_{it} : Financial leverage

bm_{it} : The book value to market value.

In this research, the market value logarithm of the company has been used to enter the size of companies in the hypothesis testing model. The ratio of market value to book value of the company (BM_t) indicates the growth opportunities of the company. The higher the size of this ratio is, the company has more growth. In this research, this ratio has been used as a control variable. Financial leverage is obtained by dividing the sum of total liabilities by the sum of total assets. The higher the degree of financial leverage is, the degree of financial risk becomes greater, so it is expected that it affects the future performance of the company too.

In which:

$$LEV_{i,t} = TL_{i,t} / TA_{i,t}$$

TL : Total liabilities

TA : Total assets.

Findings

Hypothesis 1: The stock returns synchronicity on the relationship between the board of directors independence and the financial information transparency is significant.

Table 1: Test Results of the First Hypothesis

Dependent Variable: Information Transparency				
Variable Name	(Coefficients)	(T-Statistic)	Standard Deviation	Prob.
Fixed Value	42.16329	30.89342	1.364798	0.1729
Board of Directors Independence	48.16635	11.49091	4.191692	0.0000
Stock Return Synchronicity	7.402832	13.05805	0.566917	0.5710
Board of Directors Independence* Stock Return Synchronicity	-6.503303	17.48162	-0.372008	0.7100
Company Size	-0.339400	2.113204	-0.160609	0.8725
Financial Leverage	-4.299872	7.082907	-0.607077	0.5441
Market Value to Book Value	-0.900911	0.372511	-2.418479	0.0159
Assets Return	-5.431491	9.102380	-0.596711	0.5510
Durbin-Watson	Durbin-Watson		1.872837	
Determination Coefficient	R-Squared		0.051264	
Adjusted Determination Coefficient	Adjusted R-Squared		0.040482	
F Statistics	4.754948		Prob. 0.000	
Variance Heterogeneity	8.657092		Prob. 0.1938	
H- Hausman Statistic	22.293848		Prob. 0.0023	
F- Limer Statistic	5.158124		Prob. 0.0000	

According to the test results of the first hypothesis presented in Table (1), the significance level of F-Limer statistic (0.000) was less than the accepted error level (5%), so the panel data method compared to the pooled data method is preferred. Also, considering that the significance level of H-Hausmann statistic (0.0023) was less than the accepted error level (5%), so the regression method with fixed effects is preferred to the regression method with random effects. Also, considering that the significance level of F-white statistic was 0.1938, this point indicates that regression does not have variance heterogeneity. In the next stage, considering that the F-statistic (0.000) has a significance level below (5%), so regression has explanatory power. On the other hand, the determination coefficient in the regression represents the percentage of explaining the dependent variable by the independent and control mean. As shown in the table above, the determination coefficient of this equation is equal to 0.051, which means that 5.1% of the dependent variable changes are explained by control variables. Also, since the significance level of the

board of directors independence * the stock returns synchronicity (independent variable) is more than 5%, so it can be said that the stock returns synchronicity on the relationship between the board of directors independence and the financial information transparency is significant.

Hypothesis 2: The stock returns synchronicity impacts on the relationship between the board of directors size and the financial information transparency.

Table 2: Test Results of the Second Hypothesis

Dependent Variable: Information Transparency				
Variable Name	(Coefficients)	(T-Statistic)	Standard Deviation	Prob.
Fixed Value	31.58526	34.20335	1.215824	0.0245
Board of Directors Size	16.50199	20.76865	0.794563	0.4272
Stock Return Synchronicity	25.67659	53.66911	0.478424	0.6325
Board of Directors Size* Stock Return Synchronicity	-19.95012	32.82611	-0.607752	0.5436
Company Size	0.057473	0.682966	0.084152	0.4330
Financial Leverage	2.260881	5.536680	0.408346	0.3832
Market Value to Book Value	-0.498171	0.414851	-1.200843	0.2303
Assets Return	21.04150	8.156255	2.579799	0.0101
Durbin-Watson	Durbin-Watson		1.925018	
Determination Coefficient	R-Squared		0.020962	
Adjusted Determination Coefficient	Adjusted R-Squared		0.009837	
F Statistics	2.884160		Prob. 0.039645	
Variance Heterogeneity	8.764616		Prob. 0.0133	
H- Hausman Statistic	15.120043		Prob. 0.0345	
F- Limer Statistic	4.415338		Prob. 0.0000	

According to the test results of the second hypothesis presented in Table (2), the significance level of F-Limer statistic (0.000) was less than the accepted error level (5%), so the panel data method compared to the pooled data method is preferred. Also, considering that the significance level of H-Hausmann statistic (0.0345) was less than the accepted error level (5%), so the regression method with fixed effects is preferred to the regression method with random effects. Also, considering that the significance level of F-white statistic was 0.0133, this point indicates that regression has variance heterogeneity. Therefore, having removed heterogeneity, we estimate the model. In the next stage, considering that the F-statistic (0.000) has a significance level below (5%), so regression has explanatory power. On the other hand, the determination coefficient in the regression represents the percentage of explaining the dependent variable by the independent and control mean. As shown in the table above, the determination coefficient of this equation is equal to 0.039, which means that 3.9% of the dependent variable changes are explained by control variables. Also, since the significant level of the interaction of the stock returns synchronicity * the board of directors size (independent variable) is more than 5%, so it can be said that the stock returns synchronicity on the relationship between the board of directors size and the financial information transparency is not effective.

Hypothesis 3: Stock returns synchronicity affects the relationship between the board of directors independence and financial information transparency.

Table 3: Test Results of the Third Hypothesis

Dependent Variable: Information Transparency				
Variable Name	(Coefficients)	(T-Statistic)	Standard Deviation	Prob.
Fixed Value	65.77959	9.763262	6.737460	0.0000
Separation of the Duties of CEO	-7.130170	17.05098	-0.418168	0.6760
Stock Return Synchronicity	-7.054166	3.727743	-1.892342	0.0589
Separation of the Duties of CEO * Stock Return Synchronicity	-66.69773	35.66028	-1.870364	0.0619
Company Size	0.243042	0.663229	0.366453	0.7142
Financial Leverage	3.318179	5.445341	0.609361	0.5425
Market Value to Book Value	-0.545123	0.408230	-1.335332	0.1823
Assets Return	22.54918	8.014631	2.813502	0.0051
Durbin-Watson	Durbin-Watson		1.913956	
Determination Coefficient	R-Squared		0.051511	
Adjusted Determination Coefficient	Adjusted R-Squared		0.040733	
F Statistics	4.779193		Prob. 0.000	
Variance Heterogeneity	9.094390		Prob. 0.0006	
H- Hausman Statistic	16.169468		Prob. 0.0236	
F- Limer Statistic	4.288971		Prob. 0.0000	

According to the test results of the third hypothesis presented in Table (3), the significance level of F-Limer statistic (0.000) was less than the accepted error level (5%), so the panel data method compared to the pooled data method is preferred. Also, considering that the significance level of H-Hausmann statistic (0.023) was less than the accepted error level (5%), so the regression method with fixed effects is preferred to the regression method with random effects. Also, considering that the significance level of F-white statistic was 0.0006, this point indicates that regression has variance heterogeneity. Therefore, having removed heterogeneity, we estimate the model. In the next stage, considering that the F-statistic (0.000) has a significance level below (5%), so regression has explanatory power. On the other hand, the determination coefficient in the regression represents the percentage of explaining the dependent variable by the independent and control mean. As shown in the table above, the determination coefficient of this equation is equal to 0.051, which means that 5.1% of the dependent variable changes are explained by control variables. Also, since the significant level of the effect of the stock returns synchronicity * separation of duties (independent variable) is more than 5%, so it can be said that the stock returns synchronicity on the relationship between the board of directors independence and the financial information transparency is not effective.

Conclusion

- **First Hypothesis**

The first hypothesis of the research sought to prove the effect of stock returns synchronicity on the relationship between the board of directors independence and financial information transparency, which according to the findings obtained from the research and because the significance level of interaction (stock returns synchronicity * the board of directors independence) is more than the significance level 0.05, so the obtained results show that the stock returns synchronicity does not affect the relationship between the board of directors independence and the financial information transparency. The obtained results contradict the findings of Ghiamfi et al. (2015) indicating the effect of the stock returns synchronicity on the relationship between the board of directors independence and financial information transparency.

- **Second Hypothesis**

On the other hand, the second hypothesis of the research sought to prove the effect of stock return synchronicity on the relationship between the board of directors size and financial information transparency, which according to the findings obtained from the research in the fourth chapter and as the

significance level of interaction (stock return synchronicity * the board of directors size) is more than the significance level of 0.05, so the obtained results show that the stock returns synchronicity does not affect the relationship between the board of directors size and financial information transparency. The obtained results contradict the findings of Ghiamfi et al. (2015) indicating that stock returns synchronicity does not affect on the relationship between the board of directors size and financial information transparency.

• Third Hypothesis

As stated, the synchronicity of stock price indicates the ratio of market information relative to the specific information of the company; increasing it reduces information asymmetry and increases the companies' financial information transparency. Therefore, it was expected that with increasing stock returns synchronicity in the Tehran Stock Exchange, the relationship between the separation of CEO's duties and the financial information transparency increases and affects this relationship, but as observed in the research findings, the interaction of (stock returns synchronicity * the separation of the CEO's duties) is more than the significance level of 0.05, which indicates that the stock returns synchronicity does not affect the relationship between the separation of the CEO's duties and the financial information transparency. The obtained results contradict the findings of Ghiamfi et al. (2015) indicating that stock returns synchronicity does not affect the relationship between the separation of the CEO's duties and financial information transparency.

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