Corporate Governance in Investment Efficiency, Financial Information Disclosure

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Corporate governance minimizes the conflicting interests between internal and external stakeholders and shareholders. The corporate governance structure affects the quality of accounting disclosure and information quality assessment and guides analysts to accurately forecast future performance. There is no consensus definition for corporate governance, but its ultimate goal is to achieve accountability, transparency, justice, fairness, and respect for the rights of all stakeholders. Corporate governance is not related to the primary operations of a company. Still, it is related to leading the company, monitoring the activities of the CEO, and assessing the accountability power of the company's executives to stakeholders. A proper corporate governance system can help companies gain investors' trust and encourage investment.

Keywords: investment efficiency ; financial information disclosure risk ; corporate governance

1. Introduction

Good corporate governance can provide a practical framework for balancing ownership and control, effective monitoring, appropriate incentives for the board and management to pursue goals for the company's interests and shareholders, and the equitable treatment of shareholders and other stakeholders (Peng et al. 2021). By establishing a quality corporate governance system, it is possible to take steps toward achieving a company's long-term goals by motivating its managers and employees (Black et al. 2010). Therefore, when corporate governance is appropriate, managers' behavior is expected to align with shareholders' interests (Med Bechir and Jouirou 2021). In general, corporate governance has a supervisory role over a company. Corporate governance mechanisms can maximize the interests of shareholders (predominantly minority shareholders) by monitoring the performance and behavior of managers and employees (Soliman 2020) and preventing the opportunistic behaviors of CEOs (Abd Karim et al. 2018).

Most of the research has confirmed the positive impact of corporate governance on performance (Braune et al. 2020; Paniagua et al. 2018; Iqbal et al. 2019; Mertzanis et al. 2019; Duppati et al. 2017). However, some studies have not reached such a conclusion (Rashed et al. 2018; Chen et al. 2017). Investment decisions in companies are determined by key factors such as macroeconomic factors, types of economic and monetary policies, money and capital markets, and corporate operations (Richardson 2006). In addition, managerial reasons such as unreasonable behavior of managers and inefficient financial markets in companies with a weak corporate governance system affect the companies' investment policies (Malmendier et al. 2011). It can be said that when a company has achieved a high level of investment efficiency, this ability indicates the strength of regulatory processes in the company, which has prevented inefficient investments of excess cash flow in the company. Through preventive monitoring of corporate governance over high-risk investment events, a company can detect an inefficient investment in the organization before it occurs, which can prevent an inefficient investment (He et al. 2019) because investment efficiency generally means investing in projects with a positive net present value, regardless of investing in projects with a negative net present value (Verdi 2006). Gompers et al. (2010) showed that the company's value would be less in a weak corporate governance system. This is why the ownership structure plays a significant role in the value of the company, because the lower the concentration of ownership, the more managers sacrifice some of the company's values to protect their interests, and as a result, the efficiency of the investment decreases. Managers have a strong incentive to invest in negative net present value (NPV) projects in companies with high free cash flows, especially when management monitoring is weak, where agency costs are high and corporate ownership and control are separated (Stulz 1990). Therefore, due to the infancy of corporate governance law in the Tehran Stock Exchange, evaluation of the impact of corporate governance on operational efficiency in the Tehran Stock Exchange market can demonstrate its effectiveness in this market.

In general, disclosure is the provision of the minimum legal requirement of information. Thus far, several structures, such as appropriateness, comprehensiveness, reliability, informativeness and timeliness, have been used as proxies of disclosure quality. The stronger the corporate governance system, the higher the information disclosure and the greater the information transparency (Braune et al. 2020). When corporate governance is weak, managers can increase financial reporting risk by manipulating financial information to achieve personal goals and, consequently, create information inefficiencies in determining stock prices in the capital market. According to the expectation of implementing corporate governance, corporate governance can affect the desired and more transparent disclosure of information and not allow managers to hide their poor performance with poor operational efficiency through undesirable disclosure of information. Investors consider corporate financial information as one of the sources to reduce information asymmetry. To evaluate the efficiency of the investment, investors refer to the financial information of companies. The more reliable and relevant the information is, the more possible it is to make the right decisions. The corporate governance system can prevent opportunistic behaviors of management in not disclosing sufficient and quality information by increasing management monitoring processes. Companies with better corporate governance have high-quality financial information disclosure, and providing high-quality financial information convinces investors and other stakeholders to invest (Kouki and Attia 2016). Establishing a strong corporate governance mechanism can encourage investors to purchase the company's stock at a higher price by increasing the proper disclosure of financial information and gaining investors' trust, eventually maximizing the company's value. In Europe, having investigated the reasons for disclosing intangible capital information, it was concluded that improving corporate governance, which is subject to voluntary disclosure of information, causes an increase in corporate financial performance (Braune et al. 2020).

The high risk of financial information disclosure can coincide with a company's investment performance. Due to opportunistic behaviors of management, increasing the risk of financial information disclosure can indicate the inefficiency of the company's investments. An increase in the level of high-quality disclosure related to financial statements leads to a higher level of investment in a company (Li et al. 2019). It can also indicate a two-way relationship between the level of disclosure and the efficiency of investment in companies (Elberry and Hussainey 2020). Roychowdhury et al. (2019), in their study, have shown that the quality of reporting has a direct and positive effect on investment efficiency. In addition, information transparency is positively related to investment efficiency for firms with strong governance. By improving corporate governance, the quality of information disclosure and investment efficiency increases (Chen et al. 2021). The high quality of financial information disclosure in a company, which is influenced by the strong corporate governance structure in the company through more supervision and strict rules to control the actions of managers, and thereof the increasing of investment efficiency, is achieved through limiting an overinvestment in the negative NPV projects or under-investment by neglecting positive NPV ones (Elberry and Hussainey 2021). Good corporate governance can reduce information asymmetry, agency costs, and information search costs and can increase information transparency since corporate governance allows investors to experience fewer investment errors; sound corporate governance can ensure that while a company's managers have the incentive to make their own profits, they attempt to increase the interests of investors and the firm value (Cheng et al. 2019).

Corporate governance and its importance are relatively new issues in Iran. In 2004, corporate governance, based on OECD guidelines, gained public attention with the first attempt by the Tehran Stock Exchange to codify the first draft of corporate governance bylaws. In 2008, the OECD's corporate governance principles were translated into Persian. In 2010, the Securities and Exchange Commission (SEO) completed and formally approved the corporate governance regulations, but its implementation in companies has not yet been mandatory. During this time, several seminars, conferences, and awareness-raising activities on corporate governance were held. Meanwhile, the SEO attempted to improve corporate governance through separate regulations such as disclosure and transparency.

Due to the low quality of disclosure in the Iranian capital market compared to developed countries, the desirability of domestic and foreign investors to make new investments in the Iranian capital market has been challenged (Mehrabani 2012). In addition, unlike the majority of shareholders, the interests of minority shareholders are not protected, unlike in other countries where non-controlling shareholders sometimes have significant influence. No Iranian institution ranks companies based on characteristics such as returns, revenue, total assets, number of employees and so on, and Iran's internal control supervision mechanisms are inadequate. As a result, managers often prefer personal and corporate interests (Irani and Safari Gerayeli 2017). The existence of suitable conditions for profit-seeking managers will cause problems of agency theory in companies, in which corporate governance is expected to play a significant role in reducing agency costs.

Although the corporate governance literature is fully developed and many studies have been conducted in this field, no studies have been conducted on the impact of corporate governance on investment efficiency (as one of the essential roles of company leadership) and the impact of corporate governance on the risk of financial disclosure (as one of the criteria for determining the expected return of shareholders) that can indicate the effectiveness of the presence of corporate governance in the management of the company, which can be one of the points that investors consider.

Therefore, herein, it tries to answer whether the implementation of corporate governance legislation in Iran has affected the efficiency and risk of financial information disclosure of companies. Empirical evidence obtained in this regard can provide feedback on implementing corporate governance legislation for the Tehran Stock Exchange and investors in this market.

2. Corporate Governance and Investment Efficiency

Investment efficiency means the organization invests in projects with positive net present value (Verdi 2006). The basic principles of corporate governance include ensuring the observance of ethics and protection of the stakeholders' rights, ensuring the observance of the code of ethics and other values. According to stakeholder theory, corporate governance should take into account the interests of all organizational stakeholders, increase moral obligations in an organization, and raise the responsibility of the individual to stakeholders by disclosing the information risk to stakeholders to help them make decisions, maintain wealth, and increase trust between the company and stakeholders (Habbash 2017). Ethical decision making and ethical values are fully reflected in issues such as conflicts of interest, opportunities to participate in fair transactions, gaining trust, correct use of a company's assets, operating per rules and laws, and encouragement in dealing with unethical practices (Li et al. 2019). A corporate governance system can help companies gain investors' trust; when corporate governance is appropriate, managers' behavior is expected to be in line with the interests of the shareholder. In other words, corporate governance leads to an increase in the value of a company (Black et al. 2006). Research conducted in China showed that managers in companies that have weak internal control over financial reporting are more likely to invest inefficiently (Lai et al. 2020).

The efficiency of investing in companies that have a stronger monitoring system is higher. According to agency theory, managers seek to maximize their interests in a company. In their own interests, they prefer to invest free cash flow in projects that may even be unprofitable. When the quality of corporate governance is strengthened, investment efficiency improves. High investment efficiency can indicate a strong monitoring system in a company; this system causes investment efficiency to increase. Through corporate governance's preventive monitoring of high-risk investment events, they can identify an ineffective investment in the organization before it occurs; this identification can prevent an inadequate investment (He et al. 2019). Several research studies on corporate governance and investment efficiency concluded that there is a positive and significant relationship between corporate governance and financial performance (Mertzanis et al. 2019; Med Bechir and Jouirou 2021; Li et al. 2020). Some of these research studies have shown that the board's independence positively affects the relationship between corporate governance and financial performance (Paniagua et al. 2018; Al-ahdalet al. 2020). In other words, a strong corporate governance system improves financial performance (Duppati et al. 2017; Iqbal et al. 2019; Machmud et al. 2020; Srivastava and Kathuria 2020; Peng et al. 2021; Sheikh and Alom 2021), and the efficiency of resource investment has a positive and significant effect on the growth of financial performance (Özbuğdayet al. 2020).

Soliman (2020) concluded in his study that, by having high audit quality and reducing information asymmetry, corporate governance has a positive effect on increasing the attraction of new investments and leads to an increase in the volume of investment in companies, and as a result, the value of the company increases. On the other hand, Rodrigues et al. (2020) concluded that investment efficiency has a positive and significant relationship with corporate governance mechanisms that help align the interests of managers and shareholders. Chen et al. (2016) showed that companies with positive free cash flow overinvest, while some corporate governance characteristics, such as larger board size, reduce overinvestment.

The studies conducted in the field of corporate governance and excessive managerial entrenchment and firm performance show that excessive managerial entrenchment reduces board monitoring and deteriorates the firm valuation in the capital markets because as CEOs become entrenched, they gain more control and seek to maximize their benefits rather than the interests of the shareholders. As a result, excessive managerial entrenchment has a negative impact on the shareholders' welfare. It causes a decrease in the efficiency of the company's performance and, subsequently, a reduction in the firm value (Antounian et al. 2021). On the other hand, the conclusions of the studies conducted in the field of corporate governance quality, leverage, and performance indicate that the higher the quality of corporate governance, the lower leverage (Memon et al. 2019), and as a result, financial performance increases (Zhou et al. 2021).

Wang et al. (2021) showed that investment efficiency increases with stock concentration through increasing corporate governance, such as reducing agency conflict, and according to the research conducted by Zhang (2020), earning informativeness decreases with the reduction in controlling of shareholder's ownership, and reducing agency conflict has a positive effect on improving the investment efficiency of companies. In addition, considering the recent crisis and the COVID-19 pandemic, studies (Hsu and Liao 2022) showed that good corporate governance could positively affect the stock market's performance in this era. Some corporate governance mechanisms, such as ownership structure, are strongly related to stock price reactions during the COVID-19 pandemic. Large companies and governments experience less stock price declines in response to the pandemic (Ding et al. 2021).

3. Corporate Governance and Financial Information Disclosure Risk

The term disclosure, in its broadest concept, means providing information. Accountants use this term in a more limited way, meaning publishing financial information related to a company in financial reports (usually in annual reports). In the narrowest concept, information disclosure includes management discussions and analyses, footnotes to financial statements and supplementary financial statements (Clark 2016). Today, information plays a significant role in the investment decisions of investors. Therefore, to obtain more information and to solve the problem of information asymmetry, information disclosure is used due to the separation of companies' ownership and management (Habbash et al. 2016).

With the need to disclose financial information for investors, studies have investigated the characteristics and deficiencies related to the disclosure of risks in companies' annual reports. By increasing the quality of disclosure achieved through monitoring and the composition and structure of the board, information asymmetry is reduced between a company and investors (Ghouma et al. 2018). Empirical evidence related to the mechanism of corporate governance and the quality of disclosure indicates that corporate governance plays a vital role in the quality of disclosure (Alagla 2019) such that some corporate governance mechanisms, such as board size, audit type, the audit committee independence, have a positive and significant effect on the financial reporting quality (Paul et al. 2018).

Even the effect of corporate governance on the voluntary disclosure of financial information has been proven in various research studies, indicating the company's desire to reduce information asymmetry and the risk of financial information disclosure. Al-Nimer (2019), while investigating the effect of corporate governance on voluntary disclosure, concluded that corporate governance mechanisms, including the board size and the audit committee size, have a positive and significant relationship with the level of voluntary disclosure. Shan (2019) reached a similar conclusion in another study and concluded that corporate governance mechanisms such as foreign ownership, the ratio of independent directors, and the age of a company promote voluntary disclosure. Lokman et al. (2012), by studying the relationship between the corporate governance quality and the voluntary disclosure of financial information, concluded that there is a higher probability of voluntary disclosure of information in companies with a high quality of corporate governance.

El-Deeb and Elsharkawy (2019) investigated the effect of board characteristics as one of the corporate governance mechanisms and disclosure. Herein, it will measure corporate governance mechanisms such as board independence, board size, CEO duality, and board gender diversity. The research results indicate that the auditor type and the board size have a significant and positive relationship with information disclosure. Jacoby et al. (2019) showed that both direct and indirect effects of internal corporate governance mechanisms, such as incentive compensation and board independence, increase the company's information transparency. Both corporate governance mechanisms and external control mechanisms help boost such transparency.

Li et al. (2020) showed that the risk of financial information disclosure has a positive and significant relationship with investment efficiency. This means that investment efficiency is improved by increasing financial information transparency; in addition, increasing the level of transparency when companies invest effectively acts as a positive signal for shareholders, and as a result, a high level of financial reporting disclosure is associated with an increase in investment efficiency (Elberry and Hussainey 2020; Biddle et al. 2009). In addition, other research shows that reporting quality directly and positively affects investment efficiency and provides better identification (Roychowdhury et al. 2019).

According to the theoretical foundations and the background of the study, and since financial information disclosure can be the reason for the higher efficiency of investment in companies, in the second hypothesis, the relationship between corporate governance and its effect on the risk of financial information disclosure is investigated.

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