THE STRATEGIC INVESTMENT OF CORPORATE GOVERNANCE IN IMPROVING THE STOCK PROFITABILITY

ZADEH Amir Mohammad
University of Tehran, Iran

ABBASI Ebrahim
Alzahra University, Iran

Abstract:

Corporate governance is one of the most important issues to which has been paid attention by big companies due to the massive financial scandals of recent years. Corporate governance includes supervising the company management, separating the economic units from its ownership and protecting investors' and benefiters' rights. The research goal is to assess the relation between some corporate governance mechanisms and stock profitability. The research independent variables are: institutional ownership, ownership concentration and board size. The stock return is dependent variable. The research statistical society includes all investors who have visited Tehran stock exchange to buy and sell shares in 2012. The sampling is done randomly. The data collection is done using field and library methods by distributing questionnaires among 130 stock investors. Finally, according to the collected data, the research hypotheses are assessed and analyzed through descriptive and inferential statistics. The SPSS software is used to analyze the collected data.

Key words: *corporate governance, stock profitability, strategic investment*

1. Introduction

The shareholders' worries regarding payments and drop in stock value gradually caused the demands for amendments of its corporate governance and board size to be increased. In 1983, the separation of ownership and supervision was firstly presented by Eugene Fama and Michael Jenson who are the founders of agency theory. Their theory considered the corporate governance as a series of contracts. Joy Lorsch and Elizabeth MacIver defined that many companies completely influence on their all business affairs without their board of directors' responsibility and supervision. There were big scandals of two huge companies (Enron and WordCom) and some small companies such as Tyco and Global Crossing at the late 1990s and beginning of

the new millennium. The scandals caused the shareholders and governments to pay specific attention to corporate governance (Davani, 2008).

The AICPA **(**American Institute of Certified Public Accountants) assigned specific standards to internally control the independent accountants. Also, the National Commission for the Fight against Fraud issued the report "Treadway" in 1987 and defined its study results through the report. The Congress of America passed a law in 1991 that the LTD companies had to provide a report regarding the efficiency of their internal controls. Anyhow, the present corporate governance is resulted of many studies done in different countries and its history is related to 1990s.

Some organizations and institutes which have taken part in promoting of corporate governance are: International Corporate Governance Network, International Chamber of Commerce, the World Bank, Organization for Economic Cooperation and Development, and International Federation of Accountants; and some rating agencies such as Poors & Standards. Although some issued standards and instructions are mandatory, but most of them are still optional. The position of corporate governance is different in developing countries, and it is used only to fill the legal gaps, but in developed countries the necessary structured laws and regulations such as equal treatment with shareholders and appropriate and timely disclosure of holding general assemblies are provided to execute corporate governance. However, efforts are still continued in both developed and developing countries regarding to provide approaches to make the mangers be responder and set fair relations with shareholders (Davani, 2008).

At the beginning of 21st century, corporate governance is considered as one of the most important business issues. At first, the corporate governance emphasized corporates strategies and shareholders' rights, but later its view changed toward considering the society and all shareholders' rights seriously. It has been significantly developed during the recent years, and the leader countries have continued to empower their governmental systems. Some issues which are paid more attentions are: shareholders and their relations, being responder, improvement of board of directors' performance, accountants, accounting systems and internal controlling (Davani, 2008).

2. Corporate governance in Iran

Corporate governance was firstly considered in Iran at the beginning of 2000s through that time stock exchange authorities' interviews and Islamic Consultative Assembly research center. Then, the committee "corporate governance" was formed in ministry of economic affairs and finance. At the end of 2004, the stock exchange organization issued its first regulations regarding corporate governance. The regulations were set up in 22 articles and 2 notes, but in 2007, the regulations were reviewed and its final draft was issued by Tehran stack exchange organization. The final regulations were set up in 5 chapters and 36 articles (Tutchi et al., 2012). Chung (et al., 2006) studied the qualitative relation between the profit and stock returns. The

results showed that the accruals data could be used to predict the future returns, and there was negative significant relation between the accruals data and the stock future returns. The research used the accruals data as a criterion for assessing the quality of profit.

Ditmart and Mahrt Smith (2007) assessed two criteria (institutional shareholders and composition of the board of directors) regarding corporate governance and its relation with stock returns. They concluded that in companies with weak corporate governance, the stock returns change about 0.42-0.88$ for each dollar of cash changes, but this amount is doubled regarding the companies with strong corporate governance.

Tsaia and GU (2007) studied the relation between institutional ownership and company performance regarding the casino industry in 1999-2003. Institutional ownership was equal to the percentage of total shares held by public companies such as insurance companies, financial institutions, banks and other components of the state. They showed that the institutional investors of casinos could help other investors of this industry decrease the problems resulted in separation of management and ownership.

Chung, Elder and Kim's study (2009) showed that in the companies with strong ownership structure, there were less dispersion, higher market quality indices, less exchange price effects and less possibility of exchanges based on information. Also, cash changes were significantly related to changes of structure index during the period.

Damitrescu's findings (2010) showed that displaying the shareholders' activities had negative effects on market cash. In fact, presenting the shareholders' high costs and high dispersion of ownership affects companies cashes and subsequently the market cash.

Recently, it has been paid attention to corporate governance internationally (Gaa, 2007). The accuracy of financial reports has been the standard framers' and employed persons' common concern. Regarding the Asia countries, the weak corporate governance has been considered one of the reasons of 1997 financial crisis (Chen Y., 2008). The word "governance" is derived from the Greek word "Kyberman" which means guidance or management. Then, it was adopted by Latin as "Gubernare" and was converted into "Governare" in French. Anyhow, the word is defined in different ways by organizations or committees due to their ideological interests (Abu-Tapanjeh, 2009)

Research literature study shows that there is not a single definition about corporate governance, and the available ones include a wide range of different definitions. Anyhow, it is possible to divide the definition into two parts: limited and extensive views. According to the limited view, the corporate governance is restricted to the relation between the company and sheareholders.in fact, the limited view is defined in terms of the representation theory, but based on the extensive view, the corporate governance is considered as a network of relations between not only the company and the shareholders, but also the company and a large number of

beneficiaries such as staffs, customers, sellers, bondholders and so forth. This view is defined in terms of the beneficiaries' theory. Some of these definitions are as follow:

- Corporate governance is the supervision and control process which ensures the company manager's performance according to the shareholders' profits (Hasas, Yegane, 2006).
- Corporate governance includes the procedures or actions which run the companies and also it is a way to be responsive to the shareholders, staffs and society (Ebrahim, 2004).
- Corporate governance is defined by Organization for Economic Cooperation and Development (OECD) as: "a set of relations among the management, board of directors, shareholders and other beneficiaries".
- Corporate governance is defined by the World Bank as: "the balance among social, economic, individual and collective goals is maintained by corporate governance. The framework of corporate governance can be considered as an effective tool to optimally monitor the use of resources and direct the individuals, companies and society profits".

During the recent years, the different features of corporate governance have increasingly been paid attention as a supervision mechanism to control the management authorities such as optional financial reporting. Most investors and framers of regulations believe that some features of corporate governance (such as non-profit board members' duties) help with maintenance of shareholders' profits and decrease the conflict of interests between management and shareholders (Ebrahim, 2004).

3. Problem statement

In big companies, the separation of ownership and management has caused the problem of representation to be created. The problem is defined as the question "how is it ensured that the managers' freedom of action can advance the companies according to the investors' profits"? As the result of representation theory, in order to protect public interest, it is needed the information to be immunized and the owners' and managers' interests to be aligned. Although regarding the problem of representation, different tools such as applying ethics theory in accounting, creating the theoretical framework and accounting standards, internal controls, applying reward long term practices, and even legislation by government have been used, not only the problems have not decreased, but also they have become more complicated. Therefore, it is expected that the corporate governance can solve some of these problems and increase the value of the companies. The most important target of corporate governance is to maintain the life cycle of an enterprise dynamic and protect the shareholders' interests against the organization management (Imani Barandagh et al., 2010).

There is a question "how can the shareholders control the company management"? Corporate governance provides some mechanisms to decrease the

risk of representation issue. The mechanisms are: increasing the clarification of managers' actions, limiting the opportunistic behaviors of management and improving the quality of company information. Since the institutional shareholders' main goals include increasing the wealth and achieving the profit; the reported profit figure, distributed profits, and stock returns are very important, because the stock market prices are strongly affected by the quality of reported profits and stock returns. Therefore, the shareholders try to affect the decisions related to stock returns, and even push the managers to achieve their goals.

According to the above mentioned contents, the research goal is to assess the effects of corporate governance on stock profitability. The research independent variables are: institutional ownership, ownership concentration and board size. The stock return is dependent variable.

Research Objectives

According to the research purpose, it is classified as an applied research which findings are used in strategic investment domain of corporate governance to upgrade the stock profitability. The research goals are as follows:

- Determining the mechanisms of corporate governance
- Assessing the relation between stock returns and institutional ownership, ownership concentration and board size
- Providing suggestions to improve the stock profitability

Research hypotheses

Each research is initiated by a problem. The problem causes some questions to be formed in researcher's mind, and researcher provides hypotheses according to the questions. Therefore, the researcher main task is to answer the research questions, conclude based on collected data and finally, reject or confirm the hypotheses according to the findings. The research hypotheses are as follows:

Main hypothesis:

There is significant positive relation between strategic investment of corporate governance and stock returns

Secondary hypotheses:

1- There is significant positive relation between institutional ownership and stock returns.
2- There is significant positive relation between ownership concentration and stock returns.
3- There is significant negative relation between board size and stock returns.

Methodology

Based on the method, the research is classified as a descriptive survey research. The data collection is done using field and library methods. The library

method is used to collect information regarding the internal and external research literature. The other researchers' studies and related magazines were assessed and necessary information was gathered. Also, questionnaires were distributed among 130 investors who had visited Tehran stock exchange to buy and sell shares in 2012. The questionnaires were the most important tools for collecting information to test the hypotheses. The distributed questionnaires help the researchers collect information regarding the dispersion rate, features, visions and beliefs of assessed society, and then they convert the collected information in to quantitative data.

Statistical society and sample

The assessed society usually includes a set of units which have common feature or features that the researcher is interested in studying them. The research statistical society included all investors who had visited Tehran stock exchange to buy and sell shares in 2012. Due to the high population of statistical society, the researcher had to select samples from stock investors during the research period. The sampling is done randomly. Since the number of Tehran stock investors was high, the volume of statistical society was considered as an infinite number and the Kukran formula was used as follow:

d=0.032 , a=0.05

$$n = \frac{Z_{\frac{a^2}{2}}}{4d^2} = \frac{(1.96)^2}{4(0.032)^2} = 130$$

a, d, and n stand for error rate, degree of confidence and the number of samples, respectively. According to the equation, the number of samples equals to 130. Therefore, in significance level of 95%, at least 130 samples had to be selected from Tehran stock investors to generalize the results to total statistical society.

4. Data analysis method

The descriptive and inferential statistics methods are used to analyze the collected data. The descriptive statistics method is used to quantify and summarize the collected data regarding the statistical society. Therefore, according to the descriptive statistics method, the society parameters are calculated using the census of society all elements.

The inferential statistics method uses the analysis of information to assess the uncertainty of inferences. In fact, the researcher calculates the statistics using the sample values, and then generalizes the parameters to the society by estimation or statistical hypothesis test. Finally, the research hypotheses are assessed and analyzed through descriptive and inferential statistics. The SPSS 17 software is used to analyze and assess the significance of the research hypotheses.

Each research goal is to reach the results which are used to describe and define the issues based on the relations and differences. As mentioned above, the

research uses the descriptive and inferential statistics to assess and analyze the collected data. The research descriptive statistics include frequency tables, diagrams, and central indices. The inferential statistics include Pearson correlation coefficient, gradual regression and so forth.

5. Discussion

The general characteristics of assessed society can be distinguished through understanding the sample features. It also helps the researchers generalize the results to the other societies and design questions for future researches. The descriptive statistics and tables related to sample features are presented in the following:

Table 1: frequency of distribution based on the gender

variables	frequency	Frequency percentage	Valid percentage	Mode
Male	93	71.5%	71.5%	1
Female	37	28.5%	28.5%	
Total	130	100%	100%	

Table 1 interpretation: it can be concluded from table 1 that 71.5% and 28.5%of individuals are male and female, respectively. The value of mode is reported equal to 1and it shows the highest frequency belongs to males.

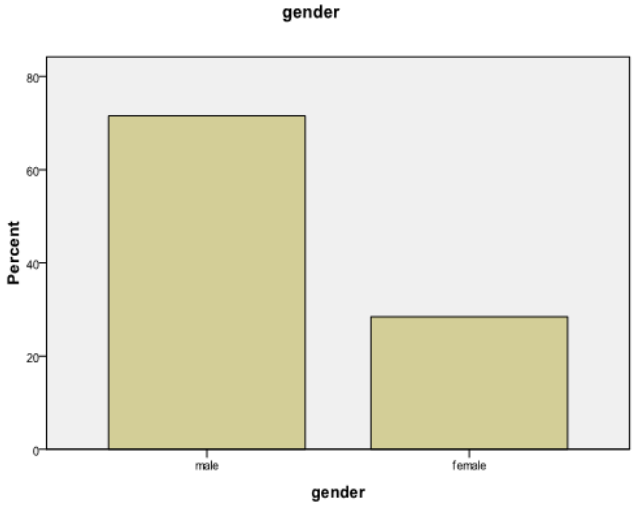

Diagram 1: frequency of distribution based on the gender

Table 2: frequency of distribution based on the education status

variables	frequency	Frequency percentage	Valid percentage	Mean
diploma	37	28.5%	28.5%	2
Associate degree	37	28.5%	28.5%	

Bachelor	43	33.1%	33.1%	
Master degree and higher	13	10 %	10 %	
Total	130	100%	100%	

The table2 interpretation: it can be concluded from table 2 that 28.5%, 28.5%, 33.1%, and 10% of individuals have diploma, associate degree, bachelor, and master degree and higher, respectively. The average number is reported equal to 2 and it means that the average level of individuals' education is about associate degree. In fact, the mean index shows the center of data distribution (the distribution point of 50%) which is reported equal to associate degree according to table 2.

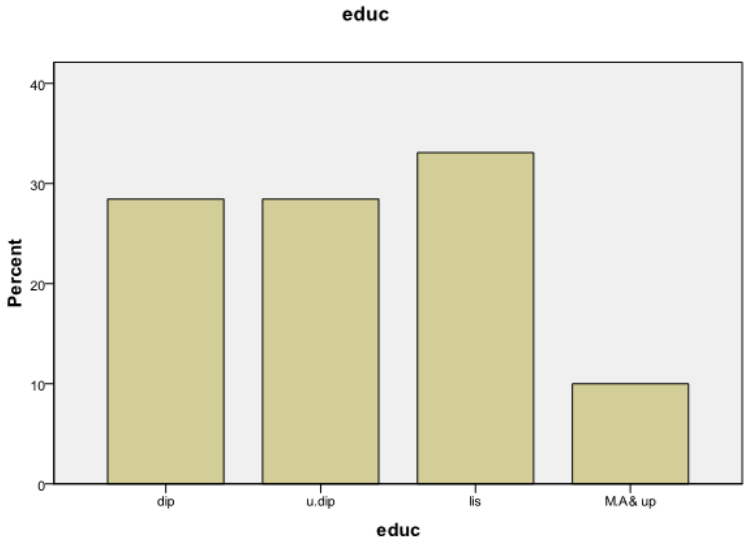

Diagram 2: frequency of distribution based on the education status

Table 3: frequency of distribution based on the ownership concentration

variables	frequency	Frequency percentage	Valid percentage	Mean
Low	56	43.1%	43.1%	2
Average	31	23.8%	23.8%	
High	43	33.1%	33.1%	
Total	130	100%	100%	

The table 3 interpretation: it can be concluded from table 3 that the ownership concentration are low, average, and high in 43.1%, 23.8%, and 33.1% of companies, respectively. The mean number is reported equal to 2 and it means that the mean level of ownership concentration is about average. In fact, the mean index shows the center of data distribution (the distribution point of 50%) which is reported equal to average according to table 3.

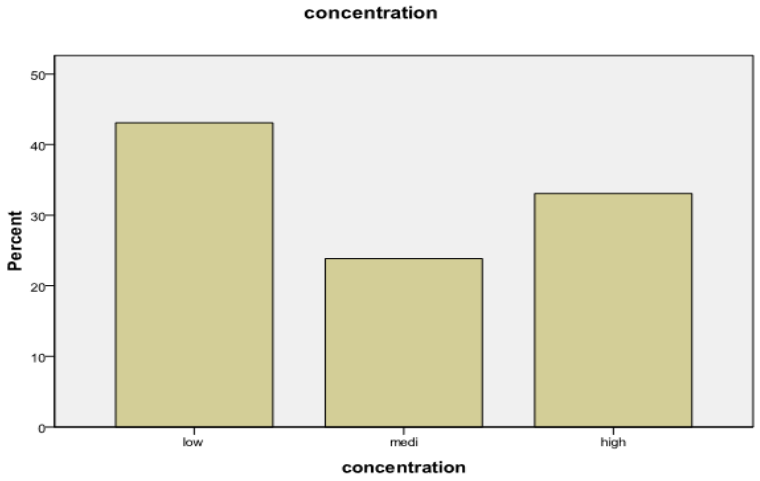

Diagram 3: frequency of distribution based on the ownership concentration

Table 4: frequency of distribution based on the institutional ownership

variables	frequency	Frequency percentage	Valid percentage	Mean
Low	44	33.8%	33.8%	2
Average	45	34.6%	34.6%	
High	41	31.5%	31.5%	
Total	130	100%	100%	

The table 4 interpretation: it can be concluded from table 4 that the institutional ownership are low, average, and high in 33.8%, 34.6%, and 31.5% of companies, respectively. The mean number is reported equal to 2 and it means that the mean level of institutional ownership is about average. In fact, the mean index shows the center of data distribution (the distribution point of 50%) which is reported equal to average according to table 4.

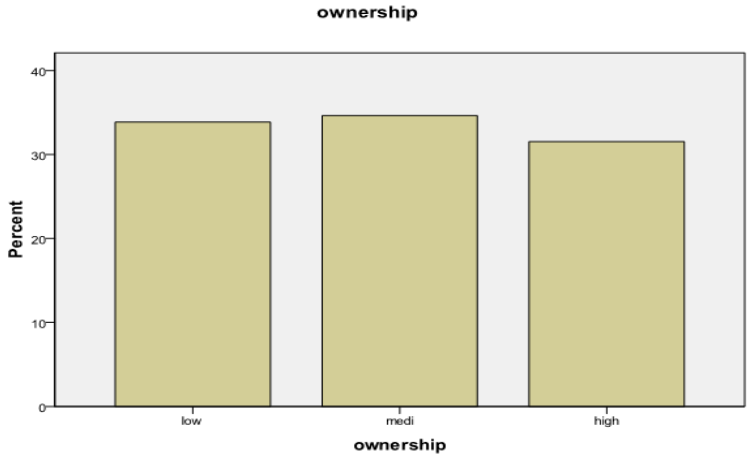

Diagram 4: frequency of distribution based on the institutional ownership

Table 5: frequency of distribution based on the stock returns

variables	frequency	Frequency percentage	Valid percentage	Mean
Low	43	33.1%	33.1%	2
Average	48	36.9%	36.9%	
High	39	30%	30%	
Total	130	100%	100%	

The table 5 interpretation: it can be concluded from table 4 that the stock returns are low, average, and high in 33.1%, 36.9%, and 30% of companies, respectively. The mean number is reported equal to 2 and it means that the mean level of stock returns is about average. In fact, the mean index shows the center of data distribution (the distribution point of 50%) which is reported equal to average according to table 5.

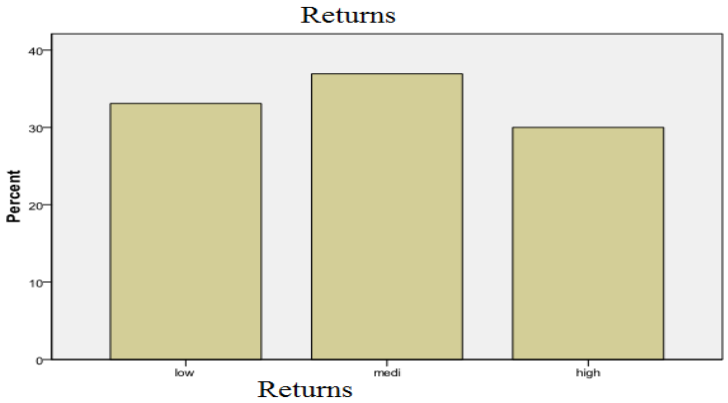

Diagram 5: frequency of distribution based on the stock returns

Testing hypotheses

Main hypothesis: there is positive significant relation between strategic investment of corporate governance and stock returns.

H_0: there is not positive significant relation between strategic investment of corporate governance and stock returns.

H_1: there is positive significant relation between strategic investment of corporate governance and stock returns.

In this hypothesis, the statistic of Pearson correlation coefficient is used to confirm the relation between strategic investment of corporate governance and stock returns and determine the intensity and direction of them. Finally, the results are interpreted.

Table 6: estimation table for Pearson correlation coefficient

Row	Variable	Pearson correlation coefficient	sig	Total
1	investment of corporate governance and stock returns	0.791	0.000	130

Table6 interpretation: in table 6, the relation between strategic investment of corporate governance and stock returns has been assessed regarding viewpoints of 130 individuals.
As observed, according to Pearson correlation coefficient (0.791) and error level (sig: 0.000), it could be stated that the relation between variables is significant at 0.99 assurance level. Hence, null hypothesis is rejected and the researcher hypothesis is accepted. Also, Pearson correlation coefficient for two variables shows the intensity of the relation between the variables is strong, direct and positive.

Secondary hypothesis:

First hypothesis: there is positive significant relation between institutional ownership and stock returns.
H_0: there is not positive significant relation between institutional ownership and stock returns.
H_1: there is positive significant relation between institutional ownership and stock returns.
In this hypothesis, the statistic of Pearson correlation coefficient is used to confirm the relation between institutional ownership and stock returns and determine the intensity and direction of them. Finally, the results are interpreted.

Table 7: estimation table for Pearson correlation coefficient

Row	Variable	Pearson correlation coefficient	sig	Total
1	institutional ownership and stock returns	0.754	0.000	130

Table7 interpretation: in table 7, the relation between institutional ownership and stock returns has been assessed regarding viewpoints of 130 individuals.
As observed, according to Pearson correlation coefficient (0.754) and error level (sig: 0.000), it could be stated that the relation between variables is significant at 0.99 assurance level. Hence, null hypothesis is rejected and the researcher hypothesis is accepted. Also, Pearson correlation coefficient for two variables shows the intensity of the relation between the variables is strong, direct and positive.

Second hypothesis: there is positive significant relation between ownership concentration and stock returns.
H_0: there is not positive significant relation between ownership concentration and stock returns.
H_1: there is positive significant relation between ownership concentration and stock returns.
In this hypothesis, the statistic of Pearson correlation coefficient is used to confirm the relation between ownership concentration and stock returns and determine the intensity and direction of them. Finally, the results are interpreted.

Table 8: estimation table for Pearson correlation coefficient

Row	Variable	Pearson correlation coefficient	sig	Total
1	ownership concentration and stock returns	0.733	0.000	130

Table8 interpretation: in table 8, the relation between ownership concentration and stock returns has been assessed regarding viewpoints of 130 individuals.
As observed, according to Pearson correlation coefficient (0.733) and error level (sig: 0.000), it could be stated that the relation between variables is significant at 0.99 assurance level. Hence, null hypothesis is rejected and the researcher hypothesis is accepted. Also, Pearson correlation coefficient for two variables shows the intensity of the relation between the variables is strong, direct and positive.
Third hypothesis: there is inverse significant relation between board size and stock returns.
H_0: there is not inverse significant relation between board size and stock returns.
H_1: there is inverse significant relation between board size and stock returns.
In this hypothesis, the statistic of Pearson correlation coefficient is used to confirm the relation between board size and stock returns and determine the intensity and direction of them. Finally, the results are interpreted.

Table 9: estimation table for Pearson correlation coefficient

Row	Variable	Pearson correlation coefficient	sig	Total
1	Board size and stock returns	- 0.635	0.000	130

Table9 interpretation: in table 9, the relation between board size and stock returns has been assessed regarding viewpoints of 130 individuals.
As observed, according to Pearson correlation coefficient (- 0.635) and error level (sig: 0.000), it could be stated that the relation between variables is significant at 0.99 assurance level. Hence, null hypothesis is rejected and the researcher hypothesis is accepted. Also, Pearson correlation coefficient for two variables shows the intensity of the relation between the variables is almost strong, inverse and negative.

To assess the impact of independent variables on traders' investment decisions in the stock

The Stepwise regression is used to assess the net impact of all independent variables on stock returns, and then the model is analyzed. In addition to assessing the significance of independent variables on the stock return variable, the most important effective variables are determined as well.

Table 10: entered and removed variables

Method	Removed variables	Entered variables	Model
Stepwise (p<0.05-0.1	-	Institutional ownership	1
Stepwise (p<0.05-0.1	-	Board size	2
Stepwise (p<0.05-0.1	-	Ownership concentration	3

In this method, all variables are entered into the model as separate blocks, and then are selected according to the acceptable significance level (p<0.05) and are

sorted according to their importance. According to the table 10, the institutional ownership is the most important factor affecting the stock returns. Therefore, none of the independent variables is removed from the model, and the net effects of them are considered.

Table 11: model summary

Estimated error	Adjusted determination coefficient	Determination coefficient	Multiple-correlation coefficient	model
0.525	0.566	0.596	0.754	1
0.449	0.682	0.687	0.829	2
0.428	0.711	0.718	0.847	3

Table 11 shows that adjusted determination coefficient, determination coefficient and multiple-correlation coefficient are calculated regarding each model. In first model, the regression equation is determined and predicted only based on the constant coefficient and the most important variable (institutional ownership). In this model, the coefficient of institutional ownership impact is reported equal to 0.596. It means that the 0.59 of total rate changes in stock returns is determined and predicted by institutional ownership. In second model, the equation is calculated based on the constant coefficient, institutional ownership and board size. The values of multiple-correlation coefficient and determination coefficient are reported equal to 0.829 and 0.687, respectively. It means that the 0.68 of total rate changes in stock returns is determined and predicted by two factors of institutional ownership and board size. In third model, the regression equation is calculated based on the constant coefficient and variables of institutional ownership, board size and ownership concentration. The values of multiple-correlation coefficient and determination coefficient are reported equal to 0.847 and 0.718, respectively. It means that the 0.71 of total rate changes in stock returns is determined and predicted by three factors of institutional ownership, board size and ownership concentration. It has to be noted that the determination coefficient is highly strong and it means that the model is practical.

Table 12: Anova analysis table

Model	Sources of changes	Sum of squares	Degree of freedom	Mean squares	F ratio	Sig
1	Among groups	46.595	1	46.595	169.046	0.000
	Within groups	35.282	128	0.276		
	Total	81.877	129			
2	Among groups	56.228	2	28.114	139.209	0.000
	Within groups	25.649	127	0.202		
	Total	81.877	129			
3	Among groups	58.778	3	19.593	106.875	0.000
	Within groups	23.099	126	0.183		
	Total	81.877	129			

The variance analysis table of variables and models

According to the table 12, the sources of changes are considered based on the regression, residual and total values. The sum of squares, degree of freedom, mean squares, F ratio (variance analysis) and the level of observed error are calculated regarding each model. In first model, the regression equation is determined and predicted based on the constant coefficient and institutional ownership; and the value of F is reported equal to 169.046. According to the level of observed error, the equation is significant at 0.99 assurance level.

In second model, the regression equation is determined and predicted based on the constant coefficient, institutional ownership and board size; and the value of F is reported equal to 139.209. According to the level of observed error, the equation is significant at 0.99 assurance level.

In third model, the regression equation is determined and predicted based on the constant coefficient, institutional ownership, board size and ownership concentration; and the value of F is reported equal to 106.875. According to the level of observed error, the equation is significant at 0.99 assurance level.

Table 13: variables weight coefficients

Model	Model variables	Non-standard B	Standard B	t-value	Sig
1	Constant coefficient	0.505	-	4.150	0.000
	Institutional ownership	0.741	0.754	13.002	0.000
2	Constant coefficient	1.535	-	8.438	0.000
	Institutional ownership	0.579	0.590	10.713	0.000
	Board size	-0.377	-0.380	-6.902	0.000
3	Constant coefficient	1.353	-	7.519	0.000
	Institutional ownership	0.386	0.393	5.289	0.000
	Board size	-0.337	-0.340	-6.337	0.000
	Ownership concentration	0.256	0.280	3.729	0.000

In table 13, the values of variables weight coefficients are considered according to the non-standard B, standard B, t-value and the level of observed error. In first model, the value of standard weight coefficient for institutional ownership variable is reported equal to 0.754. According to the table, the institutional ownership has the highest impact on stock returns. Due to the coefficients, it is possible to define the regression equation of dependent variable based on independent variables and the value of constant coefficient. Also, it is possible to predict the amount of each independent variable effect for each unit of dependent variable change. Furthermore, it is stated by the values of t and level of observed error that institutional ownership has net and significant impact on dependent variable.

In second model, the values of standard weight coefficient for institutional ownership and board size variables are reported equal to 0.590 and -0.380, respectively. However, the values of t and level of observed error show that institutional ownership and board size have net and significant impact on stock returns. In third model, the values of standard weight coefficient for institutional ownership, board size and ownership concentration variables are reported equal to 0.393, -0.340

and 0.280, respectively. However, the values of t and level of observed error show that institutional ownership, board size and ownership concentration have net and significant impact on stock returns variable.

6. Conclusion

- The strategic investment of corporate governance influences stock returns for 79%. It means that increasing the strategic investment of corporate governance can increase the stock returns for 79% and vice versa.
- The institutional ownership influences stock returns for 75%. It means that increasing the institutional ownership can increase the stock returns for 75% and vice versa.
- The ownership concentration influences stock returns for 73%. It means that increasing the ownership concentration can increase the stock returns for 73% and vice versa.
- The board size influences stock returns for 63%. It means that increasing the board size as much as 63% can decrease the stock returns and vice versa.

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