



## Effect of Board Non-Executive (outside) Managers on Accounting Performance of the Listed Companies

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**Abstract:** In this paper was addressed the effect of one of the corporate governance mechanism on the firm accounting performance. Along this line, the existence of non-executive managers in a board of directors structure was studied and its effects on the benchmark of the return on assets (ROA). In this research, a number of 119 firms were considered for five years (from 2008 to 2012) as a statistical sample that the results of research based on regression procedure showed that there is a positive and significant relation between the independent and dependent variables. Accordingly, using the non-obligated managers in a board of directors' structure of an organization was recommended to increase the optimum performance of the firms.

**Keywords:** (Outside directors) Non-executive Managers of the Board; Accounting Performance; Return on Assets.

### INTRODUCTION

How to manage the organizations and the role of the board of directors' members and their composition to achieve the optimal performance of accounting is one of the important problems that have been always raised. While considering the return on assets rate associated with the measurement of profit on assets ratio of that organization is one of the performance evaluation factors. Achieving the targeted results in an organization requires to a purposeful, planned and multilateral management that the non- executive management issue, separating the ownership from management also is raised in the same branch. Separating the ownership from management, or in a more conventional words separating the ownership from the control of companies, creates a potential possible to make decisions by managers to be in line with their interests and contrary to shareholders interests. Whereas supplying the shareholders' interests is always one of the important issues in companies <sup>1</sup>.

What now is raised in companies as one of the most effective key factors is considering the systemic goals and controlling and monitoring them to access to

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these goals; and the role of managers and how to combine them in a board of directors' structure can be important in this domain and the corporate governance is brought up. In fact, the corporate governance system refers to a set of rules, provisions, institutions and procedures that determines how the companies are running and to whose interests. So insuring the existence of a framework that provides an appropriate balance between the management freedom of action, responsibility and different beneficiaries' interests of the firm is the objective of corporate governance system<sup>2</sup>. In this paper has been addressed to non-obligated managers' role as one of the factors within the organization in return on assets rate.

### **The Ratio of Non-Obligated Managers in a Board of Directors**

The board of directors is a decision maker sector in an organization that has a direct effect on its profit and amassing wealth amount that may consist of executive and non-executive managers. In many cases, the executive or obligated managers in a board of directors raise their demands in form of crucial decisions of board of directors based on their interests and the ease of action, and give priority the personal interests to the main shareholders interests. While benefiting from the non-executive managers (managers who do not have an executive post) to improve the such problems in organizations can balance the decisions partly, because the lack of non-obligated managers' motivation to use of owners' wealth to personal interests or to achieve fame results in improve the monitoring on the firm management and so improve the performance and reduce the agency costs<sup>4</sup>.

### **Accounting Performance**

The firm performance can be divided into two categories, given to financial and economic measures. The first group is the economic performance consisting of economic value added (EVA), market value added and balanced economic value added and the second group of a firm financial or accounting performance includes the cases such as the profit and loss issues and the profit growth and divided and some financial ratios such as the interests rate of return on assets and interests rate of return on shareholders and the ratio of shares value to book value, etc. Separating the ownership from management and the conflict of interests of lacking the assessment and controlling the firm performances lead to lacking the optimal allocation to resources that this can result in the owners (stakeholders) and economy of social at the macro level lose finally. It is difficult to identify and operationalize the firm performance concept and usually is used different measures for it<sup>5</sup>.

### **Reviewing the Literature and History of Research**

Reviewing the literatures and previous experiences have always shown that the independence of board of directors' members can be increased and the firm performance improved by increasing the ratio of non-executive managers in the board of directors. Fama and Jensen<sup>3</sup> shown that it can be controlled the effectiveness of decision tasks by increasing the non-obligated managers ratio in a

board of directors and increasing the monitoring on decisions can be resulted in improving the firm's performance addition to reducing the agency costs.

Kelz et al., research has also shown that the performance of the firms with more non-obligated members in their board of directors than the firms with less non-obligated members has been better.

But in other cases, the researchers have achieved to some findings which is inconsistent with this theory. Kellin, for example, could not find a relationship between the presence of the non-executive managers in the board of directors and the results of the firm performances. Dalton et al.,<sup>6</sup> had also achieved to this result that the rate of non-obligated manager's appearance in a board of directors has not a direct impact on the firm performances. According to Permak research there is an inverse relation between these two variables. Dehine et al., also considered this relation in Belgian companies and did not explore a significant relationship. Also Fasberg<sup>7</sup> did not find any significant relation between the ratio of non-executive managers in a board of directors and performance. In most of mentioned cases, there is this view that because the non-obligated managers have no stocks in a firm and/or have little shares in the commercial units, they do not have much incentive to emphasis on improving decisions and therefore, will not have a special effect on a performance. Also in Iran a study has been conducted by Hassase Yeganeh et al.,<sup>4</sup> as a relation between the quality of corporate governance and the performance of listed companies in Tehran Stock Exchange that did not find any significant relation between non-executive managers in the board of directors and the firm performances. In Ghalibafe ASL and Rezaee research<sup>8</sup> it is not also found any significant relation between them.

### **Hypothesis**

Given the considering the literature and background of research an important question is raised: what relation is there between the ratio of non- executive managers in a board of directors and the accounting performance of the listed companies in Tehran Stock Exchange? Therefore, the research hypothesis can be as follow:

There is a positive and significant relation between the non-executive members in the board of directors and the return on assets rate of the listed companies in Tehran Stock Exchange.

### **Social and a Statistical Sample**

A statistical social under study in this research includes a number of listed companies in Tehran Stock Exchange. A systemic elimination method has been used to homogenize the community members. So, in this research the studied firms as sample should have the following requirements:

- Their fiscal year leads to the end of March.
- They have been listed in Tehran Stock Exchange before 2008.
- Their information should be available.

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- During the studied years do not lose and/or don not have the activity change .

Accordingly, a number of 119 firms have been studies as sample and the related information has been extracted from the official website of Tehran Stock Exchange.

## MATERIALS AND METHODS

### Independent variable

Non-executive managers( outside directors, Outdir): the ratio of non-executive managers in a board of directors

Dependent variable :

The rate of return on assets (ROA): the rate of return on equity is obtained through the pure profit divided by sum of equity .

### Control variables

The company size: determining the rate of firm assets at the end of each year is one of the methods to determine the firm size that has been taken into account in this study and the arithmetic average of a firm size during 5 years has been also addressed.

Leverage: The leverage of a firm can be obtained through the total debts at the end of each fiscal year divided by the equity at the end of same financial year and it shows the rate of debts usage in the capital structure of a firm.

### Method of Research

The current study is functional from the objective perspective, and because it examines the relation between variables is a correlation type. Also, it is ex- post facto because the researcher has considered to the studied problem after events occur. To examine the research hypothesis and the relationship between variables has been used the regression analyzes and S.P.S software.

## RESULTS

To examine the hypothesis test, the following statistical model was designed based on previous research and literature:

$$ROA = a_0 + B_1 Out\ dir + B_2 Lev + B_3 Size + e$$

To examine of normality of the research variables was used Smirnoff test that its results have been shown in Table (1):

**Table 1.** Considering the normality of variables

variable	Significance level	variable
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ROA	0.75	normal
Outside directors	0.63	normal
Leverage	0.07	normal
Size	0.12	normal

According to table above the significance level is greater than 0.05 and all variables are normal.

The results of analyzing the hypothesis have been also provided in Table (2) in sum:

**Table2.** Considering the varieties relationships

variable	Coefficient	Significance level	result
Outside director	2.86	0.23	A positive and significant relation
leverage	1.25	0.02	A positive and significant relation
size	2.32	0.31	A positive and significant relation
Doreen Watson statistic	1.90	Total significance level	
Adjusted coefficient of determine	0.37	0.041	

As can be seen from tables and results, the main hypothesis of study is confirmed, there is a positive and significant relation between the independent and dependent variables, means the ratio of non-executive managers in a board and the accounting performance of firms (the total significant level is 0.041 and because it is smaller than 0.05 this hypothesis can be confirmed). Also examining the relation between each of the independent and control variables and dependent variable shows that both firm size and leverage variables have also a positive and significant relation with the firm accounting performance variable .

In the other hand, the adjusted coefficient of determination is 0.37 expressed that 37% of dependent variable changes are due to independent variable changes. So can be evaluated the amount of average relationship .

This result is in accordance with those by Fama and Jensen <sup>3</sup> and also the research of Fasberg <sup>7</sup>, Ghalibafe ASL and Rezaee <sup>8</sup> and Hassase Yeganeh et al.<sup>4</sup>.

## DISCUSSION

The results of consideration showed a significant relationship between the existence of non-executive in a board of directors and the firm accounting performance. So this hypothesis that if the board of directors only consists of executive managers, then the accounting performance of firms will be decreased is confirmed here and it seems that, of course, because giving priority to the personal interests of managers than the interests of shareholders, will be observed some effects on the accounting performance of the companies. Therefore, the role

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of non-executive managers in the firms and their independence is a very important issue and this partnership should be in an extent that the non-executive managers in a board of directors can play a more important role in leading the firms. In this regard, of course, given the firm size and leverages, the enough attention to the board of directors members level is also a noticeable point that can include factors such as skills, experiences, educations, proficiency and other affairs related to working process of a firm that it can be considered as a factor to achieve the results differ from others in this research. Another impressive point in this field is authorization limit and the ability of leading the executive and non-executive managers in the board of directors structure that in turn has a tremendous contribution hereof .

### **Suggestions for Future Research**

The following suggestions for future research can be put forward in the scope of this research:

- Considering the other factors influencing the decisions in board of directors include skills, experience, educations, proficiency and other affaires related to working process of company and its effects on the firm performance
- Addressing the other criteria for assessment the performance including economic indicators
- Examining the current study hypotheses according to the type of industry

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