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# To identify the relationship between profit prediction frequency and corporate governance

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**Abstract:** The purpose of the research is identifying the relationship between profit prediction frequency and corporate governance. The statistical population of the research consists of all 91 companies of the companies listed on Tehran Stock Exchange from 2009 to 2013. Multivariate linear regression model was used to test the hypotheses. The findings indicate that there is a significant relationship between corporate governance and profit prediction frequency. With assuming constantly other factors, if corporate governance variable is increased 1 unit, profit prediction frequency will be increased. Then there is a direct relationship between corporate governance arrangement and profit prediction frequency indicating information transparency leads to profit prediction which ultimately it will be in the interest of shareholders. About control variables, it can be said that there is a significant relationship between transaction volume and share price with dependent variable among 4 variables (share transaction volume, share transaction frequency, share transaction and share price). The purpose of the research is to identify the relationship between profit prediction frequency and corporate governance and information asymmetry. The findings indicate that there is a significant relationship between corporate governance and profit prediction frequency. According to theoretical framework, it can be expected that this relationship is positive, so that with assuming constantly other factors, if corporate governance variable is increased 1 unit, profit prediction frequency will be increased. Then there is a direct relationship between corporate governance arrangement and profit prediction frequency indicating information transparency leads to profit prediction which ultimately it will be in the interest of shareholders. The findings indicate that there is a negative relationship between information asymmetry and profit prediction frequency, so that if profit prediction frequency is increased 1 unit, information asymmetry will be reduced. One way to reduce the incentive for manager towards using company's confidential information for personal benefits is to give rewards. If management' incentive reduces, management predicts with total information and existing news which ultimately it leads to reduce information asymmetry. The results of the research indicate that there is a negative relationship between profit prediction frequency and information asymmetry which that is compatible with Zang' research (2012).

**Key words:** Corporate governance; Profit prediction frequency

## 1. Introduction

Corporate governance arrangements effect on disclosed information by company for its shareholders and reduce the possibility of lack of comprehensive and desirable disclosure of information and the disclosure of low – credit information (kanagaretnam et al., 2007). The researches indicate that if there is a more effective surveillance of board of directors on management, the quality and sufficiency of published information will be increased by management (Karamanou, Irene and Vafeas, Nikos, 2005). The improvement of disclosure quality leads to reduce information asymmetry and finally it causes to lower earning management (Norosh and Hosseini, 2010). The purpose of financial reporting is to provide useful information for users to evaluate and take needed decisions about allocating scare resources. If these goals are met, financial reporting is regarded as a tool that management can achieve its accountability to users. Comprehensive and complete information disclosure in annual reports of companies play key role in taking decisions of many people, especially investors. But since user groups of financial reports consist of different people with different goals and with different awareness level, then providing a comprehensive for all users is impossible. Because information is regarded as main component of capital market, providing timely accurately information leads to reduce vague for market activities during taking decision about share transaction and importantly, information transparency causes attract the resources which expect to have more desirable performance.

In representative theory, the goal of owners is to maximize their wealth and for achieving the goal, they monitor on representative's activities and evaluate its performance. The most important property of companies is to separate ownership and management. During past 30 years, more cases have been put about interest conflict among groups and how to encounter of companies with such conflicts by economists.

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What has been received attention in capital market is that many people who invest are regular people that the only way to access to important information is published announcements by companies. An example of the announcements is estimated profit announcement for any share that recommended profit of any share is announced by company.

The research studies directly the relationship between profit prediction frequency and corporate governance.

## 2. Research background

### 2.1. Foreign background

In an article entitled "the relationship of financial reporting frequency and the cost of capital owners and information asymmetry, using the data collected manually" they found that there is a significant relationship between more financial reporting frequency and information asymmetry and cost of capital owners. The results indicated that there is a negative relationship between more reporting frequency with information asymmetry and cost of capital owners. Also, it was found similar results during studying changes mandatorily in reporting frequency. The results indicate that there are more benefits in financial reporting frequency.

In an article entitle "the effect of profit prediction by managers on capital cost" Mahdi Salehi et al. (2012) studied 102 companies in Tehran Stock Exchange from 2006 to 2010. The properties of profit prediction on capital cost consist of debt costs and equity (average balanced capital cost). They found that there is a significant relationship between information content of profit prediction and capital cost, but there is not a significant relationship between time horizon and re – prediction. These two variables are not influential information on investors' decisions.

In an article entitled " managers ' prediction and capital cost" Mei Feng et al selected 3539 companies. Among 4095 companies which provided mid – term predictions of managers, it was found that there is a relationship between profits any predicted share and capital cost. They found that there is a negative relationship between high quality of profit of any predicted share and capital cost. In other words, if the quality of prediction increases, capital cost will reduce.

In an article entitled "the improvement of relationship between capital cost and performance via reduced prediction error, managers' profitability" Dan Gode et al. 2008 studied the relationship between error in profit of any predict share and capital cost. Reviewing a sample with 54516 companies which was available their 25 – year information from 1983 to 2007, they found that there is a positive relationship between profit error of any predicted share and capital cost. They used PEG model to calculate capital cost, because OJ model does not provide a definite estimation from capital cost amount.

## 3. Methodology

From standpoint of goal, the research is an applied research and in terms of method, the research is correlation – descriptive one. the main purpose of the research is to determine existence, level and type of relationship between under – studied variables using post – event approach (via past information). Mix data set was used to analyze the research method.

## 4. Development of hypotheses and conceptual model

The research tries to achieve following goals:

To determine the relationship between corporate governance and profit prediction frequency

Following hypothesis was formulated to achieve above goal

Research Hypothesis: there is a significant relationship between corporate governance and profit prediction frequency

### 4.1. Research method

Regression model was used to test research hypothesis:

$$Freq_{it} = \alpha_0 + \alpha_1 CGI_{it} + \alpha_2 Ln(TA_{it}) + \alpha_3 LEV_{it} + \varepsilon_{it}$$

Where:

$Freq_{i,t}$: profit prediction frequency of company i in year t

$CGI_{i,t}$: corporate governance indicator of company i in year t

$TA_{i,t}$: total assets of company i in year t

$LEV_{i,t}$: financial leverage (ratio of total debts to total assets) of company i in year t

$\varepsilon_{i,t}$: residual amount for company i in year t

## 5. Empirical results

### 5.1. Data analysis

According to Table 1, profit prediction frequency equals with 5.85 indicating under – studied companies did averagely 5.85 times profit prediction. The average variable of corporate governance equals with 0.51 units. While minimum amount of the variable for under – studied companies is 0.153 units and maximum amount of the variable equals with 0.84. Meanwhile, above table indicates that corporate governance indicator has the minimum distribution level than other variables.

### 5.2. Testing research hypothesis

As earlier noted in chapter 1, the purpose of the research is to determine the existence of a relationship between corporate governance and profit prediction frequency. Following model was used to test above hypothesis:

**Table 1:** Description of used quantitative variables

| Variable | Variable symbol | Average | Standard deviation | Minimum | Maximum | Observation |
|---|---|---|---|---|---|---|
| Profit prediction frequency | $Freq_{it}$ | 5.852 | 1.732 | 2 | 9 | 455 |
| Corporate governance indicator | $CGI_{it}$ | .514 | .137 | .153 | .846 | 455 |
| Leverage | $LEV_{it}$ | .661 | .186 | .096 | 1.48 | 455 |
| Transaction volume | $VOL_{it}$ | .130 | .187 | .00001 | 1.658 | 455 |
| Transaction frequency | $Tra_{it}$ | 58.49 | 62.15 | 11.04 | 414.04 | 455 |
| Size | $Size_{it}$ | 12.94 | 1.44 | 9.05 | 18.07 | 455 |
| Stock price | $P_{it}$ | 7.9 | .786 | 5.85 | 10.73 | 455 |

$$Freq_{it} = \alpha_0 + \alpha_1 CGI_{it} + \alpha_2 Ln(TA_{it}) + \alpha_3 LEV_{it} + \varepsilon_{it}$$

The present research is done using collected data from company samples and multivariate linear regression and according to statistical rules and observed indicators about the hypotheses, needed measures will be taken.

According to Table 2, following conclusions are developed:

**Table 2:** Significance level of F-statistics

| $Freq_{it} = \alpha_0 + \alpha_1 CGI_{it} + \alpha_2 Ln(TA_{it}) + \alpha_3 LEV_{it} + \varepsilon_{it}$ | | | | | |
|---|---|---|---|---|---|
| Variable | Variable symbol | Coefficient estimation | Standard error | t-statistics | Possibility |
| Intercept | $\alpha$ | 6.116721 | .4627667 | 13.22 | 0.000 |
| Corporate governance indicator | CGIit | .7402781 | .2343145 | 3.16 | 0.002 |
| Total assets | Ln(TAit) | -.0599191 | .0338509 | -1.77 | 0.077 |
| Leverage | LEVit | .2679074 | .1553933 | 1.72 | 0.085 |
| F-statistics (possibility): 4.87 (0.000) | | | Adjusted determination coefficient ($R^2$): 0.11 | | |

Significance level of F-statistics is lower than 1 percent, then it can be said that the model is significant at 99 % possibility. In another words, the model has high reliability. Additionally, adjusted determination coefficient in the model is 11 percent indicating 11% of independent variable is explained by explanatory variables. Possibility amount of corporate governance indicator is 0.002 which this amount is lesser than 5% error level, indicating there is statistically a significant relationship between the variable with independent variable (profit prediction frequency). According to the coefficient of the variable (0.74), it can be concluded that there is a positive relationship between the variable with profit prediction frequency. Then if corporate governance indicator increases one unit, profit prediction frequency will increase 0.74 units. Theoretically, as it expected there is a significant relationship between corporate governance and profit prediction frequency. The relationship has been approved empirically.

## 6. Conclusion

The purpose of the research is to study the relationship between profit prediction frequency and corporate governance. The findings indicate that there is a significant relationship between corporate governance and profit prediction frequency. Theoretically, as it expected, the relationship is a positive one, so that if corporate governance increases 1 unit, profit prediction frequency will increase. Then if corporate governance arrangement is strong, profit prediction frequency is more indicating information transparency resulting from profit prediction is in favor of shareholders. The findings indicated that there is a negative relationship between profit prediction frequency and information asymmetry, so that if profit prediction frequency increase 1 unit, information asymmetry will reduce. One way to reduce of mangers' motive for using confidential information for personal benefits is to give reward. If management' motive reduces for this action, management predicts with all information and existing news that ultimately it reduces information asymmetry. The results of the research indicate that there is a negative relationship between profit prediction frequency and information asymmetry which is compatible with Zhang' research (2012).

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