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The Effect of Corporate Governance and Profit Management on Cost Stickiness in Listed Firms in Tehran Securities and Stock Exchange

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ABSTRACT

Good profit management increase and corporate governance reduce costs. Therefore, it seems reasonable to study their reciprocal and individual effects. Thus, this article tries to study the individual and reciprocal relationships of corporate governance and profit management on cost stickiness. Librarian method is used in this article to collect the needed data for research background and theoretical bases. Thus, the needed data was collected by studying journals, books, and specialized websites. The needed data was collected from financial statements of the listed firms in Tehran Stock Exchange and website of Islamic studies and development research management. Statistical population of this research is all listed firms in Tehran stock Exchange since the spring of 2011 to the winter of 2017 for about 5 years. This is 1056 firms whose sample volume was determined 200 by Cochran formula. Pearson inferential statistics and multivariate regression methods were used to analyze data. Results showed that profit managementincrease and corporate governance reduces cost stickiness.

Keyword:

profit management, corporate governance, cost stickiness

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Introduction

Awareness about costs behaviors on changes of activity levels or selling level are an important information for managers' decision making about planning and budgeting, pricing products, determination breakeven point, and other managerial cases (Namazi, 1998 and 1999; Noravesh and SadeghianAzhiri, 1998 and 1999). Varied costs than changes of activity volume increase or decreases properly in traditional models of costs behaviors in management accounting. It means big changes in costs only depend on big changes in activity volume and changes direction (increase or decrease) don't influence on size of changes in costs (Horngren et al., 2008). However, studies of some researchers (Narin and Sadrestram, 1997) in recent years indicated that increase in costs while increase in activity level is more than cost reduction while reduction in activity volume. Such costs behavior is called "cost stickiness" showing one feature of costs behaviors than activity changes level.

Organizational, public and selling cots behaviors than selling level changes, as a sample, can be studied and tested significantly in order to study cost stickiness, because selling level motivates costs for many elements of organizational, public, and selling costs. In addition, this test is so important, because the average cost of organizational, public, and selling level is near 5.9% in listed firms in Tehran securities and Stock Exchange (based on the provided data in Sahara software (Namazi and Davani, 2011)

Problem Statement

Recent studies have concluded that many costs are "sticky". They reduce less in reaction to selling reduction in comparison to selling increase (Anderson 5 et al., 2003). These results are in contrary to traditional models of varied and fixed costs and suggest an alternative theory for cost behavior based on conscious management decision. Anderson et al. (2003) deducted that selling reduces when managers decide to save rate resources to prevent resources moderation costs such as compensation to laid-off workers and losses for equipment disposal and removal. In contrary, when demand for more resources increase, managers can respond to demand if only they add the needed resources. This symmetrical number in resources moderation leads to cost stickiness. Various studies following Anderson et al. (2013) study confirmed costs stickiness in various issues (Kamma and Weiss, 2013). Therefore, theory of cost stickiness of Anderson et al changes to the dominant issue in cost behavior studies.

It is unlikely that management acts in a way it is expected as an ideal world while inserting the extensive nature of agency problems in the modern economic units of Jensen and Meckling (1976), and there is contrary among all beneficiaries, this issue is more visible in profit management behavior under the influence of reward contracts. Hilli (1985) concluded managers moderate profit along with more reward taking, while it is probable that managers select one accounting policy among various accounting policies under the pressure of debt contracts. (Swinnie, 1998)

In addition, previous studies have shown that managers act for increasing profit management based on achieving the previous year profit, avoiding losses report, or reaching to the analysts' predictions. For example, Burgstahler and Dichev. (2009) announced a direct relationship between costs stickiness while Dierynck and Renders (2010) announced low return salaries and wages and positive salaries and wages of assets, low increase in profit than previous year (symbols for profit management). Kamma and Weiss (2013) reported that managers reduce operational costs stickiness to prevent loss reports or profit reduction. Therefore, it is expected there is reverse relationship between profit management increase and costs stickiness.

The mechanisms of corporate governance are an indirect tool and probably incomplete tool for stockholders who try to reduce agency costs by change in behavior of managers who are agents. (Deshmukh, 20005)

Managers' behavior can be changed in 2 ways by reducing information asymmetry: 1- direct reduction of information asymmetry by motivators; 2-indirect reduction of information asymmetry by supervision. Awards can be obtained only when managers divulge the attempt level resulting in reduction information asymmetry. Moreover, it is possible that mechanisms of corporate governance reduce information asymmetry indirectly by supervision systems. These actions control collusion by opening a window for stockholders to supervise managers' behaviors and making avarice and shirking the responsibility difficult for management (Albadri et al. 2010), while self-interested behavior of managers leads to costs stickiness according to some researchers (for example Chen et al. (2008)). Therefore, improving corporate governance will reduce costs stickiness.

According to the explanations and the existed research background, good corporate governance and profit management increase help to reduce costs stickiness. Therefore, it seems reasonable to study their individual and reciprocal effects. Thus, this article tries to study individual and reciprocal effects of corporate governance on costs stickiness.

Conceptual Framework and Research Hypotheses

This research studies the relationship between profit management, cost stickiness, and corporate governance. Since general, administrative, and selling costs are an important sector of operational costs of firms, self-interested managers tend to increase general, administrative, and selling costs quickly and reduce costs very slowly in increasing selling time. This management behavior toward cost reduction or increase significantly influence on firm profit because investors seek maximum profit, and managers use this opportunity and maximize profit in their financial statements. Therefore, awareness about the costs' behavior changes by activity levels changes or selling level are an important information for managers' decision in profit management. This phenomenon leads to positive relationship between profit management and costs stickiness, and as corporate policy systems are designed and executed along with profit management reduction, it is expected as more powerful as policy systems is, as weakest as the positive relationship between profit management and costs stickiness will be. According to the theoretical bases in problem statement part, research hypotheses are classified bout the listed firms in Tehran stock Exchange.

Main Hypothesis

Profit management increase and corporate governance reduce costs stickiness.

Secondary Hypotheses

First hypothesis: profit management increase reduces costs stickiness.

Second hypothesis: corporate governance increase reduces costs stickiness.

Methodology

The methodology of this research is applied based on its objective, because the obtained results can be used in mangers' decision. In addition, this is descriptive-correlational research for the manner of inference of research hypotheses, because regression and correlation methods were used for exploration the relationships among research variables so this is inductive argument type. Moreover, this research is in group of proving theories as results are obtained by testing data. Librarian method was used in this research to collect the needed data for theoretical bases and research background. Therefore, data was collected by studying books, journal, and specialize website. Method of mining documents was used to estimate then needed data for models. Needed data was adopted from financial statements of the listed firms in Tehran Stock Exchange and website of Islamic studies and development research management for stock exchange. Pearson inferential statistics and multivariate regression model were used to analyze data.

Statistical Population and Sample

Statistical population of this research is all listed firms in Tehran Stock Exchange since spring of 2011 to the winter of 2017 equaling to 1056 firms. However, the mentioned firms were moderated with inserted limitations and conditions for lack of accessibility to the data of all mentioned firms and possibility of selecting statistical sample. Sample volume was selected 200 by Cochran testing according to the features of statistical population and big population for research and to collect data.

The calculations were done based on the following relation:

$$n = \frac{N.t^2.p.q}{N(d)^2 + t^2.pq} = \frac{1056(1/96)^2.(0/5)(0/5)}{1056(\%5)^2 + (1/96)^2.(0/5)(0/5)} = 20$$

In which,

N=200= volume of the studied population;

p=0.5= feature presence in sample volume;

q=0.5=absence of feature in sample volume;

d^2= $(0.5)^2$= reliability;

t^2=t-student= $(1.96)^2$= reliability;

n=sample volume;

Random sampling method was used in this research for sampling.

Findings

Table (1) - regression analysis of profit management and corporate governance with cost stickiness

	Sum of squares	***Degrees of freedom***	***Mean square***	***F***	***Sig. level***	***R***	***R^2***	***Justified R***
Regression	7702.814	4	1925.704	11.677	0.000	0.440	0.193	0.177
Residual	32159061	195	164.918					
Total		199	39861.961					
Predictor variables	Non-standard Coefficients	standard error		Standard coefficients	T	Sig. lev		
	B			β				
Constant	74.932	6.742		-	11.114	0.000		
Corporate governance	1.030	.279		0.777	3.685	0.000		
Profit management	2.106	0.719		0.421	2.931	0.004		

Data regression analysis showed that cost stickiness variable with 0.00 sig, level and f=11.677 is effective in results predictions. It means it has prediction power for corporate governance and profit management. According to table (1), β for each variable is as following:

β for corporate governance is 0.777, and β for profit management is 0.421.

First hypothesis: profit management reduces cost stickiness.

Table (2): relationship between profit management and costs stickiness

Variables	***Costs stickiness***		
	Pearson correlation coefficient	Sig. level	No.
Profit management	0.202	-0.04	200

According to table (2), correlation coefficient between profit management and cost stickiness in the listed forms in Tehran Stock Exchange (r=0.202) shows the significant correlation between these 2 variables (P=-0.04) and also the negative mark shows changes to increase one variables reduces another variable. Therefore, increasing 1 unit of profit management will reduce cost stickiness 20%, and effective factors on these two variables are about 13% mutual between two variables. Therefore, this hypothesis is rejected and research hypothesis is confirmed.

Second hypothesis: corporate governance reduces general and administrative costs stickiness.

Table (3): corporate governance relationship with costs stickiness

Variables	***Costs stickiness***		
	Pearson correlation coefficient	Sig. level	No.
Corporate governance	0.183	-0.013	200

According to table (3), correlation coefficient between corporate governance and cost stickiness in the listed forms in Tehran Stock Exchange (r=0.183) shows the significant correlation between these 2 variables (P=-0.013) and also the negative mark shows changes to increase one variables reduces another variable. Therefore, increasing 1 unit of profit management will reduce cost stickiness 20%, and effective factors on these two variables are about 13% mutual between two variables. Therefore, this hypothesis is rejected and research hypothesis is confirmed.

Conclusion

Generally, first hypothesis tests the relationship between profit management and cost stickiness in listed firms in Tehran stock Exchange. Based on the obtained results and results of the first hypothesis, increase in profit management reduces costs stickiness. Therefore, results of this research based on regression model test showed that there is negative relationship between profit management and costs stickiness. Therefore, first hypothesis is confirmed. The obtained results of first hypothesis are in agreement with the results of Zhu and Hung (2015) and Ki et al. (2014) research.

In addition, second hypothesis tests the relationship between corporate governance and cost stickiness in listed firms in Tehran stock Exchange. Based on the obtained results and results of the second hypothesis, increase in corporate governance reduces costs stickiness. Therefore, results of this research based on regression model test showed that there is negative relationship between corporate governance and costs stickiness. Therefore, second hypothesis is confirmed. The obtained results of first hypothesis are in agreement with the results of Zhu and Hung (2015) and Azizi et al. (2014) research.

One of the most important problems of each researcher is access to the initial data and their collection to test hypotheses based on them. Therefore, if data is accurate and complete, the obtained results from research are relatively accurate and their generalization to population can be more capability. Finally, it can be claimed that such research has proper reliability and validity. Thus, each research in this case will have limitations and the preset research is not exceptional to reach the objective of this research. In this regard, the limitations of the present research follows that results of the present research were obtained using the data of the listed firms in Tehran Stock Exchange and all firms were not studied. Therefore, the defect in data of some firms reduces number of the studied firms to 200, so the generalization of the results of the present research to all listed firms in Tehran Stock Exchange must be done carefully.

Suggestions

Real or legal persons that can enjoy this research are as following:

According to the effect of corporate governance on costs stickiness, the findings of this research can be useful in identification which element of corporate governance influence on costs stickiness and the relationship between profit management. Results of empirical studies must be considered in formulation the new code for corporate governance and revisions of old regulations. Empirical support based on importance of internal corporate governance role will confirm the affluence of the obtained resources from obligation of corporate governance on firms on their costs and losses, and it will provide efficient justification for legislators to oblige the necessities of corporate governance.

Identification the profit management consequences are important not only for beneficiaries but also for formulators of accounting regulations. This group must formulate regulations and standards for better control of firms' management as much as possible in selecting various technics of accounting to limit action freedom of managers in selecting serval technics as much as possible. However, this point must be considered that profit management is one of potential results of formulating accounting regulations, because explicit and fixed standards limit profit management by incomes; therefore, managers intention increases to use profit manager.

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