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The relationship between transparency and financial performance in Iraqi corporations

Anmar Adnan Khudhair[1],*

[1]Department of Accounting, Faculty of Management and Economics, University Pendidikan Sultan Idris (UPSI), Perak, Malaysia
Anmar.mrah90@fpe.upsi.edu.my

Norlia Mat Norwani[2]

[2]Department of Accounting, Faculty of Management and Economics, University Pendidikan Sultan Idris (UPSI), Perak, Malaysia
norlia@fpe.upsi.edu.my

Azam Abdel Hakeem Khalid[3]

[3]Department of Accounting, Faculty of Management and Economics, University Pendidikan Sultan Idris (UPSI), Perak, Malaysia
azamabdelhakeem@fpe.upsi.edu.my

Talal Mohammed Aljajawy[4]

[4]Department of Accounting, Faculty of Management and Economics, University of Karbala, Iraq
tjajawy@fpe.upsi.edu.my

Abstract

This study aimed to examine the relationship between transparency and corporate financial performance by using transparency indexes specified in Standard and Poor's model, ownership structure and stakeholder's rights, financial and non-financial information and board of directions. This study based on a sample of 25 corporations listed on the Iraq stock exchange (ISX). Based on the research results, there is a positive significant relationship between the OWSR and FNF transparency and the financial performance criteria of corporations based on ROA. In conclusion, future studies should be carried out with large sample size and conducted the studies by comprising several other countries.

Keywords: Transparency criteria, Corporate financial performance.

La relación entre la transparencia y el desempeño financiero en las corporaciones iraquíes

Resumen

Este estudio tuvo como objetivo examinar la relación entre la transparencia y el desempeño financiero corporativo mediante el uso de índices de transparencia especificados en el modelo de Standard and Poor's, la estructura de propiedad y los derechos de los interesados, la información financiera y no financiera y la junta directiva. Este estudio se basó en una muestra de 25 corporaciones que cotizan en la bolsa de valores de Iraq (ISX). Según los resultados de la investigación, existe una relación significativa positiva entre la transparencia de OWSR y FNF y los criterios de desempeño financiero de las corporaciones basadas en el ROA. En conclusión, los estudios futuros deberían llevarse a cabo con muestras de gran tamaño y llevarse a cabo en otros países.

Palabras clave: Criterios de transparencia, Desempeño financiero corporativo.

1. INTRODUCTION

Transparency and disclosure quality of companies is today's one of the prior concerning issues for people who are related to the capital market from various nations. According to ATAN, ALAM, SAID & ZAMRI (2018), definition, the information of financial transparency is the ability of broad access to relevant and trustworthy information regarding the financial performance and status, governance, investment opportunities, vibration and taking the risk in the economy. In one hand, transparency of financial information assures macro stakeholders of receiving trustworthy information

consistently regarding the company's value as well as makes the managers and macro stakeholders concerned of not violating their rights; on the other hand, rather than pursuing short term personal interests it encourages the managers to attempt for the increment of the company's value (BANO, TAHIR, ABBAS & ANSARI, 2018).

The quality of corporate performance can be minimized if the manager's discretion is questionable due to the lack of adequate transparency in financial statements. It can be paramount concerning factor for the decision making of stakeholders (HENRIQUES, 2013). It also can lead to inappropriate resource distribution as well as capitals which are directed to an unknown direction. Thus, the economy may suffer from the crisis (JAHANSHAD, HEIDARPOOR & VALIZADEH, 2013). However, the world's capital market opined that transparency always plays a vital role to prevent the corruption and provision of distorted information and it should often do with the aim of carrying out illegal acts. On the other hand, there is certainly a gap found between expectations and experimental evidence of transparency as in reality, there is no evidence for operationalizing transparency concerning reforms (DUBBINK, GRAAFLAND, & VAN LIEDEKERKE, 2008).

Moreover, a lack of transparency is also found in governance and financial issues even in developed countries and liberal communities. Therefore, this study will assist the specifying cases which result in the promotion of transparency in the companies listed

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in the Iraq Stock Exchange. Additionally, this study also investigates its connection with the corporate financial performance with the following evaluation of transparency in Iraqi corporation, (CHANG & TAYLOR, 2016). However, this study aims to investigate the relationship between transparency and financial performance in Iraq corporations (GAN, SHEK, & MUELLER, 2015; KARAGIORGOS, 2010: MARDANI & FALLAH, 2018).

2. METHODOLOGY

The data employed for this study were the outcome of the annual report of the corporations which are listed on the Iraq stock exchange (ISX) during the period of 2014 to 2017. The sample of the corporations was selected using the purposive sampling technique. A total of 25 corporations were finally chosen as samples. The method of analysis was the multiple regressions and the method of estimation was ordinary last squares (OLS).

According to BALACHANDRAN & FAFF (2015), prior literature in measuring financial performance has split performance ratios into this approach: Accounting-based ratios give financial statement users a measure of the efficiency and profitability of an organization's management practices of assets and liabilities in their operations. Common ratios users utilize when evaluating a company are profitability ratios including its ROA, ROE and ROI. According to

BUSHMAN, PIOTROSKI & SMITH (2003) since the 1980s the academics have been started debating on the practices of accounting-based measures as an indicator of financial performance (DINGWERTH & EICHINGER, 2010).

In nature, the construction of the transparency index is subjective which is used by the prior studies (BEN OTHMAN & ZÉGHAL, 2010). However, from the annual report's total of 80 proxies were selected which are involved by the transparency index construction and which are divided into three subcategories. Furthermore, the categories contain 18 factors for Ownership structure, 22 factors for management and board structure and 40 for Financial and non-financial disclosure. Where an item is disclosed the company is awarded a score of 1 and no disclosure 0 scores are awarded afterward converted into percentages. Transparency Indexes measured in this formulate:

$$\text{Transparency Indexes} = \frac{\sum X_{ij}}{N}$$

where N is the total number of items expected to be disclosed for corporation j. N is equal to 80. Xij is equal to 1 if the item is disclosed for corporation j, and 0 if not disclosed.

Transformed OLS multiple regressions have been used for financial performance (ROA, ROE and ROI) and the following subcategories of transparency index (OWSR, FNF and BDS):

$$ROA = \beta0 + \beta1 \; BDS + \beta2 \; OWSR + \beta3 \; FNF + e\ldots\ldots(1) \; equation$$

$$ROE = \beta0 + \beta1 \; BDS + \beta2 \; OWSR + \beta3 \; FNF + e\ldots\ldots(2) \; equation$$

$$ROI = \beta0 + \beta1 \; BDS + \beta2 \; OWSR + \beta3 \; FNF + e\ldots\ldots \; (3) \; equation$$

Whereby….

A firm performance measure used was ROA, ROE and ROI

FNFD: Financial and non-financial Disclosure

OWSR: Ownership Structure and Stakeholders Relations

BDS: Board of Directors Disclosures.

3. RESULT AND DISCUSSION

Descriptive statistics commonly describe the basic characteristic of the considering variables including the number of observations, mean, standard deviation, minimum and maximum values. The descriptive statistics are provided to determine the distribution and dispersion of each variable for Iraqi corporations. Table 1 presents a descriptive statistics summary of all variables applied in this research from 2014 to 2017. This table exhibits the descriptive statistics of the dependent variables including ROA, ROE and ROI. The average ROE,

ROA, and ROI for the Iraq economy are -17.13, 8.85 and -17.04 respectively, followed by a maximum score of 463.57, 200.74 and 463.57 for these DVs.

Table 1: Descriptive Statistics for All the Variables

Variables	Observation	Mean	Std. Dev	Min	Max
ROE	100	-17.13	355.53	-3475.19	463.57
ROA	100	8.85	34.26	-66.57	200.74
ROI	100	-17.04	358.94	-3475.19	463.57
OWSR	100	8.63	1.13	6.25	10.00
FNF	100	131.55	382.82	12.00	1500.00
BD	100	11.13	2.30	7.50	15.00

Notes: ROA= Return on Assets, ROE= Return on Equity, ROI= Return on Investment, OWSR= Ownership Structure and Investor Relations, FNF= Financial and non-financial Information, BOD= Board of Directors

The deviations between maximum and minimum for ROA ranged from -66.57% to 200.74%, ROE started from -3475.19% to 463.57% and ROI ranged from -3475.19% to 463.57%. The standard deviation for FNF was highest (382.82), while the lowest belongs to OWSR as transparency indicators with the value of 1.13 that were not much different from mean, suggesting that OWSR is centrally distributed. The mean of OWSR, FNF and BD (indicators of Transparency) are 8.63, 131.55 and 11.13 accordingly(Moosavinia & Baji, 2017).

As a complement of the descriptive statistic summary, the correlation matrix is presented in this section. A correlation coefficient is a statistical measure of the degree to which changes to the value of one variable predict the change to the value of another. In positively correlated variables, the value increases or decreases. In negatively correlated variables, the value of one increases as the value of the other decreases. Correlation quantifies the degree and direction to which two variables are related. Correlation does not fit a line through the data points, but simply is computing a correlation coefficient that tells how much one variable tends to change when the other one does.

When r is 0.0, there is no relationship. When r is positive, there is a trend that one variable goes up as the other one goes up. When r is negative, there is a trend that one variable goes up as the other one goes down. Correlation is a statistical measure that indicates the extent to which two variables fluctuate together. A positive correlation

indicates the extent to which those variables increase or decrease in parallel; a negative correlation indicates the extent to which one variable increases as the other decreases.

Table 2 shows the correlations between each pair of variables. This research analyses and demonstrate the Pearson-correlation coefficient, that is a renowned approach for evaluating the strength of correlation between any two variables. In table 2, the value in front of variables shows the direction and coefficient of correlation while the value below that is the probability of this correlation. The bold probabilities are the significant ones that imply that these correlations are meaningful. As can be observed, out of this correlation analysis, only a few of them are significant and the rest are not statistically meaningful. Not surprisingly, the correlations between firm performance indicators (including ROE, ROA and ROI) are significant and they are highly correlated. Therefore, these indicators of firm performance are considered a dependent variable in separate equations for analysis of this study.

Table. 2: Correlation (Pearson) ROA as Depend Variable

		(1)		(2)		(3)	(4)	(5)	(6)
1	ROA	1.00							
2	ROE	0.28	***	1.00					
		0.00							
3	ROI	0.29	***	0.99	***	1.00			

		0.00	0.00					
4	OWSR	-0.02	-0.15	-0.14	1.00			
		0.85	0.12	0.17				
5	FNF	0.00	0.03	0.02	-0.08		1.00	
		0.98	0.79	0.81	0.42			
6	BOD	-0.16	-0.08	-0.07	0.51	***	0.16	1.00
		0.12	0.45	0.47	0.00		0.12	

Note: ROA= Return on Assets, OWSR= Ownership Structure and Stakeholders of Rights, FNF= Financial and Non-Financial Information, BOD=Board of Directors.

Since this paper aims to analyze panel data, three compulsory tests (including F-test, Breusch-Pagan test, and Hausman test) should be performed to find the optimal method between Pooled OLS, Fixed effect and Random effect for panel data analysis. F-test, BP-LM test and Hausman test investigate between Pooled OLS and Fixed effect, Pooled OLS and Random effect, and finally between Random effect and Fixed effect accordingly.

Regarding the first equation which has ROA as the dependent variable, the outcome of the F-test shows (with the null hypothesis of Pooled OLS), null hypothesis rejected and alternative hypothesis which is fixed effect is accepted. Then, the result of the Breusch-Pagan test (with the null hypothesis of Pooled OLS) shows that the null hypothesis is rejected, and the Random effect is accepted. Finally, the

result of Hausman (with the null hypothesis of Random effect) shows the null hypothesis which is random effect cannot be rejected and it is accepted. Therefore, it is clear that the most suitable method for the first equation is the Random effect (RE).

After declaring the most suitable method of panel data analysis which is the Random effect for the first equation and checking the assumption of regression models, the paper discusses the outcome of the first equation that ROA acts as a dependent variable, OWSR, FNF and BOD are independent variables. Table 3 shows the final outcome of the Random effect analysis of the first equation. According to the result of panel data regression in table 3, OWSR and FNF have a significant probability at 5% and 1% respectively, that implies the meaningful impact of OWSR and FNF on (ROA). Hence, it shows that if OWSR increase by one 1 units, ROA will increase by 4.82 unit and if FNF rises one unit, ROA increases by 0.06. On the other hand, the probability of BOD is larger than 0.1 that implies the insignificant impact of BOD on ROA. Therefore, this independent variable has no meaningful impact on ROA in the first equation.

Table 3: Multiple Regression Results for First Model (ROA as Dependent Variable)

	Coefficient		Std. Err.		Prob.
OWSR	4.82	**	2.17		0.03
FNF	0.06	***	0.01		0.00
BOD	-1.09		1.28		0.39
Constant	-32.16	**	12.90		0.01

N	100				
R-square	0.59				

Note: *,**,***. *P<0.1, **p<0.05, ***p<0.01.

In the case of the second equation which has ROE as the dependent variable, the outcome of the F-test shows (with the null hypothesis of Pooled OLS), the null hypothesis cannot be rejected and Pooled OLS is accepted. Then, the result of the Breusch-Pagan test (with the null hypothesis of Pooled OLS) shows that the null hypothesis also cannot be rejected, and Pooled OLS is accepted. Finally, based on the result of these tests, it can be inferred that the POOLED OLS is the most suitable method for the second equation.

In the second model, ROE is the dependent variable, OWSR, FNF and BOD are independent variables. Table 4 shows the final outcome of the Pooled OLS for the second model. According to the result of panel data regression in table 4, FNF and BOD have a significant probability at 1% and 10% respectively, that implies the meaningful impact of FNF and BOD on ROE. Also, it shows that FNF has positive and BOD has a negative impact on ROE. Hence, it shows that if FNF increase by one 1 unit, ROE will increase by 0.07 unit and if BD rises one unit, ROE will decrease by 13.67. On the other hand, the probability of OWSR is larger than 0.1 that implies the

insignificant impact of OWSR on ROE. Therefore, this independent variable has no meaningful impact on ROE in the first equation.

Table 4: Multiple Regression Results for Second Model (ROE as Dependent Variable)

	Coefficient		Std. Err.		Prob.
OWSR	32.91		20.92		0.12
FNF	0.07	***	0.02		0.00
BOD	-13.67	*	7.99		0.09
Constant	-127.70		112.86		0.26
N	100.00				
R-square	0.05				

Note: *,**,***. *P<0.1, **p<0.05, ***p<0.01

Finally, regarding the third equation which has ROI as the dependent variable, the result of the F-test shows (with the null hypothesis of Pooled OLS), the null hypothesis cannot be rejected and Pooled OLS is accepted. Then, the result of the Breusch-Pagan test (with the null hypothesis of Pooled OLS) shows that the null hypothesis also cannot be rejected, and Pooled OLS is accepted. Finally, based on the result of these tests, it can be inferred that the Pooled OLS is the most suitable method for the third equation (ROI as a dependent variable).

In the third model, ROI is the dependent variable, OWSR, FNF and BOD are independent variables. Table 5 shows the final outcome

of the Pooled OLS for the third model. According to the result of panel data regression in table 5, FNF and BD have a significant probability at 1% and 10% respectively, that implies the meaningful impact of FNF and BOD on ROE. Also, it shows that FNF has positive and BOD has a negative impact on ROE. Hence, it shows that if FNF increase by one 1 unit, ROE will increase by 0.08 unit and if BOD rises one unit, ROE will decrease by 15.28. On the other hand, the probability of OWSR is larger than 0.1 that implies the insignificant impact of OWSR on ROE. Therefore, this independent variable has no meaningful impact on ROE in the first equation.

Table 5: Multiple Regression Results for tThird Model (ROI as Dependent Variable)

	Coefficient		Std. Err.		Prob.
OWSR	66.53		41.35		0.11
FNF	0.08	***	0.02		0.00
BOD	-15.28	*	9.17		0.10
Constant	-408.47		291.12		0.16
N	100.00				
R-square	0.08				

Note: *,**,***. *P<0.1, **p<0.05, ***p<0.01

4. CONCLUSION

In summary, it can be stated that in the first equation with ROA as the dependent variable, OWSR and FNF has a positive meaningful

impact on ROA. On the other hand, in the second and third equations (with ROE and ROI as dependent variables), FNF has a significant and positive impact and BOD has a meaningful and negative impact on dependent variables. However, future studies should be carried out with large sample size and conducted the studies by comprising several other countries. Furthermore, the future study also should include some other crucial variables such as CEO tenure, board composition and institutional ownership as main indicators. This study also recommends that future researchers can conduct more studies with the interview and questionnaire approach to get the response of the preparation of the annual reports.

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