

The Relationship between Individuality and Power Distance with the Board of Directors' Composition and Family Ownership

Hassan Vahedi¹, Mohamadreza Abdoli², Jafar Rahimikhah³

¹Department of Management, Shahrood branch, Islamic Azad University ,Shahrood ,Iran

²Department of Accounting, Shahrood branch, Islamic Azad University ,Shahrood ,Iran

³Department of Management , Economics and Accounting, payame Noor University, IR. Of Iran

ABSTRACT

The purpose of this research is to study the relationship and impact of composition of companies' board of directors and shareholders on the level of individuality and power distance. The surveyed samples include 87 companies listed in Tehran Stock Exchange which are selected randomly. The period under study is the year 2011. The applied statistical methods include simple regression, T and F statistics as well as step by step method. The results indicate that there is a significant and direct relationship between independence in companies' board of directors and the levels of individuality and power distance. Almost 19 percent of the variations in individuality among the companies and 13 percent of the variations in power distance of companies can be respectively explained through detachment of CEO from the board of directors. In addition, the relationship between the ratio of the executive board of directors who are the employed and full time managers and these components is evaluated direct and significant and almost 23 percent of it can be explained. The effect and relationship of ownership concentration in companies with the components of individuality and power distance are not confirmed, however direct relationship among them is confirmed.

KEYWORDS : Duality , Executive Board , Family Control , Individuality, Power Distance.

INTRODUCTION

One of the important achievements of research on accounting is raising awareness about the role of environmental factors in the formation of systems and accounting procedures. Such achievements have led to more stern efforts to identify the related environmental factors and their impact on accounting. In these researches, culture is considered as one of the important environmental factors affecting the accounting systems of countries. This assumption is based on the general belief that accounting is a socio-technical activity (Thaghafi, 2003 and Amir et al .2001). [18], [1]

In this regard, various studies have been conducted in different countries about the impact of culture on accountants' behavior and establishment of a systematic and controlling condition in the financial domain. In all of these studies, the concept of culture is considered based on Hofstede's definition. According to his view, culture can be studied in terms of five dimensions. These elements include the level of power distance in society, uncertainty avoidance about the future, level of individuality and masculinity, long and short term view (Hofstede et al., Cultural Translation, 2007 and Demtz and Lehn 1985) [7] , [5]. The main component used in creation of controlling system is corporate governance system in companies and concentration on its two main components namely the composition of board of directors and the composition of shareholders. In this study, these two issues are examined together in order to analyze and test the impact and interaction of these two elements. This issue is of notable importance given the fact that the legal and cultural conditions governing the economic environment of Iranian companies are different from other countries.

A REVIEW ON RESEARCH LITERATURE

Ho and Lin through their research have found out that the manipulation of profit figures by managers in companies depends on the value system (culture) as well as the structural aspects (legal environment) of the respective country (Ho, 2008). [8]

Wolfgang (2012) has studied the issue of accountability of organization/company to interest groups with regard to the establishment of corporate governance. In this study, the opinions of the executive and non-executive managers in different companies with different cultures were examined. [19]

Peter (2010) have analyzed the relationship between national culture and corporate governance. In this study, they have applied Hofstede's model to evaluate culture and have examined the relationship of corporate ownership structure in terms of ownership concentration and company shares ownership by banks and government as well as the cultural dimensions of Hofstede's model with the number and independence of board of directors. [13]

Hofstede investigated in his research on the employees of IBM in 50 different countries including 116000 people on the difference of culture in various countries which included individuality, power distance, avoiding ambiguity and masculinity.

Iran was ranked 29 in power distance, 43 in masculinity, 59 in avoiding ambiguity and 41 in individuality perspectives (Hofstede, 2002). [4]

Hofstede and etal claimed that people's sensitivity to risk is high in eastern cultures. Also, other observations show that group and collectivist cultures are more tolerant to risk than individual cultures (Hofstede, 2007). [7]. Marclo and Pagliarussi (2008) found that income manipulation by companies' managers depends on value systems (culture) and structural aspects (legal environment) of the country under study. [9]

Roya'e and Abdoli found no significant and important relationship between cultural components and earnings management. In fact, by including the type of company variable, whether public or private, the relationships between dependent and independent variables were slightly modified (Roay'e and Abdoli, 2009). [15]

Ahmed Seleim and Nick Bontis, (2009) investigate the relationship between the GLOBE (Global Leadership and Organizational Behavior Effectiveness) project national cultural dimensions of values and practices and the Corruption Perception Index (CPI). Their results provide empirical support for the influence of uncertainty avoidance values, human orientation practices, and individual collectivism practices on the level of corruption after controlling for economic and human development, which, in turn, adds to the efforts to build a general theory of the culture perspective of corruption [17],

Askary (2006) and Nguyen (2011) investigate whether national culture influences perceptions of the acceptability of earnings management. Participants from eight countries evaluated 13 vignettes describing various earnings management practices. Results demonstrate considerable variation in perceptions across nations to the earnings management scenarios, providing strong evidence that the practice of earnings management was not perceived similarly in all countries. Using Hofstede's (1991) cultural indices, we find that the differences in aggregate perceptions across countries were not closely associated with any of the cultural dimensions examined. They find that perceptions of earnings manipulations involving the timing of operating decisions were associated with both the Power Distance Index and the Masculinity Index. [3], [11],

Pascal and Christorher. (2011) and Marquis and Toffel (2011) who argue that individualistic societies may be less susceptible to corruption, we find that countries scoring high on individualism tend to have lower levels of earnings management. In addition, we find that egalitarianism, defined as a society's cultural orientation with respect to intolerance for abuses of market and political power, is negatively related with earnings management. Our results are robust to different specifications and controls. [12], [10].

(Sam et al. 2010, and Anne et al. 2010, and Aileen and Evelyn. 2005) study value information of corporate decisions and corporate governance practices. They investigate a direct link between corporate governance practices and strategic corporate decisions such as investment, financing dividend policies and cash holdings. Their findings show that the value implications of financing, investment, dividend, and cash – holding decisions are strong for firms with sound corporate governance practices. [16], [2], [4].

MATERIALS AND METHOD

Importance of Subject

In this study, the controlling and monitoring system in companies with regard to the cultural and management system governing the Iranian companies are discussed and hitherto no similar research in this regard has been conducted in Iran. In general, the behavioral study of financial and controlling events is of high importance in such a way that they have been emphasized in all theories of financial behavior.

Statement of Problem

Since the legal and economic conditions of Iran are different from other countries, the relationship and impact of cultural factors on corporate governance are studied and in particular the relationship between individuality and power distance with the composition of the board of directors and shareholders is analyzed.

Research Objectives

The aim of this study is to examine and define the effect of cultural, legal and judicial components of society on companies' governance system. Among the other objectives of this research is to study the influence of these components on the monitoring and controlling arrangements of the economic system. The governance system of companies will be reviewed in terms of the composition of the board of directors as well as that of the shareholders. The survey results will indicate that whether or not the cultural components can be effective on the controlling and governance system of companies.

Research Hypotheses

- 1- There is a significant relationship between the independence of the board of directors and the level of individuality in the company.
- 2- There is a significant relationship between the independence of the board of directors and the level of power distance in the company.
- 3- There is a significant relationship between the composition of the executive board of directors and the level of individuality in the company.
- 4- There is a significant relationship between the composition of the executive board of directors and the level of power distance in the company.
- 5- There is a significant relationship between the level of concentration of ownership in the company and the level of individuality.

6- There is a significant relationship between the level of concentration of ownership in the company and the level of power distance.

METHODOLOGY

Research Method

This study is an applied research in terms of the objectives and is an analytical-descriptive research in terms of approach (operation). This study is also a causal research because it applies precedent data.

Statistical Population

The statistical population of this research includes the companies listed in Tehran Stock Exchange which are adjusted according to the following limitations:

- Due to different nature, they should not be included among the financial investment and brokering companies
- They should be listed in stock exchange during the period leading to 2011
- The end of their fiscal year is Mid of March

Variables Measurement

Power Distance

This index is obtained using the scores given to the each company's employees selected choices in the first three questions of the questionnaire, which are related to the management style in each company. In fact, prior to designing these questions, four management styles from autocratic to fully-cooperative, were described to each respondent. The following diagram presents the questions by which the power distance in each company could be measured:

Table 1. Questions related to the measurement of the power distance

- Question 1** – What type of the above-described decision-makings are you interested in, for your top manager?
Question 2 – Which of these four types of decision-making is similar to your top manager's?
Question 3 – How many times have your colleagues hidden their disagreement with their manager's decision?

Power distance index formula:

The average score of the third question + the total percentage of the second question's choices 1 and 2 – the percentage of the first question's choice 3 (Equation1)

The answers to these questions are collected through sending written questionnaire to the statistical population and also through face-to-face visits. This questionnaire was previously used by Saghaei, Rezazadeh, Abdoli, and Roya'e in their accounting Ph.D. thesis. Therefore, it enjoys high validity and reliability.

The power distance index was calculated for each company in the same manner.

Individuality

In order to measure this variable, 14 questions (presented in the written questionnaire) related to the career goals of an ideal job were used. For eliminating the effects of optimism in answering the questions (answering positively to the questions disregarding their content), the answers were firstly standardized. During the standardization process, all answers would be stated as a distance from their common average and based on common standard deviations. Then, the factors derived from the employees standardized answers were analyzed using the factor analysis statistical technique. Firstly, the primary results of factor analysis were obtained, which indicated two effective factors and another not so much important one. Due to the fact that the primary results of each factor analysis do not generally enjoy high interpretation capability, the factors are rotated to obtain two related factors in terms of the correlation level with each career goals. Then, both factors extracted by the factor analysis as well as the correlation coefficient of each career goal with factors are examined by the help of theoretical principles and the main research literature and the basis for determining each individuality and masculinity indices.

The following table shows the factors effective on measuring the individuality variable:

Table 2. Factors related to the measurement of individuality variable

Career Goals Presented in the Questionnaire	Symbol
Personal satisfaction in performing the job	A1
To provide a desirable dwelling for family	A2
Possibility of achieving higher income	A3
Good work relationship among the colleagues	A4
To create educational opportunity in order to improve skills or to learn new skills	A5
To enjoy employment benefits	A6
To expect to be appreciated whenever doing a job properly	A7
The existence of proper physical conditions at work environment (Air-conditioning, light, etc.)	A8
Considerable latitude in applying one's desired viewpoints	A9
Job security to cooperate with the company as long as you desire	A10
Grounds for job advances	A11
The possibility to establish proper working relationship with the direct supervisor	A12
The possibility to take advantage of one's own skills and capabilities	A13
To specify an advisable and desirable time to spend with the family	A14

These coefficients are obtained considering the importance attached by the respondents to each of the career goals. In other words, these coefficients are the resultant of the viewpoints of the employees in the companies under study on individualism or collectivism components. In order to measure the individuality variable according to the theoretical principles and career goals presented in the above table, symbols A1, A2, A3, A4, A5, A6, A7, A8 and A10 were taken into account, considered by the statistical population as the indicators of the individuality concept. Therefore, the standard deviation of employees' responses in each company to every question (mentioned career goals) were calculated using the Microsoft Excel's spreadsheet, and then the standard deviation of these questions were considered as the individuality index. The average of these figures is the same expected index.

Proportion of Executive Members of the Board of Directors

The executive members of the board of directors are those members who work full time in companies based on the Commercial Law of Iran. According to this law, at least the CEO has to be full time and executive. These members are elected by the general assembly and are deliberated by dividing the number of executive members on the total number of the board of directors. This information shall be disclosed in companies' reports.

Dual Role of the Board of Directors (Duality - Board Independence)

The dual role of the board of directors means the separation of the duties of the board of directors and its chairman from the CEO duties which is called dual role. Based on the Commercial Law, upon ratification of more than two-thirds of the general assembly, companies can delegate to one person both the duties of CEO and the chairman of the board of directors. This role shall be disclosed in companies' annual reports.

Ownership Concentration

Ownership concentration means a certain number of stockholders controlling management and all company policies including financial and operational policies.

According to Iran trade law, board of directors in each company is selected by General Assembly stockholders and the number of votes of each stockholder is obtained through multiplying the number of suffrages for the number of shares by the number of directors

Thus, the stockholders with more shares will be able to select board of directors, including executive and non-executive board. In Iran, shares of most companies are mainly possessed by investment firms, banks, pension funds and insurance. Therefore, small stockholders do not play a major role.

In this study, "Herfindahl -Hirschman" Index (HHI) has been used in order to calculate the ownership concentration. The mentioned index is obtained from the total squared percentage of shares owned by stockholders of the companies. The index flagship increases along with increase in the ownership concentration and when all shares are owned by one person, it reaches to the maximum value calculated by 10,000 units. If the ownership structure is dispersed and all stockholders have equal ratios, HHI index reaches to the minimum value calculated by $N/10000$.

$$HHI = \sum (p_i / p * 100)^2 \quad (\text{Equation2})$$

RESULTS AND DISCUSSION

Results of Descriptive Statistics

The results of descriptive statistics of variables indicate that large companies consider elbow room to exercise their viewpoint as a more important issue. They also regard the existence of proper grounds for job advancement as an important matter. However, smaller companies consider the existence of working environmental conditions and access to more income as important issues. The index of power distance is higher in larger firms and this index has a smaller number in smaller companies. In addition, in companies in which the proportion of the executive board of directors is higher, the index of power distance is also high. In addition, the companies in which this proportion is higher have higher levels of individuality.

Results of Statistical Testing of Hypotheses

The results of research hypotheses testing is summarized in the following table:

Table 3: Results of Testing of Hypotheses(P-Value)

Variables	Power Distance	Individuality
independence of the board of directors(Duality)	0.032	0.0184
executive board of directors(In Board)	0.041	0.047
concentration of ownership	0.213	0.123

Table 4: Results of Testing of Hypotheses (adjustedR²)

Variables	Power Distance	Individuality
independence of the board of directors(Duality)	21	20.5
executive board of directors(In Board)	31.2	28.1
concentration of ownership	14	11.5

As shown in the table, the dual role of the board of directors has a significant relationship with the cultural components of individuality and power distance and can explain almost 20 percent of their changes. In addition, the presence of the executive board members in companies can also define more than 30 percent of individuality variations as well as power distance in companies. However, the analysis of the effect and relationship of shareholders' composition in companies can not explain the cultural components of companies in terms of individuality and power distance.

ANALYSIS AND DISCUSSION OF RESULTS

Based on the first and second research hypotheses, it is expected that separation of CEO from the board of directors, which is referred to as the independence of the board of directors, has significant impact on individuality and power distance. Accordingly, the results indicated that the significance and relationship between board independence and individuality is confirmed. It means that in the companies under study, the individuality thinking and lack of teamwork and group work is increased through detachment of chairman of the board of directors from CEO. In this regard, although the Commercial Law of Iran allow the chairman and CEO to be the same person through approval of more than two-thirds of the general assembly, our study specified that this detachment exists in about **75** percent of companies and two distinct persons hold these two responsibilities. Although this separation can help better control on the behavior of the board of directors as well as CEO, it has weakened teamwork thinking. Besides, in the second hypothesis the effect and relationship of the board of directors' independence and the level of power distance is confirmed which means that this separation has also created power distance between the managers and employees of companies. This issue completes the result of the first hypothesis.

Based on the third and fourth hypotheses, it was expected that there would be a significant relationship between the composition of the executive board of directors in companies and the level of individuality and power distance. The results indicated that the relationship between these two variables is significant and positive. It means that the companies in which the number of executive members is high and the members of the board of directors are often full-time, the level of individuality in the company is also high and there is a distance between employees' and managers' view. Since the executive managers are also the senior managers of company, this analysis shows that the thinking of managers from the perspective of employees is individualist and the spirit of cooperation and teamwork is not conveyed to their personnel and the budgets are not prepared participatory and have a command mode. This issue has created a large distance between employees' and managers' view and way of thinking. Another result of these two hypotheses is that non-executive members of the board of directors who make up 30 percent of the board on average - of course this ratio is different in various industries- cannot and have failed to overcome the individualistic thinking of executive managers and perhaps it is due to their low presence in the company.

In the fifth and sixth hypothesis, the relationship and impact of the shareholders' composition on corporate culture and the level of individuality and power distance in companies were examined. It was expected that this factor could indirectly affect the spirit and thinking of individuality as well as power distance due to the effect that can have on the composition of the board of directors. Although their relationship was directly confirmed, it was assessed insignificant and it means that the shareholders' composition in Iranian companies cannot be effective on collective work thinking and distance reduction between the views of managers and employees. Perhaps this is because of the fact that in most surveyed companies, the major shareholders of corporations are institutional investors as well as legal persons that monitor the performance of companies through selecting their representatives based on the Commercial Law. It is the managerial characteristics of natural persons which are effective on the companies' management policies and major shareholders who are mainly governmental or quasi-governmental do not adequately monitor the managerial policies of such entities. Accordingly, the most important issue for them is the budgeted dividends.

Recommendations

In view of the confirmation of the impact of the board of directors' composition on the cultural components, the managers are recommended to put emphasis on coordination of the efforts of staff in order to fulfill the interests of shareholders in order to maximize their profits. Considering the impact of some elements of corporate governance on corporate culture, it is recommended that this issue be considered in corporate governance regulations of Iran.

Conclusion

The results indicated that the board of directors and its composition have been effective on the cultural components of companies and could explain their changes. This role is stronger and higher for the executive board of directors. However, the impact and relationship of the companies' shareholders have failed to explain the changes of individuality and power distance in surveyed companies. Hence, the composition of shareholders cannot play an effective role on the governing culture in companies; however this role has been delegated to senior managers of company and the board of directors.

Suggestions for Future Research

Other components of corporate governance, including internal audit and the audit committee as well as the proportion of the executive board of directors and non-executive board of directors' changes on the cultural components are recommended

to be studied. The impact and relationship of the components of masculinity and uncertainty avoidance with the components of corporate governance are also suggested to be considered. For a more comprehensive review, the impact of other variables on the relationship of these two components such as type of corporate ownership and their size can be presented in the research model.

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