

Determining the effect of legal responsibility on corporate governance in Tehran Municipality, District 3

Abstract

This research determines the effect of legal responsibility on corporate governance in the municipality of District 3 of Tehran. Method: This research was an applied and descriptive survey. The statistical population in this study consists of all employees of the municipality of District 3, which according to the latest statistics and information, their number is 1100 people. For sampling, after estimating the sample size, we used a simple random sampling method. A sample of 285 people was selected from the statistical population of the study using the Morgan table. We have used Content validity to determine validity. For the formal and content validity of the questionnaire, we used the opinions of experts, supervisors, and consultants. Through Cronbach's alpha coefficient, we evaluated the reliability of the instrument. For this purpose, the questionnaire was given to 30 sample members and was approved. The structural equation model was for analyzing the data. The results showed that legal responsibility has an effect on corporate governance in the municipality of District 3 of Tehran. According to the results, we can say that the municipality in social activities through mass media should have a reflection on the client and customers. Training and orientation classes for employees should be held about dealing with customers and all economic, social, and cultural sectors should cooperate to improve social responsibility and move towards sustainable development.

Keywords: *Legal Liability, Corporate Governance, Shareholders, Beneficiaries*

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Introduction

Corporate governance refers to the set of methods, policies, and rules governing the proper management and control of a company that affects the administration of a firm or organization. Corporate governance is also "business unit governance" or "organizational governance system". It is a coherent structure of relationships established between shareholders, managers, beneficiaries, and supervisors to ensure the interests of all owners and stakeholders. This concept is also effective in achieving the right culture of accountability, transparency in providing information, and proper reporting. Corporate governance is one of the most common concepts in global trade terms and has been used since the 1990s in the industrialized countries of the world such as the United Kingdom, Australia, and some European countries. The concept dates back to the famous Cadbury report, published in 1992. It emphasized the establishment of an internal control system and the appointment of an internal audit committee. Subsequently, financial scandals at companies such as Enron, Worldcom, and Ajib led to stricter procedures for monitoring the performance of organizations and companies, first in the United States with the passage of the Sarbanes-Oxley Act in 2002 and then in other countries with similar laws. In Iran, this has been raised since 1982, and measures have been taken by the Stock Exchange Organization to strengthen the principles of corporate governance.

Legal responsibility is entrusted to the nature of the individual and the organization and is a reflection of the manifestation of their existence. In addition, external beneficiaries can influence standards or criteria called legal responsibilities. Corporate legal responsibility is one of the issues that

organizations should consider today to respect the rights of society, the environment, and nature (Taghizadeh and Soltani Fasgandis, 2010).

Social ethics and responsibility defined as the criterion of the right and the bad of a person's behavior have attracted the attention of management scholars recently. There are many articles and books in this field. We should say that the organization should be based on a social need for producing goods or providing services to the community, seeing that those goods or services have a general demand and that the organization can provide them and achieve income.

The pressure of the active action of the local community and NGOs have led public sector managers to consider the issue of legal responsibility as a strategic factor for the organization in their activities because they have realized that the decision of any organization can change, during a hierarchical process, the fate of the whole society. As one of the important organizations in the public sector and as a city management organization, which is responsible for urban management and is related to all different dimensions of the city such as social, economic, technological, and environmental dimensions, the municipality can regularly monitor the situation of the city from the perspective of sustainable development and improve its situation. Because one of the most important results of practicing the principles of social responsibility is economic growth, sustainable development, and welfare of society. Therefore, the municipality must go beyond its defined legal responsibilities and lead in adhering to legal responsibilities. The purpose of this research is to determine the effect of legal responsibility on corporate governance in the municipality of District 3 of Tehran.

Research theoretical foundations

Corporate governance

Corporate governance is a set of relationships between shareholders, managers, and auditors of a company that ensures the establishment of a control system to respect the rights of shareholders and the proper implementation of the resolutions of the assembly and prevent possible abuses. This law, which is based on the system of accountability and social responsibility, is a set of duties and responsibilities that must be performed by the company to ensure accountability and transparency (Shir Mohammadzadeh, 2019). During research on corporate governance, Hapeb et al. (1998) write that corporate governance describes the internal organization and power structure of the company, the board's duties, the ownership structure of the company, and the interaction between shareholders and other beneficiaries, especially the workforce of the company and its creditors.

Corporate governance models

The following is a brief description of well-known corporate governance models, including the market model, relational model, and connection model:

1. Market model

Characteristics of this model, which is specific to the United States, the United Kingdom, Australia, Canada, and several other countries, are highly dispersed shareholders, liquid capital markets, dynamics in the redistribution of capital, advanced legal and regulatory frameworks, and active markets for corporate control. At the micro-level, the board relies on both board committees and internal controls to oversee management. Management focuses on investments that show good returns and maximize company value and stock prices, especially in the short term. Shareholders are generally recognized as the main beneficiaries of the company. In general, those who work in the market model tend to focus more on exchanges than relationships and pay attention to the short term rather than the long term (Hasas Yeganeh, 2005).

2. Relational model

The characteristics of this model, established in countries such as Japan, Germany, Italy, the Netherlands, and France, are centralized and mutual ownership of shares, capital markets with medium liquidity, less activity in the redistribution of capital, and weaker (inactive) corporate control and processes. They are strong supervisors. At the micro-level of corporate governance, it is apparently under the supervision of the board of directors and in practice under the supervision of large banks or large companies or family shareholders. The management of the company is inflexible and tends to operate in a centralized style. Managers who are paid less than managers of market model companies have no incentives for the stock price

in the short term and are therefore less likely to make hasty investment decisions or seek only to maximize the current net value of projects or company value. The main beneficiaries (if not legally, in practice) are usually the employees, not the shareholders.

While relational and market models are predominant in developed countries (especially those in which regimes, corporate law, and bankruptcy law are firmly established), a third model can be considered which is for countries with emerging economies (Hasas Yeganeh, 2005).

3. Connection model

This model, established in many developing countries (such as Indonesia, Thailand, Malaysia, Korea, and Mexico), has some features of the market and relational models and some of its characteristics. Capital markets, for example, are less liquid, the corporate control market is either non-existent or inactive and regulatory and legal frameworks are often in place. They have authority, the mixing of affiliates is common, governance ties between companies and banks can be significant, and relationships and cooperation between the company and government agencies are very common. In the absence of sound regulatory or legal foundations, corporate transactions are often based on trust and relationships. A brief acquaintance with these general models will help us to identify the shortcomings of the corporate governance system and potential solutions for it (Hasas Yeganeh, 2005).

Principles of corporate governance

With the expansion of international investments, various institutions such as the World Bank, and the Organization for Economic Co-operation and Development (OECD) have become active in the field of corporate governance and have published a variety of principles in this regard. One of the last cases in this field is the principles of corporate governance of the Organization for Economic Cooperation and Development in 2004, which covers the following six areas:

- 1- Providing a legal basis for the formation of the corporate governance framework (by formulating and approving appropriate laws in the company and supervising its implementation).
- 2- Preservation of shareholders' rights and main property functions (through the establishment of an appropriate legal system).
- 3- Equal treatment with shareholders (respect for the rights of minority shareholders and the permission of minority supervision over the company's activities).
- 4- Observing the rights of all beneficiaries. (Through transparent reporting and respect for the rights of beneficiaries)
- 5- Disclosure and transparency (through appropriate regulatory laws and increasing the executive guarantee of laws and regulations).

6- Defining the responsibilities of shareholders, board of directors, and executive directors and development of supervision and controls, including the framework of internal controls, internal audit, independent audit, and increasing the independence of supervisors (Ghaffari, 2010).

Social responsibility

Classical economists believe that the responsibility of the company is only to increase the value of shareholders. However, achieving this goal should not lead to negative side effects for other stakeholders and the community. Organizations are part of society, and in this regard, the theory of beneficiaries states that an organization should manage its relationships with beneficiaries, so it will be more successful over time. Organizations must be able to ensure the performance of the organization and its role in society by implementing values and behavioral standards such as ethical programs and corporate social responsibility initiatives. Organizations, as intermediate links between the individual and society, are one of the fundamental components of today's human social body that need society to survive and continue its activities. In this regard, leading organizations pay attention to providing new social services (Gallant and Cadez, 2017).

The issue of corporate social responsibility has brought challenges to various international, national, and regional organizations in the process of developing standards for reporting non-financial information, and related disclosures have been a research paradigm in recent years. Corporate social responsibility is generally voluntary and refers to activities that go beyond compliance with the law. Companies have a responsibility beyond profit to produce goods and services. This responsibility is to help solve important social problems. One of the benefits of social responsibility for a company is its positive relationship with performance (Arsoy et al., 2012).

Nowadays, paying attention to corporate social responsibility activities has become an important issue. The company's social responsibility emphasizes that in addition to the responsibility of producing goods and services, organizations are responsible for internal and external beneficiaries as well as society and the environment. In addition, companies that engage in social responsibility activities have a public reputation. According to social identity theory, employees feel proud and self-esteem by joining such organizations. Companies meet the needs and want of employees through social responsibility activities, and make employees committed to the organization (Tafraji, 2018).

Social responsibility provides how organizations operate in their business environments and meet the expectations of society, their business, legal, ethical and social expectations. Because organizations have great social, economic, and

environmental responsibilities to their employees, shareholders, customers, government, suppliers, and all beneficiaries. Undoubtedly, if different individuals, groups, organizations, and institutions of the society consider themselves responsible for various events, happenings, and crises and each of them tries to solve the above crises within the limits of their responsibility and scope of work, many problems will be removed and a healthy and peaceful society will emerge. In other words, the organization's performance, no matter how it acts, affects society. Therefore, organizations must do things that are acceptable to society and in line with its values. Organizations that fail to adapt to this will not be successful in action. In other words, organizations need to pay attention to social responsibility to maintain or improve their position in society in a way that keeps them successful at work. Therefore, the social responsibility of organizations is the basic factor for the survival of any organization (Royaei and Mehrdoust, 2009).

Legal responsibility

In today's society, successful companies are companies that meet their legal requirements properly. Therefore, companies' legal responsibilities include compliance with product and consumer laws, environmental laws, and employee regulations. Laws are important, but sometimes they are not enough. First, they cannot answer all the problems that the company faces. Second, sometimes the rules are interpretable and ambiguous. Third, laws may be the result of the legislature's political motives for the personal interests of the individual or group (Carroll, 1998). Legal responsibilities appear at the second level. It seems logical that strict compliance with regulatory bodies is a necessary step before addressing additional voluntary commitments (Gomez and Asma, 2016).

Research method

The present research is applied research according to the purpose. It is descriptive and surveys. It is descriptive because its purpose is to describe objectively, realistically, and systematically different events, happenings, and topics. Its method is a survey. The statistical population in this research consists of all employees of the municipality of District 3, which according to the latest statistics and information, their number is 1100 people. A sample of 285 people was selected from the statistical population of the study using the Morgan table. For sampling, after estimating the sample size, we used a simple random sampling method.

The instrument used in this study is the Town Questionnaire (2012). This questionnaire has 25 items made through the ranking scale. As for the formal and content validity of the questionnaires, we used the opinions of experts, supervisors,

and consultants. Cronbach's alpha coefficient was used to evaluate the reliability of the instrument. For this purpose, we

gave the questionnaire to 30 sample members and received their approval (Table 1).

Table 1: Cronbach's alpha coefficient of research variables

Row	Dimensions	Cronbach's alpha coefficient
2	legal responsibility	0.81
4	Transparency of ownership	0.72
5	accounting information	0.77
6	Rewards and performance appraisal	0.90
7	Governance structure	0.82

In the descriptive statistics section, we use statistical characteristics such as frequency, percentage, mean and standard deviation, and in the inferential statistics section, the KS test to detect the parametric and non-parametric variables. The structural equation model test is also used. The software is SPSS23 and Smart PLS 2.

Findings

Before addressing the research questions, the normality of the frequency distribution of the research variables was used by the Kolmogorov-Smirnov test to determine the normality of its distribution. Accordingly, if the null hypothesis is not rejected, it can be said that the distribution of variables is normal and if the null hypothesis is rejected, the variables do not have a normal distribution (Table 2).

Table 2: Kolmogorov-Smirnov test for data normality

Row	Dimensions	Number	Kolmogorov-Smirnov test	Sig.
2	legal responsibility	285	1.81	0.026
4	Transparency of ownership	285	1.55	0.049
5	accounting information	285	1.91	0.007
6	Rewards and performance appraisal	285	1.77	0.031
7	Governance structure	285	1.86	0.019

In this section, based on the provided information, we review the research questions and analyze them. In this section, the

statistical test of the structural equation model is used. Due to the normality of the data, Smart PLS software was used (Figure 1,2 and Table 3)..

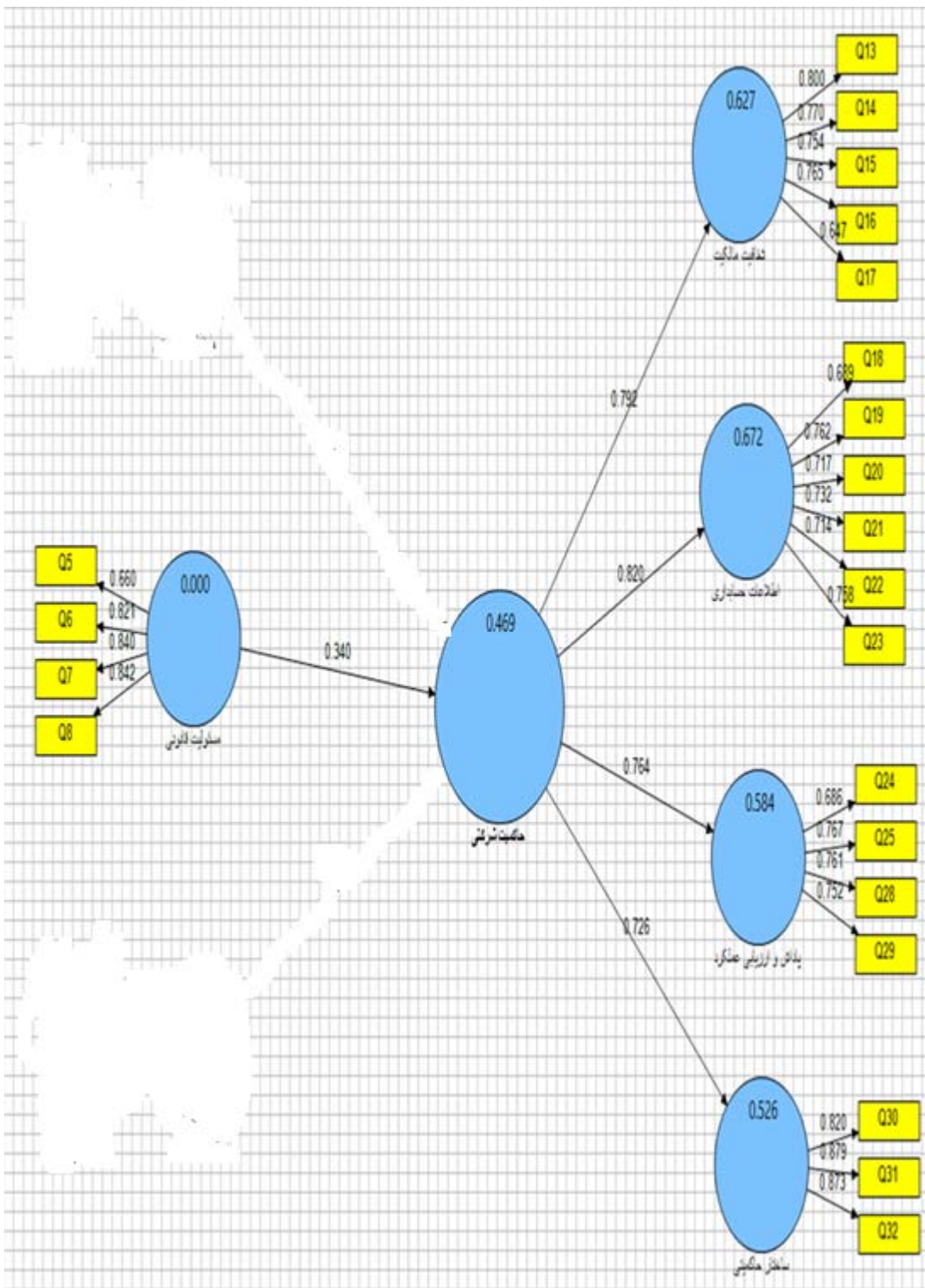


Figure 1: Test of the initial model for measuring research variables

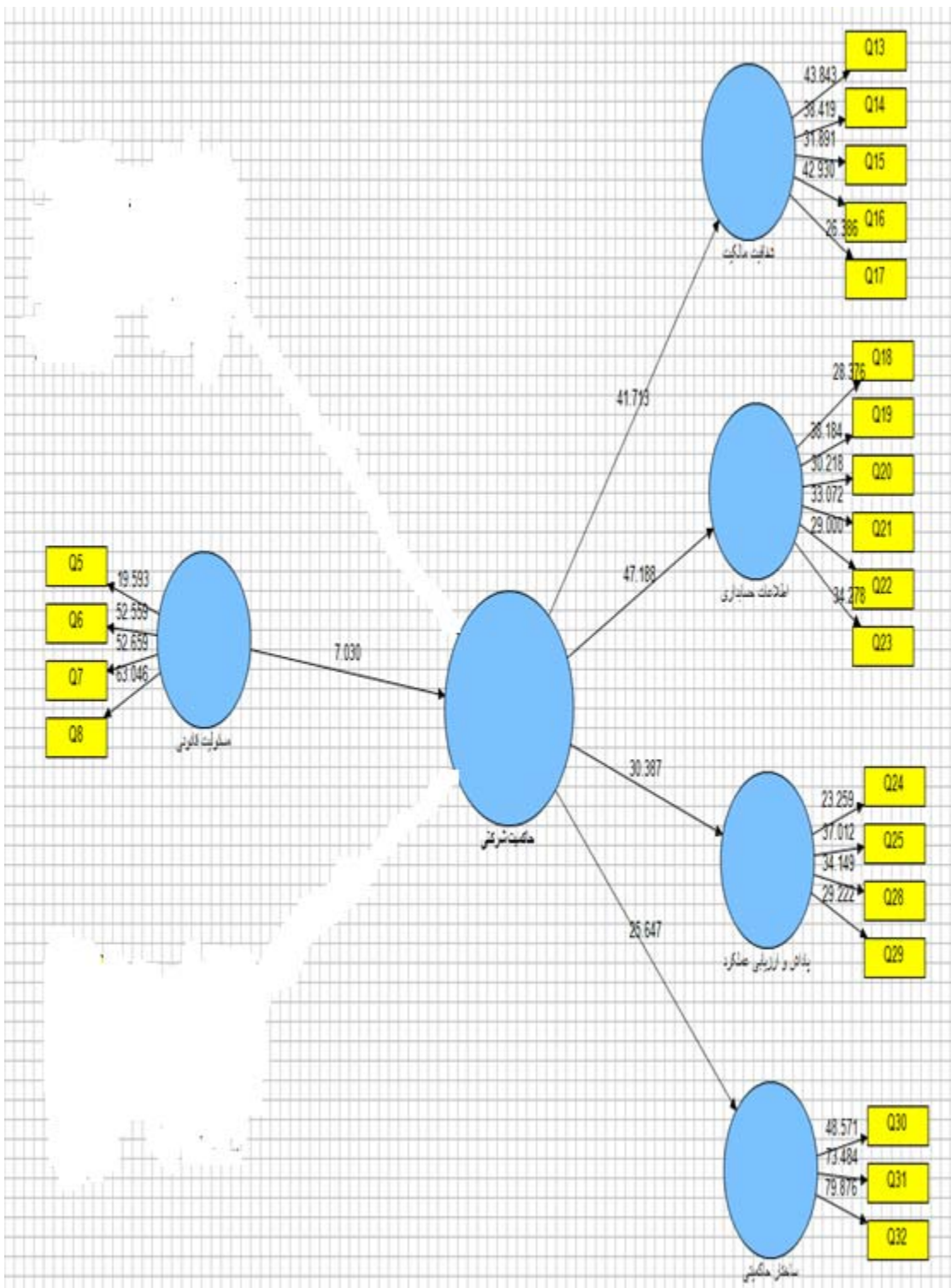


Figure 2: T scores of the test of the initial model for measuring research variables

Table 3: Factor load values and t for markers of each structure in the form of a model for measuring research variables

	Items	Factor load	T value	Sig.	Conclusion
legal responsibility	Q5	0.660	19.593	0.01	Marker is confirmed
	Q6	0.821	52.559	0.01	Marker is confirmed

	Q7	0.840	52.659	0.01	Marker is confirmed
	Q8	0.842	63.046	0.01	Marker is confirmed
Transparency of ownership	Q13	0.800	43.843	0.01	Marker is confirmed
	Q14	0.770	38.419	0.01	Marker is confirmed
	Q15	0.754	31.891	0.01	Marker is confirmed
	Q16	0.765	42.930	0.01	Marker is confirmed
	Q17	0.647	26.386	0.01	Marker is confirmed
accounting information	Q18	0.689	28.376	0.01	Marker is confirmed
	Q19	0.762	38.184	0.01	Marker is confirmed
	Q20	0.717	30.218	0.01	Marker is confirmed
	Q21	0.732	33.072	0.01	Marker is confirmed
	Q22	0.714	29.000	0.01	Marker is confirmed
	Q23	0.758	34.278	0.01	Marker is confirmed
Rewards and performance appraisal	Q24	0.686	23.259	0.01	Marker is confirmed
	Q25	0.767	37.012	0.01	Marker is confirmed
	Q28	0.761	34.149	0.01	Marker is confirmed
	Q29	0.752	29.222	0.01	Marker is confirmed
Governance structure	Q30	0.820	48.571	0.01	Marker is confirmed
	Q31	0.879	73.484	0.01	Marker is confirmed
	Q33	0.873	79.876	0.01	Marker is confirmed

Now, according to Table (3), fortunately, each of the twenty-five indicators measuring the research variable has a value outside the interval of -1.96 and 1.96, so at the 99% probability level, the factor load coefficient is significant for all questions. Therefore, there is a first necessary condition for questions to remain in the model. The results also showed that the factor load coefficients for questions (1 to 33) are above 0.5, so there is a second condition for the questions to remain in the model.

To evaluate the reliability of the model, two criteria of combined reliability and Cronbach's alpha were used. The value of these two criteria must be higher than 0.70. As shown in Table (4), the combined reliability (Delvin-Goldstein p) and Cronbach's alpha of all variables of the research variables is higher than 0.70, therefore, the reliability of the measurement model is confirmable.

Table 4: Combined reliability and Cronbach's alpha values for the model of measuring research variables

Variable	Combined reliability	Cronbach's alpha
legal responsibility	0.871	0.801
Transparency of ownership	0.864	0.803
accounting information	0.872	0.823
Rewards and performance appraisal	0.830	0.728
Governance structure	0.892	0.820

We used the extracted mean-variance (AVE) index to evaluate the convergent validity. The value of this index should be higher than 0.50. According to Table (5), the AVE index for

research variables is more than 0.50, which is the reason for the appropriate convergent validity of the model for measuring research variables.

Table 5: AVE values for the measurement model of research variables

Variable	AVE
legal responsibility	0.631
Transparency of ownership	0.561
accounting information	0.532
Rewards and performance appraisal	0.551
Governance structure	0.736

Table 6: Fornier Larker index results for diagnostic validity test of the measurement model

	legal responsibility	Transparency of ownership	accounting information	Rewards and performance appraisal	Governance structure
legal responsibility	0.794				
Transparency of ownership	0.432	0.794			
accounting information	0.494	0.530	0.794		
Rewards and performance appraisal	0.516	0.465	0.490	0.742	
Governance structure	0.411	0.482	0.404	0.521	0.858

Table 7: Model fitting

Effect of structure	Structure (direct effect)	R ²	Predictive Relationship Test (Q ²)	Overall Quality Test of the Model
legal responsibility	Governance structure	0.469	0.278	
Quorum value of each of the indicators		0.19 Weak, 0.33 medium and 0.66 strong	0.02 weak, 0.15 medium and 0.35 strong	0.1 weak, 0.15 medium and 0.35 strong

Given that R² is 0.469, we can say that it is in the moderate to the upper level. Q² test indicates whether the quality of our

prediction is to refute or confirm the above hypotheses. The standard for this value is as follows:

This value is 0.2 weak, 0.15 medium, and 0.35 strong. According to the results of this study, the predictive quality of the research hypothesis is moderate. Gof test was performed to confirm the quality of the model. The standard for this value is

as follows: This value is 0.1 weak, 0.15 medium, and 0.35 strong. According to the results of this research (0.467), the overall quality of the model is strong.

Table 8: Path coefficients and t-statistic (effect of legal responsibility on corporate governance)

Effect of structure	Structure (direct effect)	Path coefficient	T value	Sig.
legal responsibility	corporate governance	0.340	7.030	0.000

We tested the effect of legal responsibility on corporate governance. According to the t-statistic, which is outside the interval of -1.96 and 1.96 (value of t, 7.030), legal responsibility has a significant effect on corporate governance at the 95% confidence level. The obtained value is 0.340.

Conclusion

This research determined the effect of legal responsibility on corporate governance in the municipality of District 3 of Tehran. Its findings showed that legal responsibility has a positive and significant effect on corporate governance. This result is consistent with previous findings. These results are consistent with the findings of Wahba and Al-Side (2015) and Town (2012) who in their various studies concluded that the law has a positive and significant effect on corporate governance. When the municipality of Tehran District 3 pays attention to the annual reporting and all employees are required to comply with organizational standards, these standards also create a set of control mechanisms within the company and outside the company. It establishes a proper balance between shareholders' equity, on the one hand, and the needs and powers of the board of directors, on the other. Ultimately, these mechanisms provide reasonable assurance to shareholders, funders, and other stakeholders.

According to the results, the client and customers should be informed about the wide reflection of the municipality's presence in social activities through mass media. Training and orientation classes should be held for employees on dealing with customers. All economic, social, and cultural sectors should be coordinated to improve social responsibility and move towards sustainable development.

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Conflict of interest

None.

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Ethics statement

None

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