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Investigation the Effect of Corporate Governance on the Financing Cost

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Abstract

Financing companies' quality of corporate governance is one of the important factors to financing, because it can has an effect on payment risk or an unpayment, hence, we can state that the quality of corporate governance will influence on financing cost. Corporate governance causes to reduce the financing crisis risk. This problem is very important, when this risk leads to create more expenses. So, corporate governance causes to reduce the investing costs, and in conclusion increases the value of company. Naturally, the quality of corporate governance leads to create trust and reliance in investors and reduces their informational risk and surely will influence on companies financing cost. The main purpose of this study is to investigate the effect of corporate governance, shareholders control, independence of directorate on the financing cost of listed companies in Tehran Stock Exchange during 5 years (since 2006 to 2013).The population is 448 companies that 221 companies had been selected with Chochran method. The result of this research indicates that corporate governance has not significantly effect on the companies financing cost.

Keywords: company size, corporate governance, financing cost

Introduction

Since 10 years ago, the world observed important changes in private sector, economic growth and create job. Because many countries had followed the market-exist attitude, so awareness from the importance of private organizations in ground of people comfort increased. When economics consider the private sector in entirely world, corporate governance has had more important in advance.

Corporate governance is a system that companies control and lead the structure of corporate governance clears. The salary distribute and responsibilities between different sectors in company, the same as members of board directors, managers shareholders of others interests, assignment and decision–making rules (Gul and Tsui 2001) supported the effectiveness of corporate governance particularities as a supervision system.

Corporate governance defines as a process, customs, politics, rules and organizations that affect the way of company from leading control; in other hand, it defines as a clear structure and corporate operation, responsibility of managers and the members of board of directors other than shareholders and the assignment of company other than employees. Loan holder, goods suppliers and local societies that company work there.

Ashbaugh et al, has been defined corporate governance as a set of processes that reduce representative risk through increasing the supervision on executive actions, restricting their speculative behavior and improving the quality of published information of firms. The recent financial crisis in America, Europe and Asia is clears for all countries that why the subject of transparency and accountability in corporate governance, in investors' confidence and the perform of national economy are important. Corporate governance is related to the mechanisms that companies worked and were controlled with their help.

While governments shape the legal, institutional and regulatory area to create a strategy systems for institutions which have a major role, the primary responsibility of establishing the desirable system is the obligation of private sector. Such system makes sure that companies operate in the interests of so-

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ciety and cause investors' confidence and attract long-term capitals.(Hoseeini ,2007).

Costs of financing of business activities are the concern of many of activists. Financing costs may be prepare with merchant or his/her partners personal properties and/or by bank loan and co-operation with active companies in the field of financial, that the successful merchant accepts the combination of both. (Raymond Neveu, 1995). So, the costs of financing can be calculated using debts such as bank loans and issuance of stock. It seems that corporate governance can affect the cost of financing of companies.

Research Theoretical Foundation

Suitable corporate governance which requires the board of directs with any structure, focuses on long-term issues and doesn't involve itself in the more daily operational responsibilities. In general the board of directs and its members should have predetermined specific responsibilities and have a good motivational stimulus in order to properly perform (Hasass Yeganeh and Moradi 2007).

According to agency theory, the presence of independent nonexecutive directors, managers that do not have execute responsibility in the company and their supervisory performance as an independent persons, cause to reduce the conflicts between shareholder and managers. The findings of Wen et al (2002) has shown that firms with more nonexecutive directors, due to more effective supervision on managers activities for financing ,they less pay attention to debts; negative relationship between debt and the ratio of board of directors and nonexecutive director. But, the findings of Berger et al (1997) and Abor (2007) indicated a positive relationship between the dispositions to debt in the structure of company's capital. Anderson et al (2004) found a negative relationship between the percentage of board of director's nonexecutive director and financing cost.

Fama and Jenson (1983) found that nonexecutive director has this motion in order to preserve their credit capital and they can be more effective supervision and because of their independence, they affect on company management ratio to executive director, and protect the interests of shareholders against management opportunism.

Ashbaugh et al (2006) had shown with better nonexecutive director, opportunism of managers lowered, thus risk and cost of common stock declines. Another mechanism of corporate governance is institutional investors that can be supervision on company management, because they can have considerable influence on company management and also can manage the benefit of management and shareholders. Ways that shareholders can be supervision to management, generally define on agency theory framework.

According to Bushee (1998), he defined that institutional shareholders are major investors such as banks, insurance companies, investment companies, funds from theoretical approach, and the position of institutional shareholders in corporate governance is very complex. Institutional shareholders are effective measure to improve the corporate of companies and they are powerful controller at supervision to use corporate governance principles; therefore, it is expected that their presence causes improvement of corporate, enhance effective supervision on management and the value for shareholders.

Ahmad-poor et al (2010) investigated the effect of corporate governance and audit quality on financing cost. They showed that the efficient supervision of board of director doesn't have effect on financing cost and on the other hand the quality of corporate governance through institutional shareholder which is effectives on companies financing cost.

Nooravesh et al (2009) investigated the relationship between corporate governance mechanisms and agency cost of listed companies on the Tehran Stock Exchange. In this study, they investigated the effect of corporate governance and audit quality on financing cost. They represented the costs of agency as a function of interaction between growth opportunities and Tobin free cash flows. Index was defined as a measure to the growth opportunities. The results of samples, include 88 companies during 2003 to 2006, indicated that between the number of nonexecutive members of board of directs and the percentage of institutional investors with agency costs, there were a negative and meaningful relationship.

Mashayehk Smaili (2006) investigated the relationship between profit quality and some aspects of guiding principles such as the percentage of board directs members and the number of nonexecutive directors in listed companies in the Tehran Stock Exchange profit quality which has been tested with accrual items measure.

In general, this study states that the number of nonexecutive directors and the percentage of board of directors members that are the mechanisms of guiding principles don't have any important role in improving the profit quality in the Tehran Stock Exchange.

Ahmad-poor et al., (2009) investigated the effect of nonexecutive directors and institutional investors as supervisory tools of corporate governance on profit management. The results of their investigation showed that when incentive to manipulate of profit is high, nonexecutive directors and major institutional investors have weak role in reducing the abnormal of uncommon accrual items.

Fortin and Pittman (2007) investigated the number of American firms during 1977 to 1988 in terms of the effect of auditor's reputation on financing cost during nine years, the companies that have been registered on exchange commission; they found companies that hired the large audit institutions, and the average of their financing cost is lower.

Anderson (2004) as accounting report and financing cost in his research on 500 companies during 1993 to 1998 showed financing cost inversely has relations with board of directs independence, Board of directs size, and nonexecutive directors members of audit committee and number and size of board of directs meetings. Another study as the effect of corporate governance on firm credit rate was done to this study that they stated that company's debt rate positively related to board of directs independence, ownership of board of directs stock.

Research hypothesis

Because of investigating the effect of corporate governance on financing cost, the main hypothesis formulated as follows:

There is a significant relationship between corporate governance quality and financing cost.

Because in this study, corporate governance include control shareholders, existence of Board of directs independence, major institutional shareholders, thus there are three sub-hypotheses;

Hypothesis 1: There is significant relationship between control shareholders existence and financing cost.

Hypothesis 2: There is significant relationship between Boards of directs independence and financing cost.

Hypothesis 3: There is significant relationship between major institutional shareholders existence and financing cost.

Materials and methods

This study, from data gathering method is descriptive, Causal comparative and the target is applied. This study directed towards practical application of known ledge. Also, the classification is based on a method and nature is a kind of correlation research. As noted above, this type of research is the investigation of events, it means, the research studied the possible cause and effect relationships through observation of existing conditions, and in this method the cases of study occurred in the past and they are not able to manipulated by the researcher.

The population is all of Tehran Stock Exchange listed companies. To select the sample, the following criteria have been considered:

1. before 1385 to be accepted in Tehran Stock Exchange and till the end of 1390 to be active.

2. In order, comparable information, companies during the study period didn't have any changes in fiscal period and their end of year to be Esfand (February).

3. In order to homogenize information, companies don't invest the financial brokerages including insurance and bank.

4. After pay attention to above criteria, 221 firms were eligible for statistical community that 140 firms during 1385 to 1390 among the population of research have been selected randomly.

Methods of data collection

In this study, the method of data gathering was library method hat essays and documents relating to study and audited financial statements of companies, financial reports and companion notes that published with Tehran Stock Exchange have been studied these types of data which are secondary data and are reliable and valid; the tools of data gathering in this study is documented survey. Tools that used to gathering data including observation, statistical tests, databases and Excel and EVEIWS software.

The information about literature and theoretical debates were collected from library resources such as books, Persian and English periodicals and internet sites. Methods of data analysis and definition of variables in this study for data analysis have been used for two methods.

Descriptive and inferential statistics

In descriptive statistic, mean, variance and standard deviation and inferential statistic, Pearson correlation factor, t- test, F-test, in multiple regression method with Panel Data were used to examine research model. In order to efficiently estimate, a regression model with Panel Data is needed by using appropriate tests, which one of the common effects, fixed effects and random effects can be selected for this purpose to choose common effects models and fixed effects have been used for F-test. If we select fixed effects, we have to use Hasuman test to select between fixed effects and random effects. If the results of F test verify by using the common effects method, Hasuman test is not needed the model estimated with common effects.

In this research, to check the independence of regression model errors was used Watson test and to accept or reject the main hypothesis of research, the Student test was used.

To test the hypothesis research multiple regression model will be used.

$$\text{DebtCost}_{it} = \beta_0 + \beta_1\text{Control}_{it} + \beta_2\text{BrdInd}_{it} + \beta_3\text{InstBlock}_{it} + \beta_4\text{LnAssets}_{it} + \varepsilon_{it}$$

Debt cost $_{it}$: Cost of debt of i firm in t year
Control: Control shareholders
BrdInd: Independence of board of directs
InStblock: Major institutional shareholder
LnAsset $_{it}$: size of i firm in t year
ε_{it}: the error for i firm in t year

Dependent variables

Costs of financing of business activities are the concern of many of activists. Financing costs may be prepared with merchant or his/her partners personal properties and/or by bank loan and co-operation with active companies in the field of financial, that the successful merchant accepts the combination of both choose.(Raymond P.Neveu 1374[5]. So, costs of financing can be calculated through using debts such as bank loans and issuance of stock. It seems that corporate governance can affect the cost of financing of companies. Financing cost in this study is equal to the ratio of financing cost with the total of long- term and short- term receivable facilities of companies.

Independent Variables

In this study, corporate governance and its characteristics includes existence of control shareholders, shareholders that have more than 50 percents of voting shares independence in board of directs, the ratio of nonexecutive directors to executive directors in board of directors, existence of major institutional shareholders, which are more than 50 percents of common stock.

Existence of control shareholders

With regard to the matter 103/88/86 and amendment in date 1347/12/24, If person or persons have more than 50 percent's of firms stock, they can choose the members of board of directs to manage the firms, but the shareholders have less than 50 percent's of firm's stock, and they can involve only one or more persons of board of directs. In this study, if person or company has ownership more than 50 percents of voting stock, we consider 1 and otherwise we consider 0 (zero).

Independence of Board of directs (the ratio of nonexecutive members to executive members of Board of directs)

Board of directs shall have at least 3 nonexecutive members until the members can influence on decisions of board of directs; in this study if the nonexecutive members to be more then executive members we considered 1 and otherwise we considered zero.

Major institutional shareholders

Generally, imagination that the presence of institutional investors may lead to changes the behavior and policies of companies. This work leads form regulatory activities of investors. In this study, if institutional shareholders have more than 50 percent's of company with common stock, we considered 1 and otherwise we considered zero.

Control Variable

LNASSETS, (size of company): calculated with natural logarithm of total assets of the sample.

Results

Statistical tests

As the result of table (1) shows, the P-Value of F Limer test is equal to 0.000. As a result, the common effects method rejected. Results of F Limer test showed that the common effects method is not appropriate for estimating the regression models. So, the Hausman test uses to select estimate appropriate method. The P-value of Hausman test shows that the fixed method is a better option for estimated model.

The results of testing hypotheses

The results of regression model that has been done with fixed effects method, showed in table 2. P-value statistic of F fisher test is equal to 0.000and it means that model has overall adequacy. Adjusted R-squared is equal 0.8315 and it indicates that more than 83 percent's of independent variable changes explained with independent and control variables .Statistic of Dor bin-Watson is (2.0576) indicates that there is no error in component of correlation. The first sub-hypothesis, existence of control shareholders examined with financing cost; As Table 2 shows the first sub-hypothesis, the variable of existence of control shareholders has a significant coefficient of 0.2428, and the acceptable error level is 5 percent's, thus, It's represented that between existences of control shareholder and financing cost of listed companies on Tehran Stock Exchange, there is no significant relationship.

Table 1.The results of F test and Hausman test

Test Result	p-value	Degrees of freedom	Test statistic	Tests
Fixed effects method	0.0000	139.696	4.4088	F Limer test
Fixed effects method	0.0000	4	35.7952	Hausman test

As a result, the first sub-hypothesis is not confirmed. In the second sub-hypothesis, the relationship between independence of board of directs and financing cost is examined, according to table 2, the coefficient of significant level of independence of board of directs is 0.0125, and the acceptable error level is 5 percent. Thus, it's represented that there is no significant relationship between independence of board of directs and financing cost of listed companies in Tehran Stock Exchange. As a result, the second sub-hypothesis is not confirmed, too. In the third sub-hypothesis, the relationship between existences of major institutional shareholders with financing cost is examined. Existence of major institutional shareholders coefficient of significant level is 0.0022, and the acceptable error level is 5 percent. Thus, it's represented that there is a significant relationship between the existences of institutional shareholders with financing cost of listed companies in Tehran Stock Exchange, as a result, the third sub-hypothesis confirmed. The result of control variables has been showed that between the variable of size of company (LnAssets) with financing cost has a significant positive relationship.

Table 2. Regression Results

Variables	Coefficient	t-Statistic	Prob.
C	-0.3088	-11.4302	0.0000
CONTROL	-0.0046	-1.1690	0.2428
BRDIND	-0.0041	-2.5054	0.0125
INSTBLOCK	-0.0437	-3.0789	0.0022
LNASSETS_	0.0370	20.1229	0.0000
Adjusted R-squared		0.8315	
F-statistic		29.9520	
Prob(F-statistic)		0.0000	
Durbin-Watson stat		2.0576	

Conclusions

The results of the study showed that in the Tehran Stock Exchange, among three characteristics of corporate governance, existence of control shareholders, independence of board directs, exchange of major institutional shareholders, only existence of major institutional shareholders influences on financing cost, on the other hand, in the Tehran Stock Exchange, creditors only existence of major institutional governance considered.

Corporate governance is the set of control and leading mechanisms of companies. corporate governance system determines the distribution rights and responsibilities of various interests of companies such as managers, employees shareholders, and other legal entities that were influenced from companies activities in this system, that rules and procedures determine decisions process at the company and specify tools to reach the goals and planning the control systems with financial resource suppliers to insure the return of their capitals use which they have a close relationship.

Thus, the powerful corporate governance causes that companies provide more quality and transparent information that it causes to decrease the information risk of creditors and as a result it influences the financing cost of companies. The results indicated that there is no significant relationship between existence of control shareholders and independence of board of directs with financing cost but between the major of institutional shareholders with financing cost of debts, there is a significant relationship, and the results of this study doesn't correlated with the results of Ashbugh-skife(2006). According to Ashbugh-skife's finding (2006) , the effect of corporate governance on firms credit rate was stated that companies debt rate positively related to board of directs independence, ownership of board of directs stock, also with the results of Anderson's study, that showed the inverse relation between financing cost and independence of board of directs aren't consistent with the results of this study. Ahmad poor, Malekiyan, and Kurd tabar (2009) found that the incentive to manipulate of profit is high nonexecutive directors and the major institutional shareholders have weak role in the reduction of abnormally of accrual items.

Also, the results of Nooravesh, karami, vafi sani(2009), about the relationship between corporate governance mechanisms and agency cost of listed companies on the Tehran Stock Exchange indicated that there were a negative and meaning relationship between the number of nonexecutive members of board of directs and the percentage of institutional investors with agency costs.

In additional, based on the result of Noravesh and Kord Tabar (2005), companies with high degree of institutional ownership ratio to companies with low degree of institutional ownership, reflect grater future earning in stock price.

Suggestions based on research results

According to the result of third sub-hypothesis that has been confirmed, it seems that existence of major institutional shareholders in the combination of company's shareholders, as one of the important variables of corporate governance, on financing cost, is better that to accept more the major institutional shareholders.

Also, the breakdown of company's value to annual, monthly, and investigation the of relationship of each of these components with financing cost of listed companies in Tehran Stock Exchange may affect on financing cost.

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