

# Capital Structure and (internal and external) Financing in Corporations of Accepted in Tehran Stock Exchange

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## ABSTRACT

**Objective:** Companies' managements have various resources and different methods of financing at their disposal to provide required cash for capital expenses and company operations. The main purpose of this research is investigating the relationship between capital structure and financing in Corporations. **Methodology:** Statistical sample size of the research included 147 Corporations of Accepted in Tehran Stock Exchange between 2009 and 2015 (A 7-year period). To test the hypotheses of the research we used panel data method. **Results:** Research findings show that financial leverage and internal and external financing have a positive and direct relationship. **Conclusion:** Despite this, findings show a direct and significant relationship of capital structure and reverse and significant relationship of internal and external financing in active companies in Iran's capital market.

## 1. Introduction

The environment that companies operate in it is developing and competitive. Companies to continue their existence are competing numerous factors in national and international level of expanding their operations through new investments. Companies need financial resources for investment. However, financial resources and their usage must be well determined so that the company can take steps in advancement and profitability direction. And this is the duty of the financial manager to determine financial resources and how to use (Hassanpour, 2006). Ignoring the financial flexibility concept in financial decisions will create a risky situation for the company. Since if when necessary, company do not secure necessary resources from the market, it is forced to ignore appropriate investing opportunities due to lack of required financial resources.

### 1.1 Problem Statement

Companies' managements have various resources and different methods of financing at their disposal to provide required cash for capital expenses and company operations. Financing can be done through publishing stock or debt papers, which their difference is clear (Cassar, 2005).

Financial managers' duty can be known as optimization of stockholders' properties, debts, wages, and structure to maximize their wealth and finally increasing the value of the commercial unit. In this case one of the most important decisions that financial management can make, is decision making regarding financing, including decisions related to financial structure and capital structure, and determining the best method of financing and combining them. Accordingly, management's decision makings often surrounds three pivots:

1. Analysis and planning with the purpose of creating balance in the structure of properties, debts, and wages of stockholders.
2. Investments decisions regarding functionality and assigning provided budget between physical and financial properties with the purpose of more efficient outcome.
3. Financial decisions including decisions related to financial structure and determining the best method of financing and combining them.

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Therefore, financial management can affect stockholder's wealth and finally company's value through making changes in factors such as determining interest distribution policy and selecting method of financing.

Traditional company theory states that the purpose of the company is maximizing the profit, which occurs when final income is equal to final expenses. This theory does not consider internal organizational structure of the company (Lee, 2008).

Capital structure and its impact on financial and non-financial activities of a commercial unit has been considered by many researchers from long time, so that, Hope (2003) used the degree of financial leverage is considered one of the most important tasks of financial managers. They determine the needs of investors in fixed assets, the amount of dividends profit, working capital as well as other basic elements also determine the amount of financial policy in general. From this perspective, the commercial units in anticipation goal capital structure for the short term, medium term or long term, because in this way, business unit managers can make strategic decisions with regard to goal capital structure, planning and running. Each commercial unit must specify the expenses of various financing resources when making decisions to use new financial resources, and determine the effect which each of these resources have on output and operational risk, and finally company's value. Therefore, the research investigates how much organizational conflicts can affect capital structure through the relation of financial leverage with financial decisions. In other words, in this research we attempt to determine relativity or non-relativity of capital structure and financing to conclude whether changes of capital structure are determined by changes of financing.

## **1.2 Research Objectives:**

### **1.2.1 Main Objective:**

Identifying the relationship between capital structure and financing

### **1.2.2 Minor Objectives:**

- 1- Identifying the relationship between capital structure and internal financing
- 2- Identifying the relationship between capital structure and external financing

## **1.3 Research Hypotheses:**

### **1.3.1 Main Hypothesis:**

There is significant relationship between capital structure and financing in Corporations of Accepted in Tehran Stock Exchange

### **1.3.2 Minor Hypotheses:**

- 1- There is significant relationship between capital structure and internal financing in Corporations of Accepted in Tehran Stock Exchange
- 2- There is significant relationship between capital structure and external financing in Corporations of Accepted in Tehran Stock Exchange

## **1.4 Research Background**

### **1.4.1 Conducted researches in the case of capital structure**

Akhtar (2005) studied effective factors on determining the capital structure of multinational and internal corporations in Australia between 1992 and 2000 using sectional-temporal regression model. Results indicate that in all the corporations, growth opportunities, profitability, and size of the corporation are determining factors in comparison to debt. When he conducted his study for each industry separately, he found out that some of these factors are more important in some industries.

Degryse et al. (2012) studied the effect of characteristics of industry on their capital structure using the data of small and medium German corporations between 2003 and 2005. Their results show that capital structure decisions in the corporations under study, is in line with hierarchy theory, as corporations under study reduce their debt level by increasing their profitability and developing corporations take loans to provide their needed financial resources.

Aggarwal & Kyaw (2010) in their investigation of capital structure relations of multinational corporations found that the more activity and competence of corporations increase outside of a country, the less they use debt in their capital structure, in comparison to corporations that operate inside the country.

Asadi et al. (2011) investigated the relationship between capital structure and ownership structure in the corporations that are accepted into Tehran Stock Exchange in a research. Empirical evidences show that there is a negative and meaningful relationship between capital structure and ownership structure. Considering the results, although it is not clear whether capital structure leads to ownership structure or vice versa, it seems that it is necessary that investors and creditors consider both capital structure and ownership structure when making a decision regarding investing and crediting.

Rajaei (2013) investigated the relationship between financial flexibility and capital structure in a research. Research results show that, companies in the birth stage take little risk in distributing capital and debt and maintain balanced leverage ratios. Corporations in adolescence stage rely on internal financial provision and maintain low leverage ratios. Research findings are compatible with balance theory but do not match preferential theory in the case of corporation in the birth stage.

### **1.4.2 Conducted researches in case of financing**

Paulsson (2006) investigated the relationship between financing activities with accrual accounts and share output. Results indicated a negative relationship between financing activities and share output.

Cascio & Boudreau (2010) investigated the effect of investment opportunities and financing resources on profit distribution policy. The research was conducted for the 34 accepted companies into Ghana stock exchange from 1990 to 2006. And for estimation a linear multivariate model from panel data with the fixed effects method was used. Summary of the research findings indicate that investment opportunities have negative effect on profit distribution policy. Financing resources of the company have little effect on profit distribution policy of the company and profitable companies more likely distribute the profit among their stockholders.

Papanastasopoulos et al. (2011) investigated the relationship between accruals and external financing activities with future output. Research results show that portfolios with high accruals and high volume of external financing activities, obtain lower outputs. Furthermore, sectional regression results in corporate level indicate that in case of the presence of capital accruals in circulation, external financing activities gain the ability to predict future outputs.

Zanjirdar & Ebrahimizadeh, (2010) studied the case of investigating the relationship between financial methods (external resources) and stock output. Research results were indicative of the existence of a weak relationship between financing through publishing stocks and stock output, a positive relationship between financing through publishing stock and stock output and medicine industry, and a positive relationship between financing through acquiring long term loans and stock output in rubber and cement industry.

Kordestani & Mazaher Najafi (2011) investigated the effect of financing methods on future output of stocks. Their research results show that the relationship between net changes in total financing, net change in external financing and change in net secured operational properties from financial resources with cumulative abnormal output of stocks is significant, but unlike the prediction, it's positive.

Rezaei & Sayari (2014) investigated the role of financing resources on the relationship between properties growth and companies' stocks output. Results of testing research hypotheses show that, there is a positive and significant relationship between property growth and companies' stocks output. Additionally, the relationship of internal and external financing with companies output with high property growth (low) is significant negative (positive). However, the relationship of bank financial and financing through capital market with companies output with high property growth (low) is significant and positive (negative). In addition, there is no significant relationship between free floating stock and companies output with high property growth. However, the relationship between free floating stock ratios with companies output with low property growth is significant and positive.

## 2. Materials and methods

### 2.1 Research conceptual model

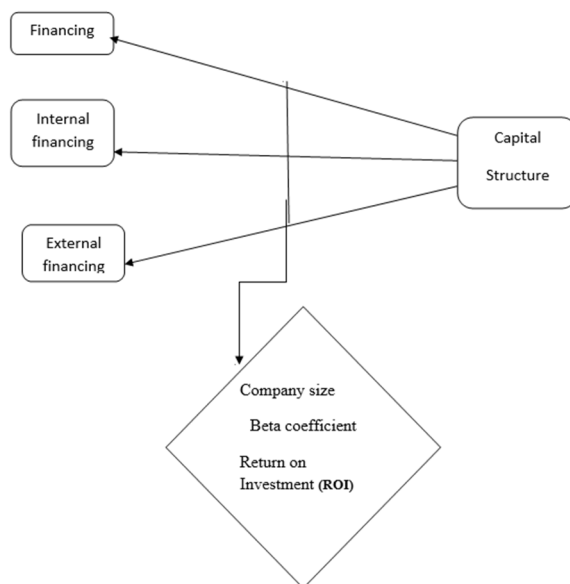


Figure 1. Proposed research conceptual model

#### 2.1 Statistical Population

Statistical population consisted of all companies of accepted in Tehran Stock Exchange during 2008 to 2015. The sampling method in this research is sampling method of systematic removal

#### 2.2 Statistical analyses of the research

In this research in order to determine whether employing panel data method in estimating the model is efficient, LIMER F test was used, and to identify which method (fixed effects or random effects) are more appropriate we used Hausman test was used.

### 3. Discussion and results

Results of these tests are presented in Table 1.

**Table 1. Results of pattern selection to estimate research model**

Test type	Test Statistic	Test Statistic rate	Freedom degree	P-Value
LIMER F test	$F$	11.114	(867,146)	0.0042
Hausman Test	$\chi^2$	90.418	6	0.000

Considering the results of LIMER F test, since P-Value of the research is lower than 0.05 (0.0042), homology of the y intercepts is rejected and it is necessary to use panel data method to estimate the model. Additionally, considering the results of Hausman test, since P-Value of the test is lower than 0.05 (0.0000), therefore fixed effects method must be used in the estimates. Estimate results of the research are presented in table 2.

**Table 2. Results of research model estimates**

Dependent variable of financing (internal and external)				
Variable	Coefficient	T Statistic	P-Value	VIF
Fixed Coefficient	-3.3845	-10.149	0.000	-
Financial leverage	2.6207	9.647	0.000	1.228
Institutional investors	-0.5933	-8.793	0.000	1.468
Percentage of Stock institutional ownership	-0.0252	0.527	0.5977	1.368
Company's size	0.2506	12.400	0.000	1.142
Beta coefficient	-0.6479	-2.714	0.0068	1.256
Return on Investment (ROI)	0.6144	0.939	0.3478	1.017
Model Determining Coefficient	0.2651			
F Statistic of the model	2.058	Jarque-Bera Statistic	2.866	
(P-Value)	(0.000)	(P-Value)	(0.2385)	

#### 3.1 Research hypotheses test

$H_0$ : There is not significant relationship between capital structure (financial leverage) and internal and external financing in Corporations of Accepted in Tehran Stock Exchange

$H_1$ : There is significant relationship between capital structure (financial leverage) and internal and external financing in Corporations of Accepted in Tehran Stock Exchange

According to the results presented in table 2, significant level (P-Value) of t statistic related to “financial leverage” variable is lower than 0.05 (0.0000) and its coefficient is positive (2.6207). Therefore, in confidence level of 95 percent capital structure (financial leverage) and internal and external financing in Corporations of Accepted in Tehran Stock Exchange have a direct and significant relationship, with an increase in financial leverage of companies, on the internal and external financing of the company's decreases. Hence, first and second hypothesis of the research is confirmed in confidence level of 95 percent and shows the direct and significant relationship between capital structure (financial leverage) and internal and external financing of the active companies in Exchange.

#### 3.2 Results of hypotheses test

There is significant relationship between capital structure and internal and external financing. Considering the conducted researches from 2009 to 2015 and research findings, results showed that investigating adjusted determining coefficient of the model is the indicative of explanatory capability of the model in describing dependent variable of financing. According to the results presented in table 2, significant level (P-Value) of t statistic related to “financial leverage” variable is lower than 0.05 (0.0000) and its coefficient is positive (2.6207). Therefore, in confidence level of 95 percent capital structure (financial leverage) and internal and external financing in Corporations of Accepted in Tehran Stock Exchange have a direct and significant relationship, with an increase in financial leverage of companies, on the internal and external financing of the company's decreases. Hence, first and second hypothesis of the research is confirmed in confidence level of 95 percent and shows the direct and significant relationship between capital structure (financial leverage) and internal and external financing of the active companies in Exchange

#### 4. Conclusion

What can be said in the general summary and conclusion of the research hypotheses test from 2009 to 2015 is that there is a relationship. Capital structure (financial leverage) a significant and direct relationship has with (internal and external) financing in Corporations of Accepted in Tehran Stock Exchange.

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