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Methods of Financing and Its Influence on the Financial Index of Firms Listed on the Tehran Stock Exchange

Author: Masoomeh Abootalebi Fard

MA, Department of Economy Energy, Central Tehran Branch, Islamic Azad University, Tehran, Iran

Corresponding Author

E-mail: aboutalebi.masi@gmail.com

ABSTRACT

The complexity of economic activities and the fast-growing development of trading transactions in today's world, including domestic and international trades, and the need by manufacturing and trading companies to maintain their capacities, along with developing activities, plans, and investments to maintain or increase the competition power both domestically and globally, have led companies to seek financing. Meanwhile, corporate abilities to create potential funding for investments and provide financial plans are among the principal factors contributing to the growth and progress of each company. Corporates have access to various funds to implement available profitable investments, settle due debts, working capital, and pay dividends to shareholders. Financing also includes funds from operational activities and the sale of assets (as intra-organizational resources for financing), banking loan borrowing, the issuance of bonds and stocks (as extra-organizational resources for financing). Corporate abilities in financing and proper decision-making are keys to their success.

Keywords: Financing, Policy, Financial index, Tehran Stock Exchange.

INTRODUCTION

The role of financial and capital markets is to absorb the liquidity in private sectors' liquidity in the form of small or large deposit savings and direct them into the productive sectors. The capital market, as a section of the financial market, should transfer funds from suppliers (lenders and savers) to applicants (production institutes), whose importance is increasing in the monetary and financial system. It plays a moderating role that completes a process called investment on the supply side of funds and implements a process called financing on the expiration side: a process that is responsible for supplying and issuing companies' shares and facilitating and accelerating exchanges and transactions. With the existence of such a market, companies can confidentially obtain their required capital in various forms of financing by referring to it. On the other hand, investors can easily turn long-term securities into liquidity, if necessary, and use their information and capital in this dynamic market to make transactions in their favor. Tehran Stock Exchange as a capital market is not excepted from this rule and it has gone through many ups and downs since 1967 in the case of private saving and its allocation to productive and industrial investments, and it is considerably developed. These are an introduction to the fact that the cycle of production and development of corporations is facilitated by appropriate financial resources. The proper capital resources are required to be provided to implement and

complete the industrial-executive projects as well as to supply the required working capital, and this reveals the significance of financing. Financial resources are divided into two categories of external resources and internal resources.

Internal sources consist of retained earnings, depreciation reserves, legal and safety reserves, current assets reduction, and sales of stagnant fixed assets, and external financial sources include borrowing from the bank, issuance of bonds, and issuance of shares. Foreign financial sources include borrowing from the bank, issuing bonds, and issuing shares. Foreign financial sources are of utmost importance in terms of their influence on financial risk and control of companies. Long-term bank loans and issuance of ordinary shares are of most applicable foreign sources among the joint-stock companies listed on the Tehran Stock Exchange. Regarding this matter that these loans and shares are useful for financing these joint-stock companies and both mentioned resources are used for financing the companies, on the other hand, the stock market's reaction to the inclusion of any kind of basic information is manifested in the price changes and stock returns, so the sources used by companies for financing are of special importance.

Review of the research literature:

The increasing development and complexity of economic activities and the rapid and ever-increasing evolution of commercial transactions in today's world, including domestic and international business, and the need for manufacturing and trading companies to maintain capacity through the development of activities and plans, investment in maintaining or empowering the competition in the domestic and global arenas has increased these companies need for financial resources, and the company's ability to recognize potential financial resources for providing investments and preparing appropriate financial plans are considered the main factors for the company's growth and development. Companies have access to numerous financial resources for the implementation of profitable investment projects, overdue debt settlement, working capital increase, and payment of dividends to shareholders. These sources include cash flow from operating activities (CFO) and assets sales (as internal sources of financing), bank loans, issuing participation bonds issues, and new shares issues (as external sources of financing). The ability of companies for the recognition of appropriate financial resources and proper decision-making in this regard is one of the main factors of the company's success (Rahimian, 2007). Companies encounter two sources of internal financing and external financing in financial decision-making. Internal financial resources include cash from operating activities, asset sales, and retained earnings; and the external sources consist of cash from the financial market, including bond issues, new shares issues, and received financial facilities (Kordestani and Najafi Emran, 2010). The most important goal that should be attended to by the management in the selection of the financing method is the increase in shareholders' wealth. That is, considering the cost of different financing sources and their effects on the company's return and risk, the management should choose sources that minimize the financing costs. The appropriate structure of financing sources is associated with properties such as low capital cost and a higher rate of return.

Miller and Modigliani (1958) believe that the company's capital cost does not change under certain conditions (non-payment of income tax and the lack of tax expenses) or the change of the company's capital structure, and the favorable effect of replacing debt with a lower financing



rate in the company's financial structure will be compensated by the decrease in the price of the company's common stock. In other words, the shareholders are exposed to higher financial risk due to the increase in the financing through debt, and the shareholders' expected rate of returns would be increased by the increase in the financial risk. Therefore, the capital cost is independent of the company's financial structure and financing decisions are less important in this case from Modigliani's and Miller's perspective (Mohajerani, 2003).

Since one of the main tasks of the managers is to maximize the wealth of the shareholders, that is, the company chooses sources that minimize financing costs considering the company's financial indicators (ratio of sales to working capital, the ratio of sales to fixed capital, overhead costs, the ratio of operating capital, capital turnover, etc.) as well as reducing the financing costs and their impact on the company's financial indicators for a noticeable increase of company's profitability. Regarding what was mentioned, the main question of the research is do various types of financing methods affect the companies' financial indicators? To answer this question, the present research aims to examine the impact of financing methods on the companies' financial indicators.

Each department of an economic enterprise prepares some information used by the manager to measure the performance of that department. This information may be related to the operations, the entire company's financial status, or the performance of the company's suppliers and customers. But this information does not have a meaning by itself and, when compared with an evaluation criterion such as the company's trend, industry averages, and similar companies, they can help the managers not to be involved in correcting the mistakes resulting from [misleading](#) information. The Sanadpardaz financial index systems are part of management accounting systems and were designed for large companies' managers who need to be aware of the performance of different departments in their organization. One of the advantages of this system is that it includes not only performance measurement in accounting departments, but also is applied to other departments such as engineering, production, procurement, human resources, sales, and marketing. In this system, two concepts of measure and index are noticed that the system can provide accurate and comprehensive reports of their periodic value. A measure is obtained from the turnover or balance of several accounts, which is directly extracted from the balance sheets and converted to meaningful information such as net sales or ownership rights. The important advantage of the measure is that it can make the financial balances of different companies homogeneous and scalable despite the difference in account headings structure. However, the index is the result of dividing the two indicators, which can be indicative of companies' status, especially when compared with similar and competing industries, or at least its trend in different periods of a company is examined. Financial indicators have diversity. There is a four-dimensional reporting tool in the Sanadpardaz system that displays the measures and indicators desired by managers easily, in different forms and from different viewpoints, in such a way that it can examine the information in different financial monthly, three-month, six-month, nine-month and one-year reporting periods compared to different companies. The most important measures and indicators of this system are presented as follows:

The measure is information items extracted from the organization's information systems, and generally, it is either the algebraic sum of some accounts (balance sheets or profit and loss) or numbers directly extracted from the organization's integrated system (ERP).



Research background

Behtar and Kimyagari (2017) examined the impact of financing methods on firms listed on the stock exchange and their research findings showed that the capital increase does not affect positively the companies' real stock returns, but using the loan has a positive effect on their real stock returns.

Rezaei and Sayyari (2015) investigated the role of financing sources on the relationship between asset growth and company stock returns. Their research findings revealed a significant positive relationship between asset growth and company stock returns. Moreover, the relationship between internal financing and external financing with the return of companies with high (low) asset growth is negative (positive) and significant, but bank financing and capital market financing have a positive (negative) and significant relationship with the return of companies with high (low) asset growth. In addition, there is no significant relationship between the ratio of free float shares and the return of companies with high asset growth, but there is a positive and significant relationship between the ratio of free float shares and the return of companies with low asset growth.

Zakari et al. (2015) in their research entitled "Investigating the effect of financing methods on the success of companies listed on the Iran Stock Exchange", examined 191 companies and concluded that financing through capital increase has a more positive effect on the stock returns of companies listed on the stock exchange compared to the other financing methods.

Rezagharehbagh and Mohammadi (2015) did research entitled "Impact of Financing Approach on Corporate's Financial Performance in Economic Fluctuations (Case Study of Automotive Industry)". Their findings revealed that the investigated equity-based firms, due to lower financial costs than the industry average, during the depression had better financial performance in terms of maintaining liquidity.

Rezazadeh (2015) did research entitled "Examining the impact of **the relationship between Corporate Governance** indicators on financing methods of companies listed on the Tehran Stock Exchange" and concluded that there is no significant relationship between the corporate governance indicators including the presence of the CEO in the board of directors, the percentage of non-executive managers in the board of directors, percentage of shares of the majority shareholder, percentage of company's float shares with the dependent variable of financing through short-term and long-term loans. However, there is a significant negative relationship between the structure of a company's distribution of dividends, quality of disclosure, and information. Further, there is a positive relationship between the percentage of ownership and the government's influence on the company with financing through short-term and long-term loans.

Ahmadpour and Ebrahimpour (2013) in research entitled "an investigation of the influence of key financial and economic indicators on profitability (a case study of Firms listed on the Tehran Stock Exchange)" revealed that there is a significant relationship between the financial leverage, sales growth, average stock price and gross domestic production with the profitability; but there is no significant relationship between liquidity and profitability.

Gharib (2014) accomplished research entitled "Ranking of companies based on financial indicators (using the TOPSIS technique with interval data)". The findings revealed that investors can choose different investment companies based on the financial ratio analysis. One of the



limitations of such analyses is that each group of ratios represents only one dimension of financial dimensions, it is not easy to conclude the results of different analyses of financial ratios and comment on the overall financial statements in the analysis of financial statements. This research proposes the application of the TOPSIS technique to help investors make investment decisions and improve the financial ratios analysis. To do so, 5 insurance companies listed on the Tehran Stock Exchange were selected and the required data were collected from the audited financial statements of these companies from 2006 to 2010. First, the weight of the indicators was determined using the entropy technique. Then, the investigated companies were ranked in terms of financial indicators applying the TOPSIS method (with interval data). As a result, the findings of this study can help investors choose the best companies for investment in terms of financial statements.

Kordestani and Najafi Emran (2010) in a study entitled “Investigating the impact of financing methods on future stock returns”, concluded that different external financing methods affect negatively future stock returns. Furthermore, the over-investment hypothesis posits that the negative relation between financing transactions and future stock returns arises when the proceeds provided from these methods are invested in operating activities. Moreover, because of transaction costs and manager/investor information asymmetries, internally generated funds should be less costly than funds raised by externally generated funds. Thus, it is expected that the internal-to-external funding ratio has a positive relationship with future stock returns. Also, this relation will be magnified for high-growth firms relative to low-growth firms since the disparity between inside information and publicly available information about high-growth firms' investment opportunities is greatest. And there is a significant relationship between the net change in total financing, net change in external financing, and change in net operating assets secured from internal financial resources with the cumulative abnormal returns of stocks; but contrary to the prediction, this relationship is positive. Further, the relationship between the ratios of internal financing to external financing and abnormal stock returns is stronger in companies with high growth compared to the ones with low growth. Moreover, regarding the cross-sectional data, there is a positive and significant relationship between the net change in internal financing and the change in net operating assets secured from internal financial resources with the cumulative abnormal stock return.

Donaldson, Mears, and Bradley (2008) researched the financing performance of large corporates and observed that management strongly favors internal financing resources as a new source of financing and even ignores external sources, and if they need external financial resources, they consider borrowing from banks. Even when the Price-to-Earnings ratio was high, they were reluctant to issue shares despite the appropriateness of time for selling ordinary shares, so they provided capital cost including investment in inventories and other current assets by internal sources.

Eli and Nieber (2003) examined the relationship between capital structure and stock returns in active companies in the United States. They concluded that there is a significant relationship between capital structure and stock returns. In other words, the debt ratio and financial leverage affect the stock returns.

Cai and Jang (2006) investigated the relationship between stable capital structure and stock returns in US public corporations and concluded that there is a significant negative effect between debt ratio and stock returns and this effect is greater in companies with high debt ratio.



It means that the higher the debt ratio, the lower the stock return would be. Ultimately, they concluded that capital increase financing has a more positive effect on the companies' stock returns listed on the stock exchange compared to the other companies.

Robb and Robinson (2009) researched the decision-making policy in the case of capital structure in newly established companies. Their findings revealed that financing in such companies through loan financing is seven times more than other methods. Further, the average performance success of the company has fluctuated throughout different financing methods applications.

Hypotheses:

The loan financing method (long-term and short-term loans) influences the companies' financial indicators.

The capital increase financing method (stock dividends or cash contributions) influences the companies' financial indicators.

The companies with a larger ratio of internal financing to external financing have a larger earnings response [coefficient](#).

The method of using the earnings obtained from different financing methods influences the company's financial indicators.

The companies' financing exchanges influence the stock return index of stock exchange companies.

Introduction to research models:

The first-order linear regression, $Y=a+bx+\epsilon$, was used to examine the relationship between two variables, where y is the dependent variable, x is the independent variable; further, a and b are coefficients. It is used for each hypothesis separately applying least squares. Then, the correlation coefficient and the determination coefficient are calculated. Beta and alpha are considered 0 in testing each of the hypotheses. The most and the least assets before privatization is equal to 72403548 and 28436, respectively. The noticeable difference between these two values indicates that all companies, both large and small, were included in the research. This situation also prevails after privatization.

$(\Delta Rev - \Delta Ar) / I$:

The most and the least value of this variable before privatization is equal to 2.3491 and -1.7471, respectively. This indicates that different companies earn their incomes in the form of cash or [credit](#) depending on their viewpoint and do not apply a uniform process. The average of this variable is equal to 0.1104, which shows that credit is the most considerable source of companies' funding that paves the way for manipulating the earnings, and the low standard deviation (0.3755) also confirms this issue. But after privatization, the difference between the maximum (2.0292) and the minimum (-2.8969) became greater than before, which also reveals the non-uniformity of viewpoints on the manner of earnings reception as well as market uncertainty. But the post-privatization average of this variable (0.0079) shows a noticeable decrease compared to the pre-privatization average, which indicates that companies are more willing to have credit sales so that they can manipulate their earning.

PPE/1:



This variable, which represents net property, assets, and equipment, has maximum and minimum values of 0.8529 and 0.0000, respectively. The pre-privatization average of this variable is equal to 0.3078, which is not a considerable value and can indicate that most companies have accrual assets and a few of them have tangible fixed assets. These values did not change much after privatization and this confirms that most of the companies' assets are accrual and not fixed.

Data collection:

Information is the most important element of any experimental research since all the results of experimental research are obtained based on the analysis of information. The most significant point that should be noticed in data collection is understanding the required information, which depends on an accurate understanding of the problem for which the researcher is trying to find the right answer. In other words, what is important is the type and quality of information, not its quantity. The need to revise the information or the lack of useful information is felt frequently during the information review. Accordingly, it can be concluded that the quantity and quality of the necessary information depends on the depth of the research and the requirements of the desired model.

Research data and information are divided into two categories. The first category is related to thematic literature and conducted research in the relevant field, and the second category includes information related to research hypotheses and variables. The library method has been applied to formulate the basics and theoretical concepts of the research. The required information was extracted and collected through reading [books](#), publications, and websites. The official website of the Iran Stock Exchange, i.e., www.rdis.ir, the Tehran Stock Exchange website, i.e., www.codal.ir, and the Rahavard Novin and Tadbirpardaz databases were used to collect data related to the financial statements of companies listed on the Tehran Stock Exchange.

The firms listed on Tehran Stock Exchange were categorized into two groups to investigate the effect of a capital increase through long-term loans on stock prices. The first group includes the companies that have been financed through a capital increase. The companies included in this group meet the required criteria as follows: firstly, their shares are transacted during the weeks before and after the extraordinary general meeting, in other words, they have active shares; secondly, they have not used the retained earnings or long-term loan during four weeks before and after the general meeting of the companies. The companies which meet these two criteria are included in the statistics of the present research, and a total of 81 companies were specified within 5 years as the population. 20 companies increased their capital in 1978. The 10 companies of them have increased their capital using their reserves and 102 of them have benefited from the claims and cash contributions. Further, 8 companies have benefited from both sources.

Research findings:

This research can expand the accounting literature concerning company ranking. Further, the findings of this research can help capital market activists in making financial decisions. It seems that the present research can help managers to make decisions in terms of voluntary disclosure of information and obtaining and maintaining a superior position, as well as investors, [creditors](#), and other users in the analysis and comparison of companies and their economic decision-



making. Moreover, the findings of this research can be an appropriate answer to the question of whether obtaining a superior position in terms of financial indicators and the effect of financing methods on these indicators persuades the manager to disclose further information.

The findings of the research reveal that financing through different ways has different effects on financial indicators. Therefore, the managers of the examined companies listed on the stock exchange should choose a way for financing that provides the highest quality of earnings for the company. Otherwise, that method of financing would not be appropriate and profitable for the company, and the managers should immediately replace it with a proper one. The present research attempted to expand the subject to more complementary or specialized discussions, such as privatization and its effects on the selection of financing methods, and all these efforts were made to provide the readers with more accurate and complete information by reading this research and not to limit themselves to a fixed abstract topic.

These findings correspond to the results of studies accomplished by Nejat et al. (2010), Moshiri (2010), Rezaei (2004), Almasi (2002), and Afshari (1996). Further, they are not in line with the results of research done by Zarringhalam (2005), Miri (1994), Gavin (2011), Emran (2004), Farinós et al. (2007), Cook and Uchida (2003) and Mendel (2000). The consistency of the result of this research with the majority of domestic research on financing methods and their consequences and their non-consistency with the majority of foreign research shows that the various financing methods in Iran have not achieved their main goal and need more time to achieve them.

This research can expand the accounting literature concerning company ranking. Further, the findings of this research can help capital market activists in making financial decisions. It seems that the present research can help managers to make decisions in terms of voluntary disclosure of information and obtaining and maintaining a superior position, as well as investors, creditors, and other users in the analysis and comparison of companies and their economic decision-making. Moreover, the findings of this research can be an appropriate answer to the question of whether obtaining a superior position in terms of financial indicators and the effect of financing methods on these indicators persuades the manager to disclose further information.

Conclusion:

The findings of the present research revealed that financing through different ways has different impacts on financial indicators. Therefore, the managers of the examined companies listed on the stock exchange should choose a way for financing that provides the highest quality of earnings for the company. Otherwise, that method of financing would not be appropriate and profitable for the company, and the managers should immediately replace it with a proper one. The present research attempted to expand the subject to more complementary or specialized discussions, such as privatization and its effects on the selection of financing methods, and all these efforts were made to provide the readers with more accurate and complete information by reading this research and not to limit themselves to a fixed abstract topic.

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