2528-9705

Örgütsel Davranış Araştırmaları Dergisi
Journal Of Organizational Behavior Research
Cilt / Vol.: 8, Sayı / Is.: S, Yıl/Year: 2023, Kod/ID: 23S0-954

Monetary Governance of Capital Management in Businesses

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ABSTRACT

The aim of this study was to investigate the effects of the features of monetary governance of banks on capital management in active private businesses. The features of monetary governance of banks used in this study include the board size, the board effectiveness, equity, and audit performance transparency. The 5-year mean of the effective capital rate was used in order to measure the capital management more accurately. The data were extracted from active private banks during the period from 2016 to 2022. The data analysis and hypotheses tests were performed using the multivariate regression model. According to the results of the research hypotheses test, there was no significant relationship between the board size and the capital management. In other words, in Iran, the board size does not influence the capital management. Also, the results showed that there is a significant negative relationship between the board composition and the effective capital rate. The other research findings indicate a significant positive relationship between the effective capital rate and the equity. In addition, there is a significant positive relationship between the audit performance transparency and the capital management.

Keywords: *Monetary governance, capital management, business, equity, audit performance transparency.*

INTRODUCTION

In the last two decades, the monetary governance of banks has become one of the fundamental aspects of businesses, attracting attentions increasingly. According to Black, (2001), Klapper and Love (2003), and Gompers et al. (2003), monetary governance of banks plays a key role in improving bank performance, and there is a positive relationship between monetary governance of banks and business performance in developed and developing financial markets. According to the results of numerous empirical studies conducted in other countries, good monetary governance of banks can result in better business performance. *Capital management* is one of the elements related to business performance. When management can reduce the effective tax rate in the long term and pay less tax, they have managed the tax. The better this activity is done, the better the performance for business management, as it will lead to an increased net profit after tax as well as a decreased cash outflow due to tax (Gupta and Newberry, 2010).

One of the factors expected to be related to capital management is business management mechanisms. Numerous studies have investigated the relationship between these mechanisms and the performance of businesses. Various studies have shown that board size, board composition, dual duties of the CEO, and audit firm size are among the elements of business management mechanisms affecting capital management. The main question in financial studies conducted on the mentioned mechanisms is whether these mechanisms are a stimulus for business performance or not? Most of these studies have used specific criteria of performance, e.g., stock market return, Tobin's Q and return on assets (ROA). In the meantime, the long-term relationship between more effective governance mechanisms and performance details has not been explained enough. This research considers capital management is as a criterion for business performance and seeks to explain the relationship between the dimensions of monetary governance of banks and capital management. In this regard, the impact of the board dimensions, including the board size, the proportion of non-executive members in the board structure, dual duties of the CEO, and capital management are investigated.

Research Theoretical Basics

Monetary governance of banks (governance mechanism) is a system that addresses the agency problems between managers and shareholders. According to studies, the shares fall of banks such as Adelfa, Enron and WorldCom was largely due to the weak monetary governance of these banks (Konzelmann and Deakin, 2014). The establishment of an effective and efficient monetary governance system for banks can align managers' and owners' interests, enhance businesses' operational performance, and make businesses grow and expand.

Management mechanisms consist of different components, one of which is an effective board. The board and the CEO play an undeniable role in choosing the capital management strategy, as these people must be responsible for the optimal allocation of the bank's resources, its performance, and increasing the shareholders' wealth. A manager who seeks to enhance the sales of his/her bank primarily thinks of increasing the sales growth rate, and as a result, invests in advertising and developing the bank's production capacity and pushes the resources in this direction. Subsequently, since the bank profit usually attracts the information users' attention, the manager should also think about increasing their profit. One of the most important tools in achieving this goal is effective tax management, because as the effective tax rate can be reduced by tax planning, resulting in an increase in after-tax profits as well as a decrease in cash outflows due to taxes (Gupta and Newberry, 2010).

The board is considered the most important factor in controlling and monitoring the bank's management and protecting the shareholders' resources. One of the board-related topics proposed in studies focuses on the issue of board composition. There are conflicting opinions on how the board composition affects the bank monitoring and, and as a result, their performance. Available literature suggests that board composition is related to the degree of agency issues, and indicate that banks with larger boards and more internal managers tend to have more agency issues; on the contrary, business institutions with small boards and a higher percentage of non-executive directors often provide their shareholders with higher welfare and a better performance. A smaller board can more easily convince management to allocate assets for capital

management. Therefore, the board size is considered one of the factors influencing capital management (Minnick and Noga, 2010).

The board composition is defined as the ratio of non-executive members to the total number of members. The higher the number of independent members of the board composition, the less agency problems (Hermalin and Weisbach, 2012). Unlike executive managers, non-executive managers are independent from the bank's management, and as a result, they play a more effective role in fulfilling their monitoring role. Hence, from a theoretical point of view, when the board is independent and consists of a high proportion of non-executive members, the bank performance enhances (Muth and Donaldson, 2018). In addition, more independent boards are in a better position to direct resources toward capital management, as they have a broader view of the bank and its overall performance due to their independence.

Duality of CEO' responsibility occurs when the CEO is also elected as the chairman of the board, which can lead to conflict of interests and loss of independence. When the CEO belongs to the board composition as well (dual duties), there is less threat of losing his/her job, and these dual responsibilities make the manager less motivated to improve performance, leading to a negative effect on the bank performance (Minnick and Noga, 2010). Therefore, the CEO does not take any action to manage capital and increase performance.

Independent auditing is considered as a suitable mechanism for controlling the contractual relations between managers and shareholders, and in most studies conducted on the interrelation between the agency theory and auditing, the effect of corporate governance mechanisms on the possibility of choosing high-quality auditing institutions is investigated. Lin and colleagues (2009) investigated the effect of corporate governance mechanisms on large auditing firms, concluding that the control by the major shareholders and the simultaneous responsibilities of CEO and board chairman (dual duties) can reduce the probability of choosing the top 10 Chinese auditors. Therefore, there is a significant positive relationship between the quality of corporate management and the auditing firm size. And it is expected that larger audit institutions will provide better audit services due to maintaining their reputation and more history, hence they prevent the bank from managing taxes due to more detailed audits.

Research Background

Minnick and Noga (2010) conducted a study to find the effects of the monetary governance characteristics of banks on capital management, showing that bonus plans act as incentives for managers to invest in long-term tax-reducing plans. Their findings also indicated that capital management benefits the shareholders and is positively associated with an increase in shareholders' income. Imam and Malik (2007) investigated bank performance and monetary governance of banks through ownership structure. They tested the relationship between ownership structure as a measure of bank governance and bank performance and dividend policy. According to their results, bank ownership has a significant positive impact on the bank performance, and the concentration of managerial ownership has a significant negative impact on the dividend policy. Lanis and Richardson (2011) concluded that there is a significant negative relationship the number of non-executive board members and adventurous tax procedure. In other words, the more the number of non-executive members of the board, the less the bank turns to capital management.

Sartori (2008) showed that there are mutual reactions between corporate governance and taxes. In fact, on the one hand, corporate governance rules impose structural effects on fulfilling companies' tax obligations of, and on the other hand, tax plans (from the government's point of view) and connecting them to tax strategies (from the company's point of view) can play a critical role in development of a dynamic corporate governance. Desaia et al. (2007) found that high tax rates can worsen the monetary governance systems of banks, and on the contrary, low tax rates can be associated with improvement of these systems and lead to an increase in tax revenues. In their study, Friese et al. (2016) concluded that tax law can affect monetary governance of banks by providing incentives or imposing penalties. In addition, the monetary governance structure of banks is affected by how banks manage their taxes. Also, the tax system can affect the monetary governance of banks during the dividend payment period.

Qaiemi and Shahriari (2009) made an attempt to investigate the monetary governance and performance of banks in order to determine the relationship between the components of the banks' monetary governance structure (including the board composition, ownership structure, and information disclosure) and the banks' performance. Their found that there is a significant relationship between information disclosure and banks' performance.

Babajani and Abdi (2010) investigated the relationship between monetary governance and taxable profits of banks in order to evaluate the relationship between monetary governance and taxable profit of banks. To this end, they investigated the relationship between some important criteria of monetary governance of banks (i.e., the percentage of effectiveness in the board composition, and the combined role of the CEO (dual duties), and institutional shareholders) and the percentage difference between declared and definitive taxable profit. The research results indicated that there is no significant difference between the average percentage of the difference between the declared and definite taxable profits in the group of banks that have the criteria of monetary governance of banks and the group of banks that do not have the criteria of monetary governance of banks. This is despite the fact that in the both groups of banks, the percentage of difference between the declared and definite taxable profit was significant.

Research hypotheses

The following hypotheses are proposed based on the research theoretical foundations and objectives:

Hypothesis 1. There is a significant negative relationship between the board size and the capital management.

Hypothesis 2. There is a significant positive relationship between the board effectiveness and the capital management.

Hypothesis 3. There is a significant negative relationship between the equity and the capital management.

Hypothesis 4. There is a significant positive relationship between the audit performance transparency and the capital management.

Research Methodology

This research is an applied study in terms of its purpose and a quasi-experimental study in terms of its nature. The multivariable linear regression equation was used in order to analyze the data

and test the research hypotheses. The required information and quantitative data were extracted from the audited financial statements of the banks and their other financial reports, as well as from modern management software.

Statistical Population and Sample

The research statistical population consisted of private businesses. The time domain of the current research was the time period between 2016 and 2021. But considering that the data of the previous 5 years were used to calculate the capital management, in total, the research data covers the time period between 2016 to 2021. A systematic exclusion method was used for sampling, and the businesses in West Azerbaijan province that had all the following conditions were selected as the sample:

1. To increase the comparability, their financial period must end at the end of March.
2. The businesses must be active for a period of at least 5 years before 2021.
3. The required information regarding such the businesses must be available.
4. The businesses must not be part of banks and financial institutions (investment banks, financial intermediaries, holding and leasing banks), because they have financial disclosures and structures.
5. The businesses have not changed their financial year or activity during the specified time period.

By applying the above conditions, out of the active private businesses, 118 companies were selected as the research statistical sample.

Research variables

Independent variables

In this study, the dimensions of monetary governance of the banks included the board size, the board effectiveness, the equity, and the audit performance transparency, independent variables. The research dependent variable of the is capital management. In addition, the specific characteristics of the banks including size, growth opportunities, financial leverage, and ROA were considered as the control variables. Each of the variables are explained below.

Dependent variable

Capital management, as capital, is a risk that arise from the contracting party's default, or more generally, it is a risk that arises from a "credit event". Historically, this risk usually occurred in bonds, where lenders were concerned about the repayment of the loan they made to their borrower. For this reason, sometimes the capital is called "default risk" (Dyreng et al., 2008).

Capital originates from the fact that the contracting party cannot or will not fulfill the contract obligations. The effect of this risk is measured by the cash replacement cost due to the contracting party's default.

Capital losses may occur before the contracting party's actual default. More generally, capital can be expressed as the probable loss that occurs as a result of a credit event. A credit event becomes real when the contracting party's ability to fulfill their obligations changes. Capital is considered as one of the most important risk factors in banks and financial companies. This risk comes from the fact that the recipients of the facility are not able to repay their debt installments to the bank.

In capital measurement, a characteristic risk must be measured, which can be interpreted in different ways: default risk, downgrade risk, interest rate risk, and interest rate difference risk.

Data Analysis Method

In this study, the multivariate linear regression model was used in order to test the research hypotheses. The regression model is given as in Relations (1).

$$ETR_{i,t} = B_1 + B_2 BOARD_{i,t} + B_3 INDEP_{i,t} + B_4 DCEO_{i,t} + B_5 AUDITING + B_6 SIZE_{i,t} + B_7 BM_{i,t} + B_8 LEV_{i,t} + B_9 ROA_{i,t} + \varepsilon \quad (1)$$

Research Findings

Descriptive Statistics Results

The descriptive statistics of the research data are presented in Table 1. The results are based on 552 bank-years, the bank size variable is expressed based on the natural logarithm. The results of the data descriptive analysis indicated that the average effective capital rate of the investigated banks is 52%. which is higher than the standard risk rate for private banks, i.e. 12.5%, considering the economic crises. The minimum effective capital rate is equal to 1%, indicating that despite the bank's losses, they have incurred risk. On the other hand, the maximum effective capital rate is equal to 80%, indicating that the bank sometimes loses 80% of their profit; it also indicates the variety of the data. The average transparency is equal to 0.29, showing that out of every 10 banks that have been audited, on average, 3 banks have been audited by the auditing organization.

Table 1. Descriptive statistics results of research variables.

Variable	Mean	Mode	SD	Min	Max
Effective capital rate	0.524	0.119	0.072	0.072	0.387
Board size	5.14	5	0.47	5	8
Audit transparency	0.29	0.11	0.43	0	1
Board effectiveness	0.42	0.199	0.21	0.2	0.100
Equity	0.052	0.023	0.22	0	1
ROA	0.221	0.202	0.106	-0.31	0.51
Business size	12.3	12.2	1.5	6.76	16.78
Financial leverage of the bank	0.67	0.66	0.17	0.17	0.96
Business growth opportunities	2.97	2.56	0.43	0.71	11.7

Results of Statistical Tests of Research Hypotheses

Considering that the data to be analyzed of the mixed data type, first, it was necessary to determine the type of model estimation by using the Chow test (F-Limer test) and the Hausman test;

Table 2. Chow and Hausman test to estimate the type of data.

Description	The statistic value	Degree of freedom	Significance level
Chow test	14.01	(134, 386)	0.000
Hausman test	16.374	8	0.032

As it can be seen in Table 2, considering that the significance level obtained from the Chow test is equal to 0.000, the hypothesis H0 (ordinary least squares method) is rejected at a confidence level of greater than 99% and the panel data method is accepted. In addition, the Hausman test was used in order to test the panel method (the panel data) with fixed and random effects. According to Table 2, since the significance level obtained from the Hausman test is equal to 0.032, the hypothesis H0 (random effects method) is rejected, and as a result, the fixed effects method is accepted. As it can be seen in Table 2, the F test is significant at a confidence level of greater than 99% and the Durbin-Watson statistic falls between 1.5 and 2.5, confirming the validity of the regression model regarding the linearity of the relationships between the variables and the independence of observations. The adjusted coefficient of determination also indicates that 68% of the changes in the dependent variable can be explained by the independent variables.

Table 3. The results of the research hypotheses test.

$$ETR_{i,t} = B_1 + B_2 BOARD_{i,t} + B_3 INDEP_{i,t} + B_4 DCEO_{i,t} + B_5 AUDITING_{i,t} + B_6 SIZE_{i,t} + B_7 MB_{i,t} + B_8 LEV_{i,t} + B_9 ROA_{i,t} + \varepsilon$$

Variable	Symbol	Variable coefficient	t statistic	Significance level
Constant	B_1	0.27	9.47	0.000
Board size	$BOARD_{i,t}$	0.007	1.56	0.118
Board effectiveness	$INDEP_{i,t}$	-0.012	-6.82	0.000
Equity	$DCEO_{i,t}$	0.019	3.04	0.002
Audit performance transparency	$AUDITING_{i,t}$	0.083	24.89	0.000
Business size	$SIZE_{i,t}$	-0.013	-10.25	0.000
Bank growth opportunities	$MB_{i,t}$	-0.001	1.54	0.122
Business financial leverage	$LEV_{i,t}$	0.02	1.79	0.07

Return on assets	$ROA_{i,t}$	- 0.001	-1.18	0.23
Adjusted coefficient of determination	0.68	F statistic		149.4
Durbin-Watson statistic	1.54	Significance level of the whole model		0.000

According to results of the research hypothesis test, the coefficient and t-statistic of the board size variable are equal to 0.007 and 1.56, respectively, which indicates that there is a positive relationship between the board size and the effective capital rate (or a negative relationship between the board size and capital management, considering that there is a positive relationship between the effective capital rate and capital management); however, this relationship is significant at confidence level of 95%. Thus, the research first hypothesis that there is a significant negative relationship between the board size and the capital management is rejected. In other words, in Iran, the board size (as it generally consists of a fixed number (5 people)) has no impact on the bank's capital management.

According to the research second hypothesis, it was expected that there is a significant positive relationship between the board effectiveness and the capital management. The coefficient and t-statistics of the board effectiveness percentage are equal to -0.012 and -6.82, indicating a negative relationship between the board effectiveness percentage and the effective capital rate, which is significant at the confidence level of 99%. In other words, the greater the board effectiveness, the greater the capital management. Therefore, the second research hypothesis is confirmed. The results of this hypothesis are consistent with the those of Minnick and Noga (2010) and contradict those of Lanis and Richardson (2011).

The research third hypothesis predicted a significant relationship between the equity and the capital management. As it can be seen in Table 3, the coefficient and t-statistic of the equity variable is equal to 0.019 and 3.04, respectively, which indicates a significant positive relationship (at a confidence level of 95%) between the effective capital rate and the equity. In other words, there is a negative relationship between the equity and capital management. The results of this hypothesis are consistent with the those of Minnick and Noga (2010).

Finally, the research hypothesis H4 predicted a significant relationship between the audit performance transparency and the capital management. As it can be seen in Table 3, the coefficient and t-statistic of audit performance transparency variable are equal to 0.083 and 24.89, respectively, indicating a significant positive relationship between the audit firm size and the effective capital rate. In other words, there is a significant positive relationship between the audit performance transparency and the capital management. The result of this hypothesis indicates that in the banks audited by the auditing organization, there is more capital management due to the more detailed auditing and more monitoring of the banks' profit and taxes by this organization.

Moreover, the results of the relationship between the specific characteristics of businesses and the effective capital rate indicate that according to the coefficient and significance level of the

business size variable, there is a significant negative relationship between the bank size and the effective capital rate at a confidence level of greater than 99%. In other words, in Iran, larger businesses are more inclined towards capital management due to more facilities, which is consistent with the results of Richardson and Lanis (2007). Also, there is a significant positive relationship between the financial leverage of businesses and the effective capital rate, indicating that the businesses with a higher financial leverage are less willing to manage capital due to the use of interest expense as a credit shield. In addition, the ROA and the business growth opportunities are significantly correlated with the effective capital rate.

Conclusion and Suggestions

Credits constitute a major figure in the cash flow of businesses, and on the other hand, capital management improves business performance by increasing profits. Also, the monetary governance structure of banks has a decisive impact on the business credit strategy. Therefore, the aim of this study was to find an answer to the question of whether the dimensions of monetary governance of banks influence the capital management of businesses. In this regard, the criteria of board size, effectiveness percentage, equity, and audit transparency were considered as dimensions of the monetary governance of banks. Moreover, the 5-year average of effective capital rates was used in order to measure the capital management.

The findings from the first hypothesis testing indicated that there is a negative relationship between the board size and the capital management, which is not significant at a confidence level of 95%. In other words, in Iran, the board size does not influence the capital management of banks. Moreover, according to the results of testing the hypothesis H2, there is a significant positive relationship between the board effectiveness and the effective capital rate. In other words, the greater the board effectiveness, the greater the capital management. This research result is consistent with that of Minik and Noga (2010) and contradicts that of Lanis and Richardson (2011). The results of the hypothesis H3 indicated that there is a significant positive relationship (at a confidence level95%) between the effective capital rate and the equity. In other words, there is a positive relationship between the equity and thecapital management. This result research is also consistent with Minnick's and Noga's (2010) study. Finally, the results of testing the hypothesis H4 showed that there is a significant positive relationship between the audit performance transparency and the effective capital rate. In other words, there is a significant positive relationship between the audit transparency and the capital management. This result shows that in the businesses audited by the audit organization, there is more capital management due to the more detailed audit and more monitoring by this organization on the profit and tax of the business.

Moreover, there is a significant positive relationship between the business size and the effective capital rate. In other words, in Iran, larger banks have more tendency towards capital management due to more facilities. Also, there is significant positive relationship between the financial leverage of businesses and the effective capital rate; in other words, businesses with higher financial leverage have a greater tendency for capital management due to the use of interest expense as a credit shield. In addition, the ROA and the business growth opportunities were not significantly correlated with the effective capital rate.

Considering the research results, the following suggestions are suggested to be used in future studies:

1. Board of directors and managers should consider the results of this research while taking into account the business strategy regarding capital management.
2. Considering the importance of monetary governance structure of banks on the one hand and the importance of credits and business profits on the other hand, investors and other stakeholders are suggested to consider the results of this research in their decision-makings.
3. Auditors are suggested to consider the results of this study in terms of the dimensions of monetary governance of banks and the specific characteristics of each business in auditing of businesses when identifying the business credit risks in the long term.

Research Limitations

In the process of scientific research, there may be a set of conditions and limitations beyond the researcher's control that can potentially affect the research results. Some of these limitations are inherent and some are caused by the environmental conditions and the research time limit. It is necessary to take into account the existing limitations while analyzing the scientific research results. This study was not an exception and had the following limitation:

The use of the effective capital rate of 5 years ago to calculate the capital management limited the research statistical population, which can affect the results.

Acknowledgment: None.
Conflict of Interest: None.
Funding: None.
Ethical statements: None.

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