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Impact of the Firm Features on the Capital Structure in the Enterprises

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Abstract: *The purpose of this study is to investigate the effect of firm management features on the capital structure and tax administration of the companies listed in the Tehran Stock Exchange. For that aim, by differentiating the existing companies in the research sample in terms of life cycle, and using the Dickinson cash flow mark model, the relationship between variables, board size, board composition, duality of the CEO duties, and auditor size were examined. The research method is descriptive-analytic and the statistical population of the study involves all companies listed in the Tehran Stock Exchange from 2013 to 2017 for 5 years, the research sample was selected based on the systematic elimination and screening and in as many as 142 companies. Data and financial statements information relating to the companies listed in the Tehran Stock Exchange were extracted from stock databases, time series statistics, etc. At the end, the Eviews and Spss software programs were used to analyze the data. Regression results from surveying the sample companies indicate that there is no significant relationship between the size of board of directors and the tax administration. In other words, in Iran, the board size does not affect tax administration. Also, there is a negative and significant relationship between the board composition and the effective tax rate. Other findings of the research indicate a positive and significant relationship between the effective tax rate and the duality of the CEO duties. Also, there is a negative and significant relationship between the size of the audit firm and the tax administration.*

Key words: *Company Features, Capital Structure, Small and Medium Enterprises, Tax Administration, The Tehran Stock Exchange*

INTRODUCTION

The ability of a company to determine the appropriate financial resources is one of the main factors in the survival and growth of that company. On the one hand, management should pay attention to the goal of maximizing shareholder wealth when choosing a financing method and select resources with regard to the cost of various sources of financing and the effects of these resources on the efficiency and risk in the firm, which minimizes the cost of financing, and, on the other hand, it must properly analyze the firm taxes and manage them well. For this reason, the capital structure that can maximize the firm value or minimize the total cost of the capital is the optimal capital structure (Kordestani and Najafi Omran, 2008). Hence, in the last two decades, the principles of firm governance have become one of the main aspects of trade and paying attention to them is increasing day by day. According to researchers such as Black (2001), Klapper and Love (2003), and Gompers et al. (2003), the principles of firm governance play an important role in improving the firm performance and there is a direct relationship between the principles of firm governance and firm performance in the developed and developing financial markets.
The results of many empirical studies conducted in other countries also show that good corporate governance principles may lead to better firm performance. One of the elements related to the firm performance is the issue of tax administration. If management can reduce the effective tax rate in the long run and pay fewer taxes, it will be able to manage taxes. The better this is done, the better the company

will be managed because it will lead to an increase in post-tax net profit, as well as a reduction in cash-flow from tax (Gupta and Newberry, 1997). According to the studies, capital structure theory offers two competing models for firm financing decisions; static equilibrium model and preferred (hierarchical) model. Hierarchy and static equilibrium theories sometimes have conflicting predictions about the factors affecting the debt ratio (capital structure). These factors include the firm size, the visibility of assets (the amount of visible fixed assets), growth and investment opportunities, profitability, profit risk (profit volatility), tax savings other than debt, and distributed profit (Serghiescu & Vaidean, 2014).

One of the things that is expected to be related to tax administration is the firm governance mechanism. The relationship between these mechanisms and the performance of companies have been examined and approved in numerous investigations. Various studies have shown that the board size, the board composition, the duality of the CEO duties, and the audit firm size are among the elements of the firm governance mechanisms which affect tax administration. The main question in the financial research about these mechanisms is whether these mechanisms are a stimulus to the firm performance. Most of these studies have identified certain performance measures such as stock returns, Tobin's Q, and asset returning. Meanwhile, what has not been answered is explanation of the long-term relationship between more effective governance mechanisms and performance details. Therefore, with an approach to what has been said, in this research, tax administration is considered as a measure for the firm performance and this research seeks to clarify the relationship between the features of corporate governance principles and tax administration.

Study Background

Minnick &Noga (2010) searched for the effects of the features of corporate governance principles on tax administration. They showed that bonus schemes may act as incentives for managers to invest in long-term plans and tax breaks. Also, the findings showed that tax administration can affect stakeholders, and tax administration is positively related to the increase in shareholders' equity.

Imam & Malik (2007) investigated the firm performance and corporate governance principles through the ownership structure. In their research, they tested the relationship between ownership structure, as a measure of firm governance benchmark, and firm performance and dividend policy. The results of their research showed that firm ownership has a positive and significant impact on the firm performance, and centralized management ownership has a negative and significant effect on the dividend policy. Lanis & Richardson (2011) concluded that the number of non-obligated members of the board has a negative and significant relationship with the courageous tax procedure. In other words, as the number of non-obligated members of the board is greater, the firm is less likely to manage the tax. Desaia et al. (2007) concluded in their study that high tax rates will worsen the systems of corporate governance principles and conversely, low tax rates will improve corporate governance principles and increase tax revenues. Friese et al. (2006) concluded that the tax code could influence corporate governance principles by offering concessions or imposing penalties. In addition, the structure of corporate governance principles is influenced by how the company manages tax. The tax system can also influence the corporate governance principles during dividend payments. Ghaemi and Shahriari (2009) investigated the principles of firm governance and firm performance. The purpose of that paper was to determine the relationship between the components of the structure of corporate governance principles, including the composition of the board of directors, the ownership structure, and disclosure of information, with the performance of companies. Their findings showed that there is a significant relationship between the disclosure of information and the performance of companies. Babajani and Abedi (2010) investigated the relationship between corporate governance principles and firm taxable profits. The results of the research showed that there is no significant difference between the average percentage difference of expressed taxable and definitive profits in the group of companies that follow the criteria of corporate governance principles with the group of companies that do not meet the criteria for corporate governance principles.

Theoretical Principles

Corporate governance principle (governance mechanism) is a system that improves the representation problems between executives and shareholders. Based on surveys, the stock crash of companies such as Adelfa , Enron and WorldCom was largely due to the weak managing principles of the companies mentioned above (Konzelmann and Deakin, 2004). Establishing an effective and efficient system of corporate governance principles brings the interests of managers and owners in one direction, improves the operational performance of the companies, and expands companies.

The running mechanism consists of several components. The efficient board is one of these components. The board of directors and CEO play an undeniable role in choosing a tax administration strategy because these people should be accountable for the optimal allocation of the firm resources, its performance, as well as the shareholders' wealth growth. A manager tries to improve his company's sales, he is primarily thinking of boosting sales growth rate and as a result, invests in the cost of advertising and developing the company's manufacturing capacity and leads the resource in that direction. Besides, since the company profits are usually considered by the users of the information, the manager should also consider increasing the figure. Effective tax management is one of the most important tools to achieve this goal because tax planning can reduce the effective tax rate, which will result in increased post-tax profits, as well as a reduction in tax-deductible cash flows (Gupta and Newberry, 1997).

The board of directors is considered to be the most important factor in controlling firm management and protecting shareholders' resources. One of the topics discussed on the subject of the board focuses on the composition of the board of directors. There are conflicting views on how the composition of the board affects monitoring and, therefore, performance. Existing literature suggests that the composition of the board is related to the degree of representation issues. The result of this literature is that companies with larger boards and more internal directors tend to have more representation issues; on the contrary, small firms with small boards and higher percentage of non-obligated directors are more relevant to shareholders' welfare and business performance; a smaller-size board can more easily convince management to allocate and share assets for tax management, therefore, the board size is one of the factors influencing tax administration (Minnick &Noga, 2010). The board composition is considered as the ratio of non-obligated members of the board to the total number of board members. As the composition of the board is composed of more independent members, the problem of representation becomes less (Hermalin and Weisbach, 1992). Unlike responsible managers, non-obligated directors are independent from the companies' management, and for the same reason it is more effective in controlling its role. Hence, from a theoretical point of view, when the board is independent and composed of a high proportion of non-obligated members, the performance of the company improves (Muth and Donaldson, 1998). Independent boards are also in a better position to push resources toward tax administration because they have a broader insight than company and its overall performance due to their independence. The duality of CEO responsibilities occurs when the CEO is also elected as the chairman of the board of directors. This may lead to conflict of interests and loss of independence. When the CEO is in the board of directors (duplication of duties of the CEO), there is less risk of losing the job for him/her and this duality of duties makes the manager less likely to improve performance and negatively impacts the company's performance (Minnick &Noga, 2010). Therefore, no action is taken to manage taxes and increase performance by the CEO.

Independent auditing is considered as an appropriate mechanism for controlling contractual relationships between managers and shareholders and in most studies on the mutual relationship between agency and audit theory, the effect of firm governance mechanisms on the probability of selecting high quality audit institutions has been studied. Lin et al. (2009) examined the impact of firm governance mechanisms on large audit firms. The results of their review indicated that the control exercised by the major shareholders and the sameness of the CEO and the chairman of the board of directors (the duality of the CEO's duties) would reduce the likelihood of electing 10 major Chinese auditors. Therefore, there is a positive and significant relationship between the quality of firm governance and the size of the audit firm. And the larger auditing firms are expected to provide better audit services due to their reputation and

experience; hence, regarding more accurate audits, they will prevent tax to be administered by the company.
Accordingly, the research hypotheses are:

- There is a negative and significant relationship between the size of the board of directors and the tax administration.
- There is a positive and significant relationship between the percentage of non-obligated directors and tax administration.
- There is a negative and significant relationship between the combined role of the CEO (duality of CEO duties) and tax administration.
- There is a negative and significant relationship between the audit firm size and the tax administration.

Research Methodology

This research is practical in terms of its purpose and is quasi-experimental in terms of its nature. In order to analyze the data and test the hypothesis of the research, multiple regression equation has been used. In order to conduct this research, the required quantitative information and data have been extracted from audited financial statements of corporations and other financial reports as well as Tadbir and Rahavard Novin software programs. The statistical population of this research involves the companies listed in the Tehran Stock Exchange. The present study was carried out in the time domain of 2013-2017. For sampling, a systematic elimination method was used and companies which had all of the following conditions were selected as sample:

1. In terms of increasing comparability, their financial period will end by the end of March.
2. The company had been listed in the Tehran Stock Exchange prior to 2013.
3. Information required for these companies is available.
4. Companies are not a part of banks and financial institutions.
5. The company did not change the fiscal year or change the activity during that time period.

Applying the above conditions, among the companies listed in the Tehran Stock Exchange, 142 companies were selected as the statistical sample of this study.

Research Variables

In this research, the features of corporate governance principles including the board size, the board composition (the number of non-obligated members), the duality of the CEO duties, and the auditor size, are independent variables. The dependent variable of the research is the tax administration; also, the company's specific features including size, growth opportunities, financial leverage, and asset returns are considered as control variables, which are explained below.

The Dependent Variable

Tax administration is defined as the ability to pay less tax in long term periods. Following Dirang et al. (2008), in this research, the effective tax rate was calculated first. The effective tax rate is defined as the ratio of the total tax expense to the pre-tax income.

$$ETR = \frac{Tax - E_{i,t}}{Pre - tax_{i,t}}$$

Where $Tax - E_{i,t}$ is tax and $Pre - tax_{i,t}$ is the pre-tax income.
Given that the one year standard is not a good measure for tax evasion, to control this like Dyreng et al. (2008), effective tax rates are considered for a long period of time. In this research, this period is 5 years. The long-term effective tax rate criterion is the average total amount of tax payable over a period of 5 years divided by the total taxable income for the same period.

Independent Variables

In this research, independent variables include the features of corporate governance principles, including the size of the board of directors, the ratio of non-obligated members in the structure of the board of directors, the combined role of the director (duality of manager's duties), and auditor size.

Number of board members (Board): involves the number of members forming the board of directors.

Combination of the board (Indep): the composition of the board is the number of non-obligated members on the board.

Duality of CEO (Dceo): it equals one if the CEO has no seats on the board, and equals zero otherwise.

The size of the audit firm (Auditing): it is equal to one if the auditor is the audit organization, and is zero otherwise.

Control Variables

In this research, the specific features of companies including size, growth opportunities, financial leverage, and asset returns are considered as control variables.

Financial leverage ($LEV_{i,t}$): the financial leverage is obtained by dividing the total debt of the company into the total assets. Jensen (1986) showed that a high level of debt would create representation problems. We used the breakdown of total debt on the book value of equity as a debt ratio.

Return on assets ($ROA_{i,t}$): one main reason why companies engage in tax administration is for performance improvement. In order to control the overall performance and to determine the specific effect of our tax management, we used the return on assets ratio. Return on assets is the result of dividing net profit by total end-of-period assets.

Firm size ($SIZE_{i,t}$): the firm size is obtained through the natural logarithm of the market value of the company.

Ratio of market value to book value ($MB_{i,t}$): the ratio of the market value of equity to its book value is used as a representative for the growth of the company.

Data Analysis Method

In this research, multivariate linear regression model was used to test the hypotheses of the research. The regression model used is given in equation (1).

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

Descriptive Findings

Table 1 shows the descriptive statistics of the data used in the research. The results are based on 552 years–company; the firm size is based on the natural logarithm. The results of the descriptive analysis of the data indicate that the average effective tax rate of the companies surveyed is 12%, which according to tax exemptions below the official tax rate for the companies listed in the Tehran Stock Exchange is 22.5%. The minimum effective tax rate is -10%, which indicates that despite the company's losses, it has been taxed; also, the maximum effective tax rate is 80%, which indicates that the company sometimes taxes 80% of the profit; it also indicates the diversity of data. The average auditor size is 29.0. This shows that of the companies surveyed from each of the 10 audited companies, an average of 3 companies were audited by the audit organization.

Table 1: Descriptive statistics of the research variables

Variable	Average	Middle	Standard deviation	Minimum	Maximum
Effective tax rate	0.124	0.119	0.072	-0.072	0.387
Board size	5.14	5	0.47	5	8
Auditor Size	0.29	0.11	0.43	0	1
Percentage of non-obligated members	3.01	2.99	1.01	1	6
CEO duality	0.052	0.023	0.22	0	1
Return on assets	0.221	0.202	0.106	-0.31	0.51

Firm size	12.3	12.2	1.5	6.76	16.78
Firm financial leverage	0.67	0.66	0.17	0.17	0.96
Firm growth opportunities	2.97	2.56	0.43	0.71	11.7

As shown in table (1), the average board size in these companies is 5, and the average non-obligated members are 3. In other words, almost 60% of the board members are non-obligated members. Also, on average, out of every 100 companies, there are 5 CEOs in the board of directors. Meanwhile, on average, 67% of the assets of the companies investigated were financed from the debts. And the average return on assets of companies is 22%.

Results of Statistical Tests of Research Hypotheses

Given the fact that the data analyzed are of the combined type, first the estimation type model is determined using the Chow test (F Limer) and the Hausman test.

Table 2: Chow and Hausman tests to estimate data types

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

As shown in Table (2), the significance level obtained from the Chow test is equal to (0.000); consequently, the hypothesis H0 (ordinary least squares method) is rejected at a confidence level of more than 99% and the panel data method is supported. Also, to test the use of panel method (panel data) with constant effects and random effects, the Hausman test was used. As shown in Table (2), since the significance level obtained from the Hausman test is (0.032), the hypothesis H0 (random effects method) is rejected, and therefore the method of fixed effects is supported. As shown in Table (3), the F test at the confidence level of more than 99% is significant and also the Durbin- Watson statistic is between 1.5 and 2.5, which confirms the validity of the regression model for the linearity of the relationships between variables and the independence of the observations. The adjusted coefficient of determination also indicates that 68 percent of the variation in the dependent variable is explained by independent variables.

Table 3: the results of testing the research hypotheses

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

Variable	Symbol	Variable coefficient	T-statistic	Significance level
Fixed value	B_1	0.27	9.47	0.000
Board size	$BOARD_{i,t}$	0.007	1.56	0.118
Percentage of non-obligated members	$INDEP_{i,t}$	-0.012	-6.82	0.000
Duality of CEO duties	$DCEO_{i,t}$	0.019	3.04	0.002
Audit size	$AUDITING_{i,t}$	0.083	24.89	0.000
Firm size	$SIZE_{i,t}$	-0.013	-10.25	0.000
Firm growth opportunities	$BM_{i,t}$	-0.001	-1.54	0.122
Firm 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

The results of testing the research hypothesis showed that the coefficient and t-value of the board size variable were 0.007 and 1.56, respectively. As a result, there is a positive correlation between the board size and the effective tax rate (or a negative relationship between the board size and the tax administration, given that there is a negative relationship between the effective tax rate and tax administration); this relationship, though, is not at 95% confidence level. And the first hypothesis of the research is that there is no significant and negative relationship between the board size and the tax administration. In other words, in Iran, the board size (because it is generally composed of a fixed number (5 persons)) does not affect the tax administration of the company.

According to the second hypothesis of the research, a positive and significant relationship between the percentage of non-obligated members and the tax administration was expected. The coefficient and t-statistic of the percentage of non-obligated members of the board are -0.012 and -0.82, respectively, which indicates a negative relationship between the percentage of non-obligated members of the board and the effective tax rate, this relationship is significant at the 99% confidence level. In other words, the more non-obligated members are on the board of directors of the company, the more tax administration will be. Therefore, the second hypothesis of the research is supported. The results of this hypothesis are consistent with the research by Minnick &Noga (2010) and contradict the research by Lanis & Richardson (2011).
The third hypothesis of the research predicted a significant relationship between the percentage of non-obligated members and tax administration. As it can be seen in table (3), the coefficient and t-variable of the CEO duality is 0.019 and 3.04, which indicate a positive and significant relationship (at a 95% confidence level) between the effective tax rate and the duality of the CEO duties. In other words, there is a negative relationship between the duality of the CEO duties and the tax administration. The results of this hypothesis are consistent with the research by Christina Minnick and Tracy Noga (2010).
Finally, the fourth hypothesis of the research predicted a significant relationship between the auditor size and the tax administration; as shown in Table (3), the audit firm size is 0.083 and the t-statistic is 24.88. Therefore, there is a positive and significant relationship between the audit firm size and the effective tax rate. In other words, there is a negative and significant relationship between the audit firm size and the tax administration. The result of this hypothesis indicates that in the companies that are audited by the audit organization, tax administration is less due to more accurate auditing and monitoring the profits and taxes by the organization. Also, the results of the relationship between specific features of firms and the effective tax rate indicate that, regarding the coefficient and significance level of the variable of the firm size, there is a negative and significant relationship at a confidence level of more than 99% between the firm size and the effective tax rate. In other words, in Iran, bigger companies are more likely to be taxed due to more facilities. And this is consistent with the research findings of Richardson & Lanis (2007). The relationship between firm leverage and effective tax rates is also positive and significant; in other words, companies with high financial leverage tend to be less willing to tax administration because of the use of interest expense as a tax shield. Meanwhile, there is no significant relationship between the return on assets and the growth opportunities of the firm with the effective tax rate.

Conclusion

Research in the field of capital structure has sometimes yielded contradictory results. Some studies have followed the hierarchical theory of financial options and some others have supported static equilibrium theory. Even some studies have pointed to the simultaneous use of both theories by companies. It seems that the lack of attention to the stages of the companies' life cycle as one of the factors affecting their financing can be the origin of these contradictory results. Therefore, in this research, we tried to investigate the relationship between financial features of the company and the capital structure of the companies in different stages of their life cycle. The findings of the research showed that tax costs constitute a major figure in the form of profit and loss, and, on the other hand, tax administration reduces company tax payments and improves firm performance by increasing profit after deduction of taxes. On the other hand, the structure of corporate governance principles plays a decisive role in the tax strategy of the firm. Hence, this research sought to find an answer to the question of whether the features of corporate governance principles affect firm tax administration. In this regard, the board size, the percentage of non-obligated members, the duality of the role of the manager, and the auditor size were used as features of the corporate governance principles. Also, for measuring tax administration, the average effective tax rate was used for a 5-year period.
The findings from the first hypothesis testing indicate that there is a negative relationship between the board size and the tax administration, this relationship is not significant at 95% confidence level, however. In other words, the board size does not impact the firm tax administration. Also, the results of

the second hypothesis of the research showed that there was a negative and significant relationship between the percentage of non-obligated members of the board and the effective tax rate. The result of this study is in line with Minnick &Noga (2010), and contrary to the research by Lanis & Richardson (2011). The results of the third hypothesis of the research showed that there is a positive and significant relationship (at a confidence level of 95%) between the effective tax rate and duality of the CEO's duties. In other words, there is a negative relationship between the duality of the CEO duties and the tax administration. This result of the research is also consistent with Minnick &Noga's research (2010). Finally, the results of the fourth hypothesis of the research showed that there is a positive and significant relationship between the audit firm size and the effective tax rate. In other words, there is a negative and significant relationship between the audit firm size and the tax administration. This indicates that in companies audited by the audit organization due to more precise audit and more monitoring of the organization on the company's profits and taxes, tax administration is less.
Also, there is a negative and significant relationship between firm size and effective tax rate. In other words, in larger firms, they tend to be taxed more often because of more opportunities. In other words, in larger firms, they tend to tax administration more often because of more opportunities. The relationship between the company's financial leverage and the effective tax rate is also positive and significant; in other words, companies with high financial leverage tend to be less willing to tax administration because of the use of interest expense as a tax shield. Meanwhile, there was no significant relationship between the return on assets and the growth opportunities of the company with an effective tax rate. According to the research results, the following suggestions can be presented:

- Due to the importance of the structure of corporate governance principles and, on the other hand, the importance of firm tax and profits, the investors and other stakeholders are suggested to consider the results of this research in their decisions.
- Auditors are suggested to consider the results of this research regarding the features of corporate governance principles and the specific features of each company in auditing the companies to identify company tax evasion in the long run.
- Board of directors and managers are suggested to consider the results of this research considering the company's tax administration strategy in the selection of the auditor.

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