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Presenting the Corporate Governance Model of Holdings Financed Through the Internal Capital Market with a Theoretical Approach of Stakeholders

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Abstract

Holding companies collect funds from subsidiaries and allocate them to important areas (Internal Capital Market). Managers of holding companies have the ability to transfer funds between subsidiaries. Some specific orientations cause the non-optimal allocation of financial resources. One of the concerns of investors is investing in companies where transparency is fully implemented. Companies are trying to achieve this by implementing corporate governance mechanisms. In this research, using a systematic review method, the dimensions of corporate governance were extracted with the stakeholder theory approach. Finally, in order to examine the question of whether the managers of holding companies consider the interests of all stakeholders when using the internal capital market or not, according to the assumptions of the research, the dimensions of corporate governance on stakeholders have been investigated. To investigate this relationship, a set of questions based on Likert scale about the measured variables of the target society was designed. After data collection, finally, data analysis was done by statistical method using SPSS software and structural equations using SPLS software, and the results of path analysis and causal relationships between the research variables were interpreted in the conceptual model. The data analysis also showed that the value of the path coefficient, the effects of dimensions and components of corporate governance and stakeholders, is a positive value. The null hypothesis of the research is rejected and the opposite hypothesis is confirmed. This shows that there is a relationship between the effects of corporate governance dimensions and stakeholders. The direct effect value indicates a strong and high effect size. As a result, the interests of all stakeholders should be considered.

Keywords: Internal Capital Market, Stakeholder Theory, Holding Companies, Corporate Governance, Social Corporate Responsibility

Introduction

In most countries, holding companies have a legal personality, and in terms of economics and accounting, they have an economic personality. Holding companies are a public phenomenon in the economies of countries and play a significant role in newfound and developed economies. Holding companies include a group of companies working in one or more markets or industries under the control of a parent company or they are jointly controlled (Chang, 2003). Businesses can enjoy many positive outcomes by membership in holding companies, including facilitating the financing of holding companies. It is easier to loan from the holding members by joining a holding company. In other words, companies can finance from the parent company or other members of the holding more easily (Yoshi et al. 2019). Holding companies can collect funds from subsidiaries and allocate them to strategically critical areas. The internal capital market is created through such use of free cash flow. Despite businesses working in developed countries with advanced capital markets, the internal capital market in firms of developing countries can lead to favorable synergies and be regarded as a source of competitive advantage (Chang, 2003). Using the internal capital market, holding companies create many advantages in their complex. By controlling cash flow within the group, these companies can enhance financial efficiency. To reduce transaction costs created by information asymmetries between the company and investors, business groups use the internal capital market and overcome capital market shortcomings in this way (Li and Zhao, 2006).

Therefore, the use of the internal capital market contributes to inefficiencies due to information asymmetry (Stein, 1997). The use of the internal capital market makes the motivation of investors double (Granwater et al., 1994). Administrators of holding companies can transfer funds between subsidiaries to invest in the best opportunities. Senior administrators, in this regard, evaluate business opportunities in holding companies as an investor and determine the best method to allocate and distribute financial resources. There are some specific orientations of senior managers of holding companies along with the complexity of the issue of resource distribution that cause a lack of optimal allocation and sometimes inequity (Masulis and Reza, 2014; Kompopiano and Demis, 2015; Choi et al., 2018; Cao et al., 2018). Generally, in developed countries, it is common to seize the corporate resources through transactions with affiliates, but it is more observable in emerging economies due to the weakness of foreign markets and poor corporate governance (Qing Yuan and Yongmin, 2021).

Transactions with affiliates are inevitable and beneficial in many cases and are repeated in the company's operating cycle, but in certain circumstances, controlling shareholders or corporate executives are allowed to pursue their interests at the expense of minority shareholders. The opportunism of transactions with affiliated companies is one of the factors that lead to the devaluation of the capital market, specifically in Asian countries. It is not true for all transactions with affiliates to be opportunistic, but the prevailing view is that they are one of the risky factors, and investors pay great attention to them before investing. In recent financial scandals, transactions with affiliated companies have been the main concern. Accordingly, purposeful use of these transactions and their non-disclosure or insufficient disclosure is one of the reasons for the collapse of companies (Lane and Yeh, 2020). Accordingly, when using the internal capital market and the distribution of resources among the companies affiliated to the holding, this issue must be considered whether the financial managers consider the interests of all stakeholders, or only the interests of the main shareholders (controlling shareholders). This study evaluates this issue by presenting the corporate governance model of holdings financed through the internal capital market and its impact on stakeholders.

Literature Review

Holding companies have an organized structure and play a key role in the economy of any country. One of the major factors in creating holding companies is the development of different businesses along with the acquisition of new companies. Environmental and operational changes have especially emphasized the issue of financing. According to (Winsu, 1982), these institutions and enterprises are highly dependent on financial markets to provide their necessary capital. The methods and amount of financing are the main issues that the financial managers of holding companies pay attention to them (Abzari et al., 2007). The use of the capital market, which includes internal and foreign capital markets, is one of the methods of financing holding companies. According to the financing hierarchical theory of Myers, companies prefer to use internal financing sources (Kordestani and Najafi, 2010). Holding companies can collect funds from subsidiaries and allocate them to strategically critical areas. The internal capital market is created through the use of free cash flow. Despite businesses working in developed countries with advanced capital markets, the internal capital market in companies of developing countries can lead to favorable synergies and be considered a source of competitive advantage. Businesses that are subordinates of holding companies can use the internal capital market and have better access to financial resources compared to independent companies (Lensik et al., 2003).

These aspects of holding companies make investors more sensitive to the cash flows of companies under the supervision of holding companies. Various studies have indicated that holding companies utilizing the internal capital market have a better position in terms of financial performance than companies that are not a kind of holding company and operate independently (Shane and Stalls, 1998). The use of internal capital markets significantly increases the motivation of controlling stakeholders (Granwater et al., 1994). Nevertheless, the greater power of controlling shareholders over minority shareholders increases the possibility of unfair transfer of resources to sectors with low growth opportunities (Scharfstein and Stein, 2000).

Transactions that are mostly accomplished by administrators, the controlling shareholders of board members, have indicated their negative effects on the value of companies and have led to bankruptcy and uncertainty of shareholders. In holding companies, as transactions completed by the controlling shareholders increase, the security of the minority shareholders decrease and uncertainty is created. This uncertainty leads to a decrease in the company's stock (Nakhili and Moyz, 2011). Recent scandals concerning conducting transactions with affiliated companies by managers, supervisors, and controlling shareholders have raised concerns among investors about investing in corporations. Therefore, shareholders investigate transactions to avoid potential losses (Gordon, Henry, Palia, 2004).

Tunneling protocol is more common in countries with less developed markets or less civilized legal systems. The reason is that in these countries, due to the lack of clear framework and explanation of laws and the lack of laws to protect minority shareholders, managers, and major shareholders and generally those who seek opportunism, can easily identify legal gaps and sometimes carry out their profitable transactions completely legally and not be prosecuted. This issue ultimately causes losses to minority shareholders (Ismailzadeh Moghari et al., 2016).

Accordingly, one of the concerns of investors is to invest in companies where transparency is totally implemented, and managers are concerned about the interests of all stakeholders. Companies try to achieve this goal by implementing corporate governance mechanisms. In other words, corporate governance includes a legal, cultural and institutional mechanism that determines the direction and movement of companies (Abdolreza Asadi 2016). Hasas Yeganeh (2006) assumes corporate governance as laws, regulations, structures, cultures, and systems that fulfill the goals of accountability, transparency, justice, and respect for the rights of stakeholders (Ghaemi and Shahriari 2009). The studies conducted in Iran have analyzed corporate governance with four dimensions (ownership, shareholder rights, transparency, and effectiveness of the board of directors) (Hasas Yeganeh and Salimi 2011). Recent studies however, have investigated corporate governance in five dimensions and counted social responsibility as one of the important and major dimensions of corporate governance (Ho 2005, Diba Jamali 2008; Diba Jamali et al. 2008, Jamshid Yahyapour 2015, and Rashid Zaman et al., 2020).

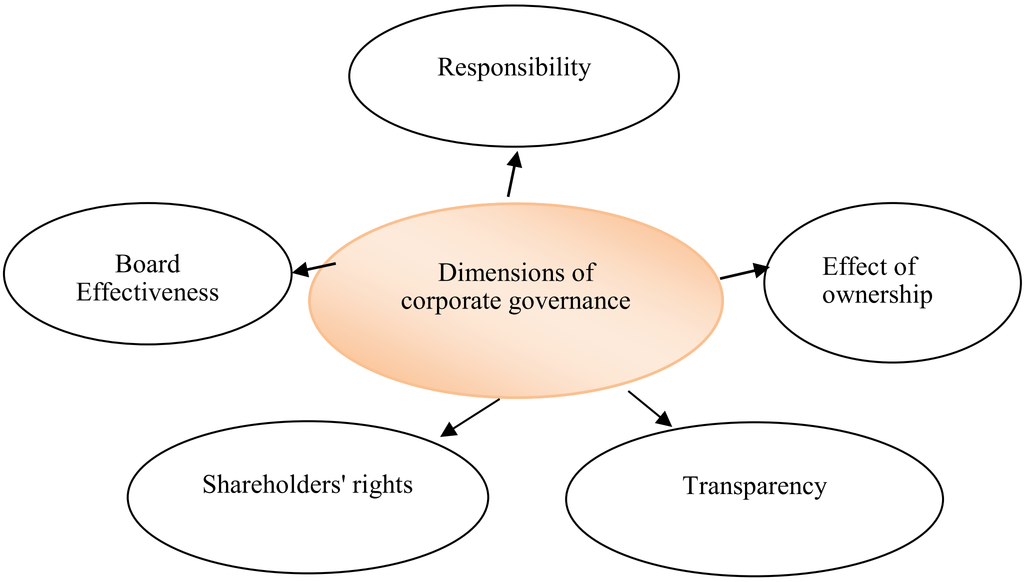

Figure 1. Dimensions of corporate governance

There is some recent evidence indicating that organizations today have more tendency to change their short-term financial outlook to long-term, which includes socioeconomic, environmental, and value-added impacts (Hardjono and Van Marwijk, 2001). Here, the concepts of corporate governance and corporate social responsibility are used. Under the supervision of corporate governance, companies are encouraged to promote ethics, fairness, transparency, and accountability in all their transactions. It is expected of companies to continue achieving profit by implementing corporate governance standards. A company's decisions must also be consistent with the interests of all stakeholders inside and outside the company (Freeman, 1984).

Accordingly, companies have to maintain their activities following the moral and legal demands of society. This issue occurs in the area of social responsibility, which, in recent years, has attracted more attention to how companies deal with various stakeholders, including providing quality products and services and performing charitable activities. Due to the economic dominance of holding companies over affiliated companies, it is necessary to make the performance of holding companies transparent to build trust among stakeholders. Therefore, the social responsibility behavior of holding companies must be interpreted. Social responsibility is a mechanism that affects the way managers invest and make decisions. Accordingly, managers' opportunistic behaviors are decreased due to more accountability to stakeholders, and it leads to information transparency and quality of financial reporting (Izadnia and Hashemi, 2017). Previous literature indicates that information asymmetry between managers and shareholders significantly impacts the company's investment decisions and worsens agency issues (Jiang et al., 2010). With high social performance, companies tend more to publicly disclose their social activities. The high level of information disclosure decreases information asymmetry between the company and investors, and this issue, in turn, reduces risk (Sarafim et al., 2012).

Observing social responsibility is considered a factor for gaining a competitive advantage among companies these days. The purposes of implementing social responsibility are to increase shareholder wealth through the satisfaction of internal and foreign stakeholders (McWilliams et al., 2002). Social responsibility includes issues such as environmental protection, human resource management, occupational health and safety, local community relationships, and relationships with suppliers and customers (Gross Gale et al., 2016). Observance of ethical and environmental standards are clearly other aspects of social responsibility that can lower fines in the company, which can ultimately affect the profit, company performance, and satisfaction of stakeholders (Moradi et al., 2014).

It is concluded that the effects of the activities of corporate social responsibility are directed not only to foreign stakeholders but also to the company's internal stakeholders that act as a reliable communication channel with external groups of stakeholders (Collier, Esteban, 2007). Accordingly, social responsibility and related disclosures is one of the critical factors for the continuation of the activities of for-profit units due to their relationship with society and the fact that society provides the conditions for the survival and continuity of companies. The theory of legitimacy states that there is a social contract between the for-profit units and the society in which they operate. Therefore, it is expected that corporate governance mechanisms that rule the company, including a set of rules managing governance and control of companies would be able to affect the performance of corporate social responsibility (Jane and Jamali, 2016).

Freeman (1984) claims that a company is known for its relationships with stakeholders. He represents the stakeholders as any group or individual who can influence or be influenced in achieving the goals of the organization. According to his opinion, the theory of stakeholders states that companies have relationship with a wide range of stakeholders, including employees, consumers, environmental regulators, and the government. The complete concept of corporate governance accordingly means corporate governance, responsibility, paying attention to the demands of all stakeholders (Kendall, 1999), and also being ensured that companies respond to all stakeholders. (Dunlop, 1998). Accordingly, it seems logical and accurate to use social responsibility as one of the dimensions of corporate governance (Freeman, 1984; Post, Preston and Sachs, 2002; Diba Jamali, 2008; Diba Jamali, 2008; Rashid Zaman, 2020). Today, the impact of companies on society is a concern for the world, and stakeholders' expectations of the performance of business units are increasing in today's society. Stakeholder theory declares that the success of companies for legal, economic, and ethical reasons needs to consider the interests of stakeholders such as employees, local communities, customers, the environment, etc., beyond the controlling stakeholders (Tang et al., 2019). Accordingly, stakeholder dissatisfaction in one of the markets in which the company operates can quickly spread to other markets; therefore, business activities in markets that the company perceived as a successful and socially responsible company will be endangered (Bhattacharya et al., 2008). The impact of corporate governance on all stakeholders has been investigated in this study.

Research Method

This study has been conducted in three stages. In the first stage, by studying the literature on the corporate governance model of holdings financed through the internal capital market with the stakeholder approach, the importance of identifying these variables and their relationships has been realized. In the next stage, the effects of the dimensions of each variable as well as the mutual effects of the research variables have been considered. Since, in today's world, corporate governance plays an important role in the development of companies in the capital market, we examined the variables of capital market research to concentrate on the effects of these relationships. Various methods, opinions, and views have been expressed about the research methodology in different books. Like other topics in the humanities, the multiplicity of opinions is so great that it is not possible to offer a single opinion in this regard. A study is classified into different types according to different perspectives and criteria such as purpose, subject, method, and the like. In terms of research purpose, this research is descriptive, and in terms of strategy, it is a survey, and in terms of data collection method, it is a questionnaire. At the descriptive level, this research has analyzed the characteristics of the society using characteristics such as frequency.

Statistical population

In the first stage of the research, the statistical population includes the opinions of all managers in the field of corporate governance in Iran. In the second stage, the statistical population includes Arvin Melal Zarin Holding Company and its subsidiary companies that are financed through the internal capital market. This statistical population has been determined based on the purpose of the company, which is the impact of the implementation of the corporate governance mechanism on the shareholders. The statistical sample are composed of 70 managers of Arvin Melal Zarin Holding Company and its subsidiary companies. In this research, the regular (systematic) random sampling method has been used. Furthermore, the samples have been chosen based on the following criterion:

The criterion included the holdings listed on the Tehran Stock Exchange that are financed through the internal capital market.

The research data collection method

The data should be collected with appropriate instruments in each research, and research hypotheses should be examined by analyzing and processing the collected data. The dimensions of research variables were first identified through the library method to conduct this research. There are various instruments for collecting data, including questionnaires, interviews, and observations. The questionnaire is composed of a set of questions (items) about the variables measured by the target population, which the respondent provides the necessary answers by considering them. The instrument used in the field method in this research is a researcher-made questionnaire. According to the Likert scale, this questionnaire includes the items (very low, 1; low 2; somewhat, 3; high, 4; very high; 5). To communicate effectively and appropriately with the respondents and motivate them to respond, after designing and arranging the questionnaire, the researcher has prepared a letter that determines the identity of the researcher and the purpose of the research, in which he has assured the respondents that the answers provided will remain confidential. The draft of the questionnaire has been reviewed several times from different perspectives before the final adjustment, and its drawbacks have been minimized. Accordingly, it is reliable. The questionnaires were distributed in person (manually) among all the participants to collect the required data.

Research data analysis method

The data analysis method will be conducted using SPSS software to describe the demographic information (descriptive statistics) of the studied variables. This research is the type of survey study that its data were analyzed. The data were analyzed by the statistical method using SPSS software and structural equations using SPLS software. In the end, the results of path analysis and causal relationships between research variables will be interpreted in a conceptual model.

Research model

Each of the research questions has been analyzed individually using the structural equation modeling. Furthermore, the general model of the research is arranged using Smart PLS software. The research question is as follows: Is there a relationship between the effects of the dimensions and components of corporate governance and stakeholders?

Fitting the measurement model:

Convergent validity and reliability

The questionnaire will have convergent validity if the correlation between the scores of the tests that measure a single aspect is high. It is essential to have this correlation to ensure that the test measures what ought to be measured. The average variance extracted (AVE) and composite reliability (CR) are calculated for convergent validity. The following relationships must be confirmed:

$$AVE>0.5 \qquad CR>AVE \qquad CR>0.7$$

Table 1. Convergent validity and reliability of research variables

Latent variables	Cronbach's alpha	CR	AVE
Effects of ownership	0.971	0.879	0.836
Board effectiveness	0.884	0.945	0.806
Stakeholder's rights	0.985	0.941	0.791
Beneficiaries	0.963	0.970	0.845
Transparency	0.988	0.952	0.886
Social responsibility	0.801	0.933	0.654

Cronbach's alpha of the variables is greater than 0.8, so the reliability of all variables is confirmed. The value of average extracted variance (AVE) is always greater than 0.5; therefore, convergent validity is also confirmed. The value of composite reliability (CR) is also greater than AVE. Fornell Larcker test:

Table 2. Correlation coefficients between latent variables (Fornell-Larcker test)

	Effects of ownership	Board effectiveness	Stakeholder's rights	Beneficiaries	Transparency	Social responsibility
Effects of ownership	0.860					
Board effectiveness	0.546	0.837				
Stakeholder's rights	0.438	0.471	0.800			
Beneficiaries	0.307	0.307	0.404	0.919		
Transparency	0.450	0.470	0.558	0.382	0.821	
Social responsibility	0.540	0.579	0.451	0.609	0.378	0.874

The root mean extracted of each latent variable is greater than the maximum correlation of that latent variable with other latent variables. Therefore, the divergent validity of the measurement model was confirmed using the Fornell-Larcker test.

Structural model fit

Table 3. Values R2 and Q2 of model structures

Latent variables	R^2	Q^2
Beneficiaries	0.851	0.671

As the values of R2 and Q2 related to the endogenous structures of a model are greater, the model has better fit. This table confirms the suitability of the structural model for both Q2 and R2 criteria. Furthermore, a value of predictive power (Q2) above 0.5 indicates a high predictive power indicator for the variable.

GOF criterion

Overall Fit Test Formula (Tenenhaus et al., 2004)

$$\mathrm{GoF} = \sqrt{\overline{\mathrm{Communalities}} \times \overline{R^2}} \tag{1}$$

So in here, communalities indicate the average of the common values of each structure and also the value of the average values of the coefficient of determination of endogenous structures of the model. Wetzels et al. (2009) introduced three values of 0.01, 0.25, and 0.36 as a weak, medium, and strong values for GOF.

Table 4. Common values of each structure

Structures	Common value	R^2	*GOF*
Beneficiaries	0.671	0.851	0.618

The overall fit value or GOF criterion is 0.618, which indicates a strong overall fit of the research.

Model predictive power or common redundancy

Table 5. Predictive power of variables model

	SSO	SSE	Q^2 (=1-SSE/SSO)
Effects of ownership	3,840.000	2,637.176	0.313
Board effectiveness	11,136.000	7,185.758	0.355
Stakeholder's rights	6,528.000	3,834.679	0.413
Beneficiaries	2,304.000	616.725	0.732
Transparency	13,440.000	8,942.009	0.335
Social responsibility	6,912.000	4,333.772	0.373

The predictive power of the model for the variables is above 0.313, which is in the above the intermediate range.

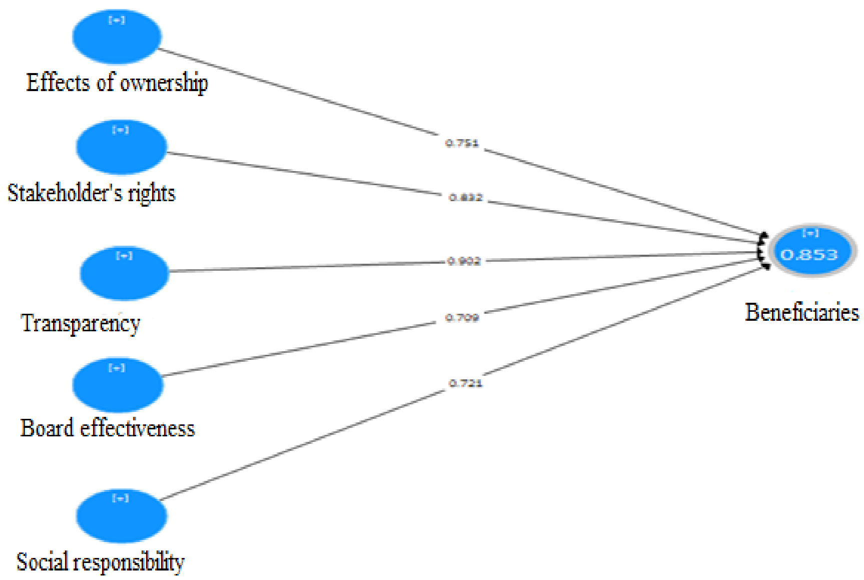

Figure 2. The initial model (corporate governance) in the estimation of standard coefficients

The ultimate model of structural equations for the effects of corporate governance

In this research, the relationship between variables in hypotheses has been tested based on a causal structure with PLS. The general research model calculated the measurement model (the relationship between each of the visible variables with the latent variable) and the path model (the relationship between the latent variables with each other). This model presented a summary of the results related to the standard factor loading of the research variables.

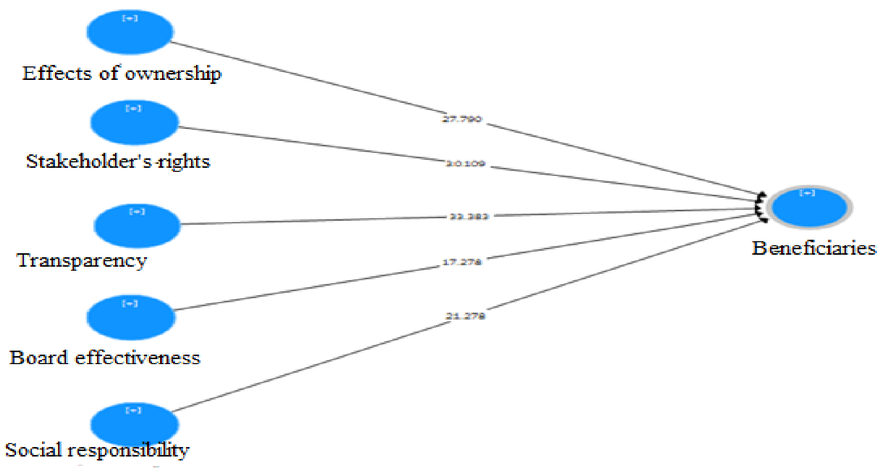

Figure 3. The last model after modification (corporate governance) with the t value

The results of the test of this question indicated that the value of the path coefficient, the dimensions of corporate governance, i.e., 0.751, 0.832, 0.902, 0.709, 0.721, respectively, are positive for the effects of ownership, shareholder rights, transparency, the effectiveness of the board of directors, and social responsibility. The t-value and the level of significance for the effects of ownership, shareholders' rights, transparency, the effectiveness of the board of directors, and responsibility were reported at 27.790, 30.109, 33.398, 17.278, and 21.278, respectively, which was significant at the level of 99%. Accordingly, the null hypothesis of the research is rejected, and the opposing hypothesis is confirmed. In other words, the dimensions of corporate governance are confirmed in the model.

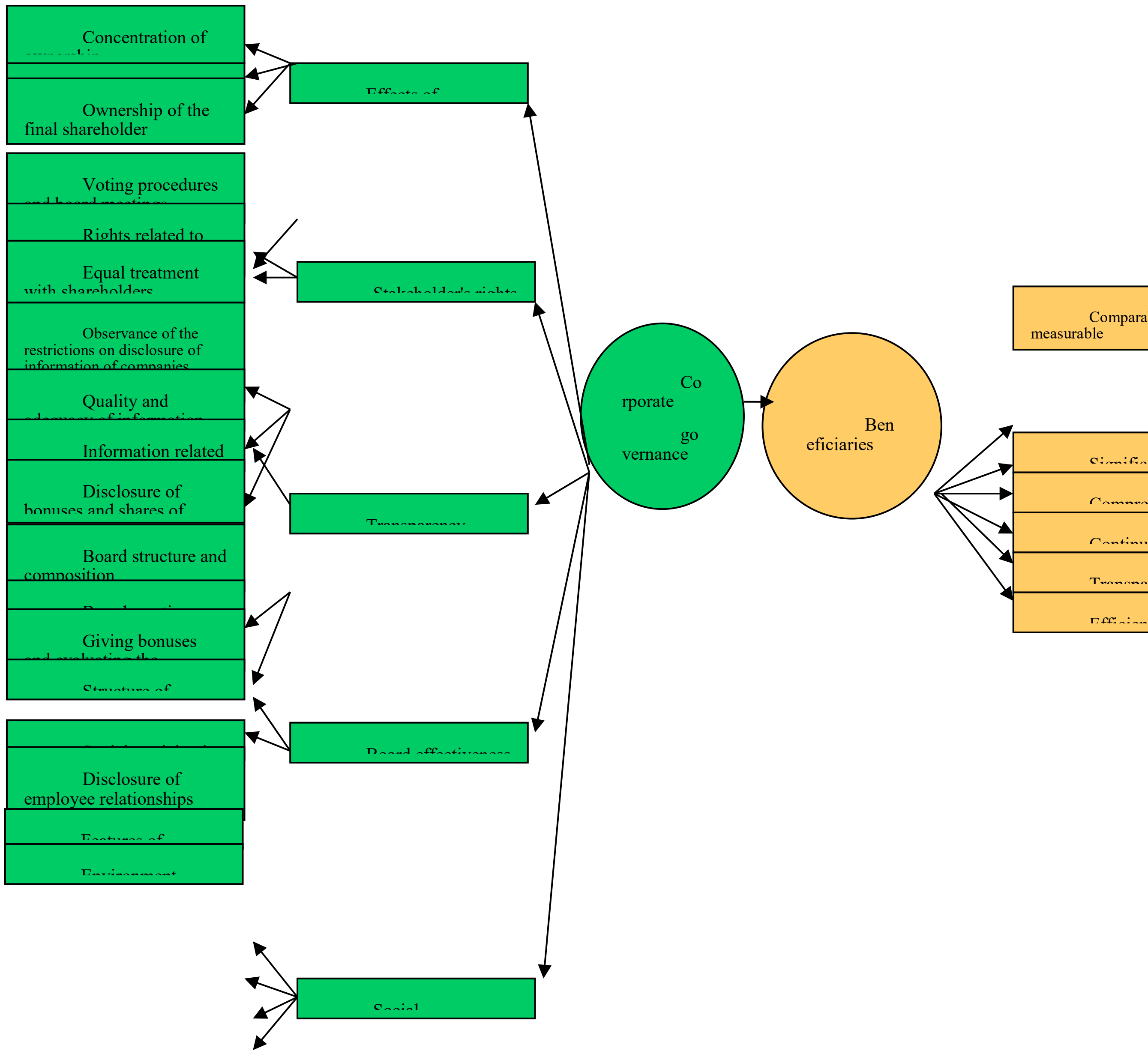

Figure 4.The final model of the research

Conclusion

The value of the path coefficient, the effects of the dimensions and components of corporate governance, and stakeholders is positive. The null hypothesis of the research is rejected, and the opposing hypothesis is confirmed. There is a relationship between the effects of corporate governance dimensions and stakeholders. The amount of direct effect indicates a strong and high effect size. Holdings improve their business performance by developing a specific model of corporate governance. As a result, the implementation of corporate governance needs a proper understanding of the requirements and its application in the appropriate conditions of that country. The requirements to implement corporate governance include: transparency of ownership and ownership level of institutional shareholders, preparation and approval of regulations of joint stock companies with modern business needs, especially holdings, paying special attention to the need to create specialized committees under the supervision of the board, including the audit committee, structure and composition of board members and governance structure of each company, paying special attention to the preparation and full establishment of external controls, paying special attention to the importance of equal and fair treatment with all shareholders, the manner of giving bonus and evaluating the performance of managers, the manner and necessity of information disclosure, implementation of mechanisms of corporate social responsibility. As a law enforcement system, corporate governance must also put environmental and social considerations in its framework.

Corporate governance needs to emphasize the responsibilities of the business to all the various stakeholders and provide the required resources for its survival, competition, and success. Accordingly, managers must be accountable to both shareholders whose wealth is at risk and employees, suppliers, customers, and communities whose investments in the company are equally significant in other important regards. Therefore, the interest of all stakeholders should be considered, which is presented as managerial performance and shareholder rights. The implementation of corporate governance with five dimensions reduces information asymmetry and makes the company accountable to all stakeholders, and reduces the risk of the company's activities. Therefore, it contributes to the ethical business following the legal norm and causes better financial performance.

Research suggestions

According to the results of the research, it is suggested that companies should consider ownership effects in their corporate governance in the form of ownership concentration, ownership transparency, and ownership of final shareholders. The rights of shareholders include voting procedures and assembly meetings, rights related to dividends and equal treatment with shareholders. In relation to transparency in the field of corporate governance, it includes compliance with the information disclosure regulations of companies admitted to the stock exchange, the quality and adequacy of information disclosure, information related to auditing, disclosure related to bonuses and shares of board members. Also, in their corporate governance, companies should consider the effectiveness of the board of directors in the form of structure and composition of the board of directors, regular board meetings, reward and performance evaluation, governance structure. Finally, in the field of corporate governance, companies can consider social responsibility in the form of social participation, disclosure of employee relations, characteristics of products/services, and the environment.

Declaration of Conflicting Interests

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