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Evaluate the Effect Corporate Governance the Components on the Free Cash Flow of the Companies Listed in Tehran Stock Exchange

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Abstract: This study aims to investigate the relationship between corporate governance with the free cash flow in companies listed on the stock exchange in Tehran. In fact we are looking to determine whether corporate governance, important and significant impact on the free cash flow of the company or not? Hence number, 500 companies in the period 2008-2012 were examined. Corporate governance and its components as independent variables and the dependent variable amount of the free cash flow, calculated. In order to test hypotheses, Pearson correlation and regression methods were used panel data methods. The result is a positive relationship between the percentage of institutional shareholders, the percentage of ownership concentration, composition board and the free cash flow confirmed.

Key words: The percentage of institutional shareholders, the percentage of ownership concentration, composition of the board of directors, corporate governance, the free cash flow

INTRODUCTION

In recent years, considerable progress in the establishment of corporate governance through legislation and regulation and voluntary measures in developed countries and developing companies have been made. Investors and shareholders have been greater awareness the necessity and importance of corporate governance and the pursuit of the establishment of this system have been interested in the company. Some empirical research suggests a positive relationship between corporate governance and efficiency of the Company. A general statement of corporate governance, control and guidance system of the company. The system determines the relationship between the company and its stakeholders will control and direct. Corporate governance at the micro level and macro-level resource allocation to achieve the company's goals will follow. In general, corporate governance including legal arrangements, institutional culture and the direction of motion and determine the company's performance (Kashanipoor, 2009). The most basic element of the corporate governance practices ensure the proper governance of the company's shareholders on corporate governance for management to provide control and balance the interests of managers and shareholders and thus reduces the contrast agent is created (Izadinia and Amir, 2009). Therefore, companies that have better corporate governance should be less difficult to face opposition representatives. On the other hand free cash flow is a measure of the company's financial flexibility and cash shows that after doing the necessary funding for the maintenance or development of assets at its disposal. Without cash, new product development, conduct of business education, pay equity and debt interests is not possible. The concept of positive the free cash flow shows that the company after payment of costs and investments of surplus cash. Must be noted, a negative value indicates that the company has enough money to cover their investment costs and activities not made. Negative free cash flow can be a symptom of many problems for the company (Moradzadehfard*et al*., 2008).

Background of research: Lim *et al*. (2014) a non-linear relationship between concentration of ownership and reported delays in reporting. Domestic and foreign companies as the largest shareholder of price discovery are less timely. When the delay in the reporting period following the merger of corporate governance in Malaysia in shorter exchange regulations, its impact on the timeliness of price discovery is largely unimportant.

El-sayed and Wahba (2013) in their study to investigate the relationship between ownership structure and management of inventory in 1076 the company paid during the period 2000 and 2010, the results of their study showed that institutional investors, property management, board structure and board size there is a significant relationship with inventory management board.

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Fatma and Chichti (2011) concluded that based on the theory of free cash flow (Jensen, 1986), debt policy as the main governance mechanism can limit the risk of cash flow. The free cash flow hypothesis states that where debt managers the opportunity to reduce waste of resources on the shares to debt financing will increase the company's value.

MATERIALS AND METHODS

The study of the correlation and methodological research in the field of research proving the Quasi-experimental and post-event accounting is done with actual data and because it can be used in the process of using information, it is a kind of applied research. The population of the investigation all industry groups Tehran stock exchange from 2008 until 2012 in stock which have been active.

Research hypotheses:

- H_1: the relationship between the percentage of institutional investors and significant the free cash flow
- H_2: the relationship between the percentage of ownership concentration and significant the free cash flow
- H_3: free cash flow is a significant relationship between the size of the board and there
- H_4: the relationship between the composition of the board of directors and significant the free cash flow

Research variables

Independent variables

Percentage institutional shareholders: The group of shareholders with respect to the ownership of a significant proportion of the company's shares have enjoyed considerable influence in these companies be they policies (including accounting practices and financial reporting) influence. Also, because the largest group of shareholders comprised of institutional owners. Their role in the monitoring procedures implemented by the management of great importance and is expected to approach the owners of shareholders on the company. Institutional owners have a strong motivation to oversee financial reporting. The amount of property held by institutions and foundations, semi-government departments and charities and institutional investors (natural persons) for firm i in year t measured.

Concentration of ownership: Active monitoring hypothesis states that the major shareholders of the management company in order to manage the company's voting or decision uses. In contrast, self-interest hypothesis states that owners of its power to administer the company in the course of their choice. The case is referred to the remarkable amount of shares to major shareholders belong and shows the percentage of the company's shares are in the hands of a few. To measure and calculate these variables refer to the notes to the financial statements percent stake is in the hands of major shareholders above 5% is added.

Board of directors size: That total members of the board of directors (obliged and non-obligated) for firm i in year t measured.

Composition of board of directors: That as the division of the board of directors and all members of the board of directors member obliged for company i in year t measured.

Dependent variables

The free cash flow: In this study, Lehn Kenneth and Annete Poulsen used to measure the free cash flows of the entity. According to the model, free cash flow is calculated by the following equation:

$$FCF_{it} = (INC_{it}\text{-}TAX_{it}\text{-}INTEP_{it}\text{-}PSDIV_{it}\text{-}CSDIV_{it})/A_{i,\,t\text{-}1}$$

Where:

$FCF_{i,\,t}$ = Free cash flow of firm i in year t
$INC_{i,\,t}$ = Operating profit before amortization of firm i in year t
$TAZ_{i,\,t}$ = The total tax paid by the company i in year t
$INTEP_{i,\,t}$ = The cost of interest paid by the company i in year t
$PSDIV_{i,\,t}$ = Profit paid by shareholders, company i in year t
$CSDIV_{i,\,t}$ = Profit shareholders ordinary of firm i in year t
$A_{i,\,t\text{-}1}$ = The total book value of assets of the company i in year t-1

The research model:

$$FCF_{it} = \alpha_0 + \alpha_1\, INSIDER_{i,t} + \alpha_2\, Own_{i,t} + \alpha_3\, B\,SIZE_{i,t} + \alpha_4\, CBM_{i,t} + \varepsilon_{i,t}$$

Where:

FCF = Free cash flow
INSIDER = Percentage institutional shareholders
Own = The concentration of ownership
B Size = The board of directors
CBM = Composition of the board of directors

RESULTS AND DISCUSSION

Hypotheses:

- H_1: the first hypothesis is a significant relationship between the percentage of institutional shareholders and the free cash flow there

The relationship between the percentage of institutional shareholders and a free cash flow statistic t 3/048 and p-value to 0/0025 at the level of 5% is significant. This variable coefficient is 0.414 indicating a direct correlation between the percentage of institutional shareholders and there is free cash flow. In keeping other factors constant by changing a single variable percentage of institutional shareholders, the the free cash flow will increase at a rate of 0.414 (t ratio is a statistical distribution. Theoretical distribution of t, the probability that the statistic exceeds the critical value specifies. If t ratio exceeds a critical value, the null hypothesis is rejected and otherwise not) (Table 1).

- H_2: relationship between the percentage of ownership concentration and significant the free cash flow

The relationship between the percentage of ownership concentration and free cash flow statistic t 14/995 and p-value equal to 0/0000 levels the error is 5%. This variable coefficient is 0.673 indicating a direct relationship between the percentage of ownership concentration and there is free cash flow. In keeping other factors constant by changing a single variable to the percentage concentration of ownership, the free cash flow rate is increased at a rate of 0.673 (t ratio is a statistical distribution. Theoretical distribution of t, the probability that the statistic exceeds the critical value specifies. If t ratio exceeds a critical value, the null hypothesis is rejected and otherwise not) (Table 2).

- H_3: the relationship between the composition of the board of directors and significant the free cash flow

The relationship between the composition of the board of directors and free cash flow statistic t 516/6 and and p-value equal to to 0/0000 levels the error is 5%. This variable coefficient is 0.548 and show a direct correlation between the composition of the board and there is free cash flow. In keeping other factors constant by changing a single variable composition of the board of directors, the the free cash flow will increase at a rate of 0.548 (t ratio is a statistical distribution). Theoretical distribution of t, the probability that the statistic exceeds the critical value specifies. If t ratio exceeds a critical value, the null hypothesis is rejected and otherwise not) (Table 3).

Table 1: Using panel data regression (first hypothesis)

	Dependent variable (free cash flow)		
Variables	Coefficient	t-statistics	p-values
Y-intercept	0.152	3.047	0.0025
Percentage institutional shareholders	0.414	3.048	0.0025
R^2	4.2%	Dorbin-Watson	1.8870
Test result	Hypothesis confirmation		

Table 2: Using panel data regression (second hypothesis)

	Dependent variable (free cash flow)		
Variables	Coefficient	t-statistics	p-values
Y-intercept	0.153	3.076	0.0022
Percentage ownership concentration	0.673	14.995	0.0000
R^2	0.05	Dorbin-Watson	1.9380
Test result	Hypothesis confirmation		

Table 3: Using panel data regression (third hypothesis)

	Dependent variable (free cash flow)		
Variables	Coefficient	t-statistics	p-values
Y-intercept	0.151	4.711	0.0009
Composition of the Board of directors	0.548	6.516	0.0000
R^2	0.12	Dorbin-Watson	1.8420
Test result	Hypothesis confirmation		

CONCLUSION

When the growth and investment opportunities are limited, managers lose his investments with higher risk and higher return company is different from the current operation. In such a situation, the company's profits will fluctuate and administrators to curb these fluctuations, the risk of investment would be smoothing action. One of the important aspects of earning its role in the financing agreements. There liabilities in addition to being one of the motivating factors for earnings management. Could reduce opportunistic behavior by managers to reduce fluctuations Tlbanh profit entity and therefore, result in a decrease in earnings management. The factors that can influence the behavior of managers Tlbanh opportunity, free cash flow and growth opportunities and investment company. A summary of the results is as follows:

- The first hypothesis is a significant correlation between the percentage of institutional shareholders and the free cash flow there

According to a Sig. results of 0/0025 can be said that the percentage of institutional shareholders and the free cash flow is meaningful relationship. This means that a company that has a high percentage of institutional shareholders, the company's the free cash flow is an issue in a high level. In other words, the hypothesis that there is a correlation between the percentage of institutional shareholders and the free cash flow Shvd.yafth confirms the hypothesis that the association percentage institutional shareholders and the free cash flow with the findings of other researchers including Harford *et al.* (2008). Given that our results correspond with the findings of the literature is consistent, it can be said that a strong hold and are supported by theoretical assumptions based on reliable theoretical basis.

- The second hypothesis significant relationship between the percentage of ownership concentration and the free cash flow there

According to a Sig. obtained that can be said of 0000/0 between the percentage of ownership concentration and free cash flow is meaningful relationship. Correlation between concentration of ownership and free cash flow with the findings of other researchers including Harford *et al.* (2008). Given that our results correspond with the findings of the literature is consistent, it can be said that a strong hold and are supported by theoretical assumptions based on reliable theoretical basis.

- The third hypothesis free cash flow is a significant relationship between the size of the board of directors and there

According to a Sig. obtained that can be said is equal to 0/0000 and free cash flow is a significant relationship between the size of the board of directors there. The size of the board and free cash flow with the findings of other researchers including Harford *et al.* (2008). Given that our results correspond with the findings of the literature is consistent, the be supported by theory and hypotheses it had a strong hold on the basis of reliable theory is based.

In general, companies with good corporate governance are (whether they are strong or weak corporate governance) more free cash flow, i.e. in such companies, less investment takes place. Also, companies with good corporate governance are at the same levels of the free cash flow less corporate governance ability. This means that in some cases including when the company needs less supervision, poor corporate governance can be controlled by the agency is sufficient.

Companies with poor corporate governance to companies with strong corporate governance, not necessarily more free cash flow. Overall, these results indicate that the quality of corporate governance, corporate governance in the ability the free cash flow is a significant relationship. Thus, the results indicate that the quality of corporate governance is one of the determining factors affecting free cash flow. Finally, an important aspect of this study, the use of past performance of the company as one of the measures represent additional cost and is adequate corporate governance. Free cash flow and growth factors influencing the opportunistic behaviors of managers with respect to the behaviors of earnings management may affect the rate of interest. High levels of free cash flow and growth opportunities and low investment managers to lead the venture capital that profits fluctuate and therefore uses its profits to smooth their management practices but when these companies are gradually involved increasing financial leverage, debt is a limiting factor in managers opportunistic behaviors and it reduces the amount that reduces the profit fluctuations caused by such behavior and to reduce the profitability and investment leads Ineffectiveness of institutional investors to increase free cash flow, confirming the hypothesis of the convergence of interests and respect institutional investors to short-term profit which causes the common policies in the interests of managers and their companies, not companies.

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