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The Effect of Political Relevance on the Rate of Adjustment of Financial Leverage in Firms Listed on the Tehran Stock Exchange

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Abstract

Objectives: The main purpose of this study is to investigate the effect of political communication on the speed of adjustment of financial leverage.

Design/methodology/approach: To achieve the research objectives, a sample of 130 firms listed on the stock exchange that were selected according to a systematic exclusion pattern was collected for 7 years, from 2016 to 2022. To test the research hypotheses, a linear multivariate regression model was used.

Findings: Testing the research hypotheses showed that the financial leverage of the firm depends on the speed of its adjustment during its periods, but political communication does not affect the speed of adjustment of the financial leverage.

Innovation: Current research provides evidence that the political relations of managers could not help them develop financial leverage.

Keywords: Adjustment Speed, Financial Leverage, Political Communication.

1. Introduction

Flexibility is a feature that allows an enterprise to control and manage uncertainty. Financial flexibility is defined as the degree of capacity of a company to mobilize its financial resources in response to activities that maximize the value of the company. It is the most important part of determining the firm's leverage and can be used to maintain borrowing capacity. To study and develop the future of the enterprise, or to minimize debts and prevent financial distress in the face of economic recessions (Salehinia and Tamradi, 2019). The speed of adjustment of financial leverage reflects the company's move toward an optimal capital structure and clearly shows the financing policies of the firm. The importance of leverage optimization is such that the growth and survival of companies depend on this factor. Optimal financial leverage is a combination affected by the proper and targeted use of financial resources and earning reasonable returns with the risks of these resources. The speed of movement of firms toward optimal ratios depends on various factors, with the cost of adjusting the financial leverage being one of the most important factors (Hashemi & Keshavarz Mehr, 2015). The most important issue in the research on capital structure of enterprises is the correct estimation of their speed of movement towards the target leverage. Most firms deviate from their target capital and often take action to adjust their capital structure when the benefits of adjusting capital structure outweigh its costs. According to dynamic balance theory, it can be argued that each of the firms faces different adjustment costs considering their characteristics and consequently, with different speeds, companies are moving towards their target leverage (Rameshe et al., 2016).

The theory of political economy has entered the economic literature of the world since the second half of the twentieth century, with the spread and influence of the liberal school of thought. This theory has not only been considered by economists and politicians, but sociologists have also provided works in the development and explanation of this theory, which is based on the fact that economics and politics have mutual influence. This means that political action and decision-making are intertwined. Political activity and decision-making have a direct and indirect impact on economic activities and vice versa (Khalife Soltani et al., 2018). The interdisciplinary field of political communication, which connects the two main fields in the social sciences, communication, and political science, is a relatively new realm in terms of its academic background and its beginning, from an academic perspective, to research and scientific studies of the 1950s. Michael Rush gives a fairly comprehensive definition of political communication: Political communication is the transfer of politically appropriate information from one part of the political system to another between social and political systems. Appropriate information is not only about the real issues (what happened) but also the transmission of ideas, values, and attitudes. Now the fundamental question is whether these political relations can change the capital structure of the enterprise or not, whether these connections benefit or disadvantage the enterprise? In the continuation of the structure of the research, firstly, the development of the theoretical foundations, hypotheses and experimental foundations of the research are presented, and then the implementation method and operational definitions of the research variables and finally the findings and conclusions of the research are presented.

Hypothesis development

Optimal leverage is a measure of debt-to-asset ratio in which the value of the company is maximized and the total cost of capital is at the least possible (Behbahani et al., 2018). Therefore, managers are always looking to choose the optimal capital structure to show the company's status and performance to the stakeholders. Chang and All (2014). Hence, the optimal capital structure is determined as the target capital structure that companies are trying to put their actual capital structure within its limits. Based on theoretical concepts, managers should plan the optimal capital

structure of the company (Nazemi Ardakani & Zaree, 2016).

The economy has many horizons and is influenced by a variety of factors, including political relations, the financial situations of firms, and their financial levers. Political and economic relations are inseparable, political influence in determining economic outcomes has become very powerful and affects macroeconomic decisions. The impact of politics at the domestic level of countries and smaller units has been proven. At the macro level, it is caused by alternations and changes in political power and changes in regulation and policies, such as the presidential election. Before elections, businesses operate under the possibility that unpredictable and specific political situations may lead to poor decision-making and worse performance. After the election, subsequent changes in laws and regulations and financial, monetary, and foreign policy will have a long-term impact on the decision-making of an enterprise. These policy changes may directly affect how the firm makes investment decisions, how it receives and increases capital, and how much it pays for capital (Julio and Yoke (2012 and 2016), Houston, Jiang & Lin (2014), Blizzard and Darnay (2017)). At the micro level, political communication plays a greater role in the day-to-day operations of enterprises. Firms make political investments in the form of political donations, lobbying, and presenting positions and advisory positions. Enterprises with stronger political connections receive more state investment (Dachin and Sociara (2012), Cohen, Caval, and Malloy (2011), Goldman & Rochelle (2009). At the micro level, political communication facilitates access to external financing; political communication is the communication between the government and large enterprises through the performance or capability of operations. In the way that this communication leads to an interaction between the enterprise and the government, the government considers establishing contacts with enterprises as a means of controlling them (Rezaei and Rafieinia, (2014), Rezaei and Afroozi, 2014)).

Political influence and support have two aspects: government political support may create value for enterprises (e.g., firms that have good political ties to the government, pay fewer taxes, take more market share for goods and services, provide loans easily, pay lower customs tariffs, get exemptions, and also get paid by the company. Bringing in the state currency dramatically reduces their import costs to the government and in fact, the political relevance they have helps in the public offering of these firms in the stock exchange, the political enterprises with political connections more easily than other firms and with the minimum cost of the most important concessions). Although government support brings an advantage, such as lower financing costs for these enterprises, it may also lead to high efficiency of the enterprise (Rahnema Roodposhti and Mohseni, 2018). One of the most important tasks of financial managers in achieving the goals of companies is to combine financial resources in the capital structure in an optimal way, so that internal and external risks have the least effect on the deviation of financial leverage from the target financial leverage, and finally, the combination of equity and debt can be the least cost of capital and bring the highest value to the company (Owino and Yukaegbo, 2015). Finally, the managers are trying to use the mentioned advantages in political relations with the government by establishing relations with the government and make optimal use of access to resources and other things, while the government will also include more benefits for its Firms. According to the presented basics, the research hypothesis is presented as follows:

Research hypothesis: Political communication is effective in the speed of adjustment of financial leverage.

Research background

Babaj et al (2024) in a research titled Does economic state matter for leverage adjustments? An India–China comparison they said, We examine the impact of the economic state on capital structure dynamics of Indian and Chinese listed firms using a 10-year sample

period. The empirical analysis is based on the standard partial adjustment mechanism. The economic state (in the base model) is categorised into a good and bad state based on the gross domestic product growth rate. Using system generalised method of moments estimation, our findings suggest that the capital structure speed of adjustment is pro-cyclical for Indian firms, i.e., they exhibit faster adjustments during a good state of the economy than the bad state. In contrast, the speed is countercyclical in the context of Chinese firms, i.e., they exhibit slower adjustments during a good state of the economy and vice versa. Furthermore, consistent with the existing literature, Indian firms do faster rebalancing than the Chinese ones. Our findings are robust across alternate measures of leverage as well as the economic state.

Rostami et al. (2022) conducted a study titled "The Impact of Risk Management on the Pace of Adjustment of Financial Leverage in the Life Cycle Stages of Companies". They found that the speed of adjustment of financial leverage reflects companies' movement towards an optimal capital structure and reveals their financing policies. The significance of optimal leverage is critical for the growth and survival of companies, as it affects risk and expected returns. The study showed that risk management directly influences the speed of adjustment of financial leverage. Specifically, risk management has a direct impact on the speed of adjustment during the growth phase of companies, while it does not affect the speed of adjustment during the maturity phase. In the decline phase, risk management has a negative effect on the speed of adjustment. Overall, managing risks can help companies achieve optimal leverage faster, although this effect diminishes during the transition stages of the corporate life cycle.

Moradi and Parhizkar Malekabad (2021) focused on the impact of inflation rate risk and company-specific risk on the speed of adjustment of capital structure. They concluded that both inflation rate risk and company-specific risk negatively affect a company's financial leverage and slow down the speed of adjustment toward target leverage. Internal risks within the company have a more significant impact on the speed of adjustment compared to external factors.

Asadi et al. (2021) explored the relationship between financial situation, industry characteristics, and the speed of adjustment of capital structure. They found that companies with a higher debt ratio than the target ratio are more inclined to reduce their debt. Companies under centralized leverage are less likely to adjust their debt ratio, while those above dynamic leverage tend to reduce their debt ratio faster.

Sabzi et al. (2021) studied the effect of recession and boom on the speed of adjustment of capital structure. They determined that capital structure adjusts towards the goal regardless of the financial sector's boom or recession, and the real economy has no impact on the speed of adjustment.

Khalifeh Soltani et al. (2018) explored the impact of political communication on the risk of stock price crash under information asymmetry. They found that political communication has a positive and significant impact on the risk of a stock price crash, as managers withholding bad news can lead to a stock price crash in the long run.

Rahnemaye Roudposhti and Mohseni (2018) concluded that government and political interference in a company's board of directors can disrupt decision-making processes and negatively impact business operations.

Chalaki et al. (2018) investigated the mediating role of financial flexibility in explaining the relationship between management ability and financial distress. They found a positive relationship between management ability and financial flexibility, while financial distress was negatively correlated with both management ability and financial flexibility.

Davoodi Nasr and Habibi (2017) studied the effect of political communication on real earnings management and found that the reward plan affects the relationship between political communication and real profit management.

Geo et al. (2017) discovered a positive and significant correlation between capital expenditure and deviation from optimal capital structure. Companies

with higher sensitivity in capital expenditure tend to adjust their capital structure at a faster rate.

Rahmani (2016) investigated the relationship between political communications and cash holdings in companies listed on the Tehran Stock Exchange. They found a negative and significant relationship between cash holdings and political communications, indicating that cash holdings decrease with an increase in political costs.

Sheeri Anaghiz et al. (2015) studied the relationship between financial flexibility and the speed of adjustment of capital structure in firms listed on the Tehran Stock Exchange. They found a positive and significant relationship between financial flexibility and the speed of adjustment for firms operating under optimal leverage.

Trang et al. (2022) conducted a study titled "Product Market Threats and Leverage Adjustment" and found that the impact of product market threats on leverage adjustment is more significant for companies with poor governance quality and exposure to these threats. Achieving the target capital structure ultimately increases the company's value.

Wua and Tai (2021) explored "The Impact of COVID-19 on the Speed of Leverage Adjustment" and discovered that, on average, companies adjusted their capital structure more rapidly after the COVID-19 outbreak. Companies in countries severely affected by COVID-19 adjusted their target leverage faster than those in less affected countries.

Chen et al. (2021) in their study "Foreign Ownership and the Speed of Leverage Adjustment" established a positive relationship between external institutional ownership and the speed of corporate leverage adjustment. Foreign institutional investors play a crucial role in reducing conflicts between shareholders and directors.

Maloul et al. (2018) investigated the impact of political communication on the performance and value of Tunisian economic firms. Their findings showed that political communication enhances firm performance and value, attracting investors to economically connected firms with higher profits.

Wang et al. (2017) concluded in their study "Investigating Political Communications and Fraudulent Financial Reporting with an Emphasis on Management Ability" that as management ability increases, financial reporting quality improves, particularly in non-governmental enterprises.

Norfrisal et al. (2017) examined the relationship between firm governance, political communications, and accounting conservatism, finding no significant correlation between government governance, political communication, and accounting conservatism.

Ideham and Imrashan (2017) found in their study on the impact of political communication on earnings management that politically connected companies tend to report lower profits, while self-directed companies do not significantly influence earnings management behavior.

Ling et al. (2016) discovered that firms with stronger political connections have easier access to long-term financing sources, though this intervention by politicians may weaken the firms in the long run.

Harry Mawan and Nuland (2016) analyzed political communications and profit quality in Indonesian companies, observing that profit quality increases with political connections due to improved government effectiveness but decreases with political stability.

Wang (2015) found that political managers in government-controlled firms exacerbate the risk of stock price crashes while hiring political individuals in private firms reduces this risk. Institutional quality does not mitigate the positive correlation between political communication and stock price risks.

Li and Zhou (2015) studied the relationship between political connections and access to China's stock exchange, revealing that political communication significantly impacts IPOs, with politically connected firms facing lower scrutiny during initial public offerings.

Oztekin (2015) examined factors influencing capital structure decisions and leverage adjustment speed globally, finding that institutional factors

significantly affect leverage adjustment speed, with high-quality institutions leading to faster adjustments.

Viet An Dong et al. (2013) investigated capital structure adjustment in U.S. companies from 2002-2012, noting the negative impact of the global financial crisis on leverage adjustment speed, with finite-finite firms adjusting their capital structure more rapidly pre-crisis.

Falkander et al. (2012) concluded in their study on the effect of cash flow and trading costs on leverage adjustments that operational cash flow allows for low-cost leverage adjustments, impacting both target leverage and adjustment speed.

In 2009, Maramour explored the relationship between financial leverage and firm performance, establishing a significant correlation between the two.

Research Methodology

Due to the existence of basic theoretical foundations related to the studied variables, the present study is classified as applied research in terms of the purpose of implementation and terms of the method of execution. This classification is due to the lack of investigation of the effect of changing one variable (independent) to measure its effect on another variable (dependent). Additionally, the study aims to investigate the variables as they are, without tampering with them, making it classified as descriptive-causal research.

Furthermore, historical and post-event data were collected using the library and archival methods to test the research hypotheses. The statistical population of the study includes all listed companies on the Tehran Stock Exchange. Companies with financial periods other than the end of March, those that changed their financial period during the research period, companies with insufficient information for comparability, as well as investment companies, banks, and insurance companies were excluded to ensure homogeneity of the required data.

A total of 130 companies were selected using a systematic screening pattern, and their data were collected for a period of 7 years from 2016 to 2022. Combining data by applying the dimensions of time and place in different periods provides the researcher with complete and reliable information. Regression analysis using a powerful standard error tool is considered the best option for investigating the relationships in the present research.

A multivariate linear regression model was applied to the combined nature of the research data after ensuring homogeneity and meeting other preconditions for regression analysis using Eviews 12 software. The use of powerful standard error tools and appropriate statistical methods for the final testing of hypotheses was performed.

Comprehensive regression model of research:

$$
\begin{aligned}
Actual\ Leverage_t\ = (\lambda\beta)\big[\hat{\alpha} + \widehat{\beta_1}(M/B)_{i,t-1} \\
+ \widehat{\beta_2} Aseet\ tangibility_{i,t-1} \\
+ \widehat{\beta_3} Porfitability_{i,t-1} \\
+ \widehat{\beta_4} R\&D\ Expense_{i,t-1} \\
+ \widehat{\beta_5}\ R\&D\ Dommy_{i,t-1} \\
+ \widehat{\beta_6} Selling\ Expenses_{i.t-1} \\
+ \widehat{\beta_7}\ Firm\ Size_{i,t-1}\big] \\
+ \big[(1-\lambda) Actual\ Leverage_{i,t-1}\big] \\
+ \big[(1-\lambda) Actual\ Leverage_{i,t-1}\big] \\
\times Politics
\end{aligned}
$$

Table (1), Operational Definitions of Variables

Definitions	Symbol
Real leverage of this year (total liability/total assets)	$Actual\ Leverage_t$
Real leverage last year	$Actual\ Leverage_{t-1}$
Stock market value/book value of equity	$Market\_to\_Book\ (M\ /\ B)$
Fixed Asset / Total Asset	$Asset\ Tangibility$
Net profit / Total assets	$Profitability$

Definitions	Symbol
R&D cost divided by total sales	*R&D Expense*
R&D If a company does not report a number 1 on it, otherwise the cost is zero.	*R&D Dommy*
Sales/Sale Costs	*Selling Expenses*
Logarithm of Total Assets	*Firm Size*
Political Communication: If the largest shareholder of an enterprise is a public sector, the number is 1, and otherwise the number is zero.	*Politics*

Research Findings

Descriptive statistics of research variables:

Table 2 displays descriptive statistics. In descriptive statistics, the mean and standard deviation play a crucial role as they indicate the distribution. From the first table, it is evident that the average financial leverage of companies is approximately 0.53 percent. For instance, the average growth rate of companies is 4.72 percent. Interestingly, company growth exhibits the highest standard deviation, while the cost of research and development has the lowest standard deviation.

As shown in Table 3, 387 (42.53%) of the companies were politically connected, while 523 (57.47%) were not politically related. Additionally, 749 (82.31%) of the year-firms did not disclose research and development costs, while 161 (17.69%) of the year companies had disclosure in their financial statements.

The results in Table 4 show that the significance level of the test in the research model is less than 5%. This indicates a difference in variance in the disruptive sentences, which has been resolved in the final estimation of the model by implementing the GLS command.

According to the results of Table 5, it is observed that the significance level of the serial autocorrelation test for the research models is more than 5%, indicating the absence of serial autocorrelation in the model.

According to the results obtained in Table 6, it is observed that the significance level of variables in the stability test is less than 5%, indicating the stability of the variables.

According to the results obtained in Table 7, it is observed that the significance level of the test for the research models is less than 5%, indicating the acceptance of the panel data pattern. Additionally, the significance level of the test in the research model was less than 5%, indicating acceptance of the fixed effects of the width from the source.

The results of Table 8 indicate that the rate of adjustment of financial leverage is approximately 53%, meaning that companies can reduce the annual gap between real and optimal leverage by 53%. The key coefficient in this study is the political communication coefficient, as shown in the table above, with a significant level above 5% (0.10), indicating that political relations do not impact the speed of adjustment of financial leverage. This implies that political communication does not influence the speed of adjustment of leverage to achieve optimal levels. Therefore, the research hypothesis is rejected at a 5% error level.

The variables of company growth, investment growth, and sales cost ratio exhibit a significant relationship with the dependent variable of the research. The coefficient of determination is 92%, suggesting that the independent and control variables in the model explain 92% of the dependent variables. Additionally, the Durbin-Watson statistic is 1.94, indicating no serial autocorrelation in the model. Statistical tests with a significance level below 5% demonstrate that the research model fits well. The Durbin-Watson test is close to 1, below 5, suggesting no correlation between the research variables.

Table (2), Descriptive statistics of quantitative variables of research

Variable	Mean	S. dev.	Min.	Max.
ACTUAL_LEVERAGE	0.53	0.53	1.10	0.10
ASSET_LONGIBILITYT_1	0.26	0.22	0.80	0.019
MBT_1	4.72	2.94	15.98	1.01
PROFITABILITYT_1	0.13	0.10	0.59	0.20-
R_DT_1	0.0004	0.0000	0.022	0.0000
SELLING_EXPENSEST_1	0.73	0.75	1.16	0.19
SIZET_1	14.7	14.4	20.18	11.40

Table (3), Frequency Distribution of Qualitative Variables

Variable	Value	Frequency	Percent Frequency
politics	1	387	42.53
politics	0	523	57.47
Dummy R&D	1	749	82.31
Dummy R&D	0	161	17.69
-	-	910	100

Table(4), Variance Heterogeneity Test Results

Test Model	Test Statistics	Significance level
White	210.83	0.0000

Table(5), serial autocorrelation test results

Test Model	Test Statistics	Significance level
Breusch-Godfrey	5.59	0.061

Table (6), Stability Test Quantity Variables

Variable	Test Statistics	Sig	Results
ACTUAL_LEVERAGE	-21.4757	0.0000	Stationary
ACTUAL_LEVERAGE-1	-16.7793	0.0000	Stationary
ASSET_LONGIBILITYT_1	-26.3076	0.0000	Stationary
MBT_1	-3.59660	0.0000	Stationary
PROFITABILITYT_1	-12.9462	0.0000	Stationary
R_DT_1	-14.4339	0.0000	Stationary
SELLING_EXPENSEST_1	-12.3176	0.0000	Stationary
SIZET_1	-15.6027	0.0000	Stationary

Table(7), F-Limmer and Hausman test results

Test Model	Test Statistics	Sig
F Limer	1.70	0.0000
Hausman	158.8	0.0000

Table (8), Hypothesis Test Result

Variables	Coef	Std	Statistic t	Sig	VIF
MBT_1	-0.003	0.0009	-3.82	0.0001	1.15
ASSET_LONGIBILITYT_1	0.10	0.037	2.71	0.006	1.19
PROFITABILITYT_1	0.015	0.059	0.25	0.80	2.89
R_DT_1	0.99	0.77	1.28	0.19	1.32
DUMMY_R_D_T_1	-0.021	0.011	-1.81	0.070	1.39
SELLING_EXPENSEST_1	0.10	0.038	2.74	0.006	2.04
SIZET_1	-0.001	0.007	-0.15	0.88	1.17
ACTUAL_LEVERAGE t_1	0.47	0.11	4.12	0.0000	2.27
ACTUAL_LEVERAGE t_1×Politics	-0.025	0.015	-1.61	0.10	1.20
C		0.20	0.16	0.21	-
Coefficient of determination		0.92			
Watson Durbin		1.94			
F		65.077			
Sig		0.0000			

Research Results

The purpose of this study is to investigate the role of political communication in the speed of adjustment of financial leverage. Since the second half of the twentieth century, the theory of political economy has become prominent in economic texts worldwide with the spread and influence of liberalism. This theory has captured the attention of economists, politicians, and sociologists alike in its development and explanation. It is based on the idea that economics and politics mutually influence each other, meaning that political parties' actions and decision-making impact each other. Political actions and decisions have direct and indirect effects on economic activity, and vice versa.

Statistical analysis shows that the estimated coefficient of the previous period's financial leverage and political communication does not significantly affect the speed of adjustment of financial leverage. Other factors should be considered when examining the effects on financial leverage adjustment speed. Companies that receive government support may not feel the need to adjust their leverage to reach an optimal level, as they have sufficient liquidity with government protections. This lack of adjustment may contribute to the bankruptcy of many state-owned companies, such as automobile and social security firms.

The findings of this study align with Rafi'inia's (2014) results, which suggested that political relations with the government do not impact a firm's leverage. Shareholders and stakeholders can assess a firm's debt capital by analyzing its leverage and determining whether the firm is striving for optimal leverage. This knowledge can lead to safer investments and higher returns. Companies should establish specialized teams knowledgeable in market economics and financial issues to address increases in leverage and work towards achieving optimal leverage.

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