

The relationship between Corporate Governance and Cost of capital for Thai Listed Companies

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Abstract

The purpose of this research is to study the relationship between corporate governance and cost of capital for Thai listed companies. Samples used in this study were 300 Thai listed companies. Data collections were carried out by using the 2013 financial statements and annual reports from SETSMART database and company profiles. Multiple regression analysis was used for analyzing the relationship between corporate governance and cost of capital. The corporate governance was accessed by the responsibilities of the board aspect which can be divided into five topics regarding number of board meetings, proportion of independent director, percentage of shares holding for the boards, remuneration for the board and role duality of the chairman. The cost of capital was defined by gross borrowing cost, dividend payout ratio, cash flow from operation ratio and current ratio. The results found that cost of capital in terms of gross borrowing cost and dividend payout ratio are significantly negative to the corporate governance whereas cash flow from operation ratio and current ratio were not related to the corporate governance at significance level ($P < 0.05$).

Keywords: Corporate governance / Cost of capital

Introduction

The Asian financial crisis in 1997 – 1998 as the result of the failure of prominent companies such as Enron, WorldCom, Tyco and

HealthSouth has a great negative impact on the capital market and economy of many countries in the world. It also has shaken confidence of investors (Agrawal & Chadha,

[322]

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2005). The bankruptcies of such organizations and the more recent global financial crisis have further highlighted the importance of the corporate governance and internal control (Doupnik & Perera, 2015).

In the current global and dynamic environment, corporate governance has become a significant factor in managing firms. It facilitates effectiveness, transparency, entrepreneurial and potential management of the executives that can deliver a long term successful. Moreover, good corporate governance leads confidence and trust for investors and other stakeholders. In capital market, financial institutions have put rules and regulations concerning corporate governance which companies in stock market must comply. In Thailand, the Stock Exchange of Thailand (SET) has been continuously promoted good corporate governance policy and regulations for listed companies in order to support sustainable economic growth in capital market (Sukanantasak, 2014). Besides, the equity structures of business have changed due to the providers of financing. The major providers of financial for Thai business firms in the past were family members or partners (Kaseamsap, 2010). The owner therefore, would be both

investor and manager. When the business is growing up, it needs more funding. The equity structure has become more dependent on financing from general populace through the public selling of shares of stock or borrowing money from banks and financial institutions. Investors become shareholder or the owner of the company. This leads to the complex administration. Therefore, there should be a group of executive board to be representative administration for shareholders. The board is also known as “Agency” and is responsible for managing the company to achieve its goals and contributing the return for investors.

The cost of capital refers to expense arising from raising new funds. Listed companies can raise capital by selling shares and borrowing money. Investors surely require a return on their investment in terms of interest payments or dividend. The cost of capital will be low if the company has good corporate governance resulting of the effective oversight of the board’s operation. In the other words, the healthy and stable organizations have steadily low cost of capital. The financial ratio that related to cost of capital should be analyzed.

Therefore, this research is aimed to study the relationship between Corporate Governance and shareholder's equity capital cost for Thai Listed Company. The result of this research can be used as the information for investors or other stakeholders for decision making in the investment.

Research Objective

The purpose of this research is to study the relationship between corporate governance and cost of capital for Thai listed companies.

Literature Review

Corporate Governance theory

The topic of corporate governance has attracted enormous attention by researchers in many countries. It involves with the way organizations are managed and governed. However, corporate governance seems not to have a single universally accepted definition. As a new term, it can mean many different things to different people (Doupnik & Perera, 2015). According to the Organization for Economic Corporation and Development (OECD) states that corporate governance is about the procedures and processes according to which

an organization is directed and controlled (Tricker & Tricker, 2015; OECD, 2001). It also involves a set of relationship between organization's management, executives, shareholders and other stakeholders such as employees, customers, creditors and suppliers (Elena, 2012). The company that has good corporate governance will provide appropriate intensives for the board executives and management to achieve objectives that are in the interests of the organization and the shareholders. Moreover, it should facilitate effective internal control and monitoring. The general principles of corporate governance are relied on the concept that the result of the management will create value added for the company and shareholders (Srijunpetch, 2008).

The theories that related to corporate governance are Agency theory and Stakeholder theory. Agency theory is firstly explained by Jensen and Meckling (1976). This theory explains the relationship between principals such as shareholders and agent such as organization's executives. The agent has some decision making authority on behalf of the principle to perform some service (Hill & Jones, 1992). Therefore, the executives are responsible for managing the organization to

get the highest return to shareholders, while they are gained salary or remuneration from working. This theory believes that the executives may have motivation to work for their own benefit rather than the interests of the shareholders (Ho & Wong, 2001). For example, the executive show misleading financial report or do some creative accounting in order to get some intensive for their own benefit. These would have a negative impact for the company performance and shareholders as when the company has come to the time of closing down or bankruptcy the shareholders would have the most to lose. According to Stakeholder theory, the executives should make decision by taking account of the interests of all stakeholder including customers, employees, communities and governmental officials (Jensen, 2001). So that, they need to ensure that they satisfy the firm's various stakeholders not just for their self-interest.

The OECD has formed the basis principles of the corporate governance components to deal with the responsibility of the board, the importance of disclosure and transparency of information, the rights and fair treatment of various groups of shareholders and the role of various stakeholders. These

principles are designed to strengthen corporate governance practice. It also has been taken around the globe by governments and worldwide regulators.

Corporate Governance in Thailand

In 2002, The Stock Exchange of Thailand (SET) proposed the 15 Principles of Good Corporate Governance as basic guidelines for listed companies to implement. The Principles were revised in 2006 to be comprehensive and in comply with the Principles of OECD (SET, 2012). Respectively, the Principles were revised again in 2012 in order to bring the Principles to a high level and be comparable with ASEAN CG Scorecard criteria. The principles and the recommended best practices are comprised with five areas of concern: rights of shareholders, equitable treatment of shareholders, roles of stakeholders, disclosure and transparency and responsibilities of the board. Therefore, Thai listed firms are required to report on how they have applied this principles or provide an explanation so that the shareholders can understand the reasons and can judge whether they would continue investing in the company. From the previous studied showed that the quality of corporate governance practices for

Thai companies were nullified due to the complex ownership structure or family power control through ownership structure (Connelly *et al.*, 2012). The corporate governance system did not formally recognize the uniqueness of the circumstance. Thai corporate governance system therefore has tried to implement measures and policies to solve this issues (Limpaphayom & Connelly, 2004). However, in the report of the Thai Institute of Directors Association (IOD), with support from the SET revealed that in 2016, Thai listed firms achieved higher CG scores. It showed that 601 listed companies had overall average score of 78% which is considered good and was higher than 2015's score of 75%. It also demonstrated that the firms placed more emphasis on disclosure of non-financial information, business sustainability and more active leadership role on the board of directors (IOD, 2016).

In this study the corporate governance was accessed by the responsibilities of the board aspect which can be divided into five topics regarding number of board meetings, proportion of independent director, percentage of shares holding for the boards, remuneration for the board and role duality of the chairman.

Cost of capital

The capital of the firm may gain from a variety of sources. Each source has different cost of capital such as funding arising from loans, the cost would be the interest expense. Funds receive from issuing shares, the cost would be dividend. Shareholders expect a reasonable return from investment. The return to shareholders will be the cost of funds or cost of capital for the organization. Cost of capital can be identified by many ratios. According to Ohlson (1995) current ratio has negative impact on corporate governance. It also can be caused bankruptcy and further impact on the return for shareholders. Therefore, the costs of capital focus for this research were gross borrowing cost, dividend payout ratio, cash flow from operation ratio and current ratio. The ratios for calculation can be expressed as follows;

$$\text{Gross borrowing cost} = \frac{\text{Finance cost} \times 100}{\text{Net financial liabilities}}$$

$$\text{Dividend payout ratio} = \frac{\text{Dividend} \times 100}{\text{Net profit}}$$

$$\text{Cash flow from operation ratio} = \frac{\text{Cash flow from operating} \times 100}{\text{Net profit}}$$

Liabilities

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100$$

Current assets

Tian (2005) examined the capital structures of 1,252 Chinese firms and found that debt financing facilitated a better quality of corporate governance. However, the institutional arrangement of shared government ownership created the failure of corporate governance and bad loans.

Dehipegedara (2015) emphasized that good corporate governance is effect to the lower risk of the investors, attaching more investments and improving the performance of organization.

Black & Khanna (2007) studied on the effect of business valuation on corporate governance reforms and found that corporate governance had positive relationship with the value of the business according to the increase of share price.

Methodology

Populations used in this study were 597 Thai listed companies. The samples size was determined by Krejcie & Morgan (1970) in

a total of 300 companies. Data collections were carried out by using the 2013 financial statements and annual reports from SETSMART database and company profiles. Multiple regression analysis was used for analyzing the relationship between corporate governance and cost of capital. The significant level was 5%.

Independent variable is corporate governance practices which are divided into five areas including number of board meetings (DM), proportion of independent director (ID), percentage of shares holding for the boards (SB), remuneration for the board (RB) and role duality of the chairman (DC).

Dependent Variable is cost of capital (CC) regarding gross borrowing cost (BC), dividend payout ratio (DP), cash flow from operation ratio (CF) and Current ratio (CR).

Results

The aim of this study was to investigate the relationship between corporate governance and cost of capital.

H₁: There is a relationship between corporate governance in terms of gross borrowing cost.

Table 1 The relationship between corporate governance and gross borrowing cost

Corporate Governance	Unstandardized		Standardized	T	P-value
	Coefficients		Coefficients		
	B	Std.Error	Beta		
(Constant)	1.819	3.809		0.478	0.633
DM	0.211	0.271	0.046	0.779	0.437
ID	0.180	0.077	0.136	2.326	0.021*
SB	-0.035	0.032	-0.064	-1.106	0.270
RB	1.9278	0.000	0.040	0.684	0.495
DC	-2.916	1.937	-0.088	-1.505	0.133

F = 1.851 p = 0.066 Adj R² = 0.014

*Significantly difference at P<0.05

Table 1 showed that the corporate governance (ID) had an impact on gross borrowing cost at regarding proportion of independent director significant level (P<0.05)

Table 2 Coefficients of Model of gross borrowing cost

Corporate Governance	Unstandardized		Standardized	t	P-value
	Coefficients		Coefficients		
	B	Std.Error	Beta		
(Constant)	235.869	329.126		0.717	0.003*
ID	-1.868	7.894	-0.014	-0.237	0.000*

F = 0.056 p = .813 Adj R² = -0.003

*Significantly difference at P<0.05

The multiple regression test has been used to explore the impact of proportion of independent director (ID) on cost of capital in term of gross borrowing cost. It showed negative correlations (Adj R^2) is at -0.003 . The forecasting equation can be identified as follow;

$$CE(BC) = 235.869 + (-1.868)(ID)$$

Therefore, hypothesis 1 is supported.

H_2 : There is a relationship between corporate governance and cost of capital in terms of dividend payout ratio (DP)

Table 3 The relationship between corporate governance and dividend payout ratio (DP)

Corporate Governance	Unstandardized		Standaraized	t	P-value
	Coefficients		Coefficients		
	B	Std.Error	Beta		
(Constant)	35.388	10.639		3.326	0.001
DM	0.267	0.758	0.021	0.353	0.724
ID	-0.112	0.216	-0.030	-.521	0.603
SB	-0.141	0.090	-0.092	-1.580	0.115
RB	1.858	0.000	0.137	2.360	0.019*
DC	-4.212	5.412	-0.046	-0.778	0.437
F = 1.851 p = 0.103 Adj R ² = 0.014					

*Significantly difference at $P < 0.05$

Table 3 showed that the corporate governance in terms of remuneration for the

board (RB) had an impact on dividend payout ratio at significant level ($P < 0.05$).

Table 4 Coefficients of Model of dividend payout ratio

Corporate Governance	Unstandardized		Standaraized	T	P-value
	Coefficients		Coefficients		
	B	Std.Error	Beta		
(Constant)	175.218	108.959		1.608	0.000*
RB	-8.1327	0.000	-.016	-0.279	0.001*
F = 0.078 p = 0.780a Adj R ² = -0.003					

*Significantly difference at P<0.05

The multiple regression test has been used to analyze the impact of remuneration for the board (RB) on cost of capital in term of dividend payout ratio. It showed negative correlations (Adj R²) is at -0.003. The forecasting equation can be identified as follow;

$$CC (DP) = 175.218 + (-8.1327) (RB)$$

Therefore, hypothesis 2 is supported.

H₃: There is a relationship between corporate governance and cost of capital in terms of cash flow from operation ratio (CF)

Table 5 The relationship between corporate governance and cash flow from operation ratio (CF)

Corporate Governance	Unstandardized		Standaraized	t	P-value
	Coefficients		Coefficients		
	B	Std.Error	Beta		
(Constant)	36.708	399.055		.092	.927
DM	31.178	28.429	.065	1.097	.274
ID	-3.775	8.087	-.028	-.467	.641
SB	-1.325	3.358	-.023	-.395	.693
RB	-9.9797	.000	-.020	-.338	.736
DC	191.986	202.988	.056	.946	.345
F = 0.435 p = 0.824 Adj R ² = -.010					

*Significantly difference at P<0.05

Table 5 demonstrated that the corporate governance did not have an impact on cost of capital in terms of cash flow for operation ratio (CF) at significant level ($P < 0.05$). Therefore, hypothesis 3 is not supported.

H₄: There is a relationship between corporate governance and cost of capital in terms of current ratio

Table 6 The relationship between corporate governance and cash flow from current ratio (CR)

Corporate Governance	Unstandardized		Standardized		t	P-value
	Coefficients		Coefficients			
	B	Std.Error	Beta			
(Constant)	22.008	50.568			.435	.664
DM	1.761	3.603	.029		.489	.625
ID	-.543	1.025	-.031		-.530	.596
SB	-.598	.426	-.083		-1.406	.161
RB	-1.8417	.000	-.029		-.492	.623
DC	-2.333	25.723	-.005		-.091	.928
F = 0.566 p = 0.726 Adj R ² = -0.007						

*Significantly difference at $P < 0.05$

Table 6 demonstrated that the corporate governance did not have any effect on current ratio at significant level ($P < 0.05$). Therefore, the hypothesis 4 is not supported.

CONCLUSION AND DISCUSSION

From the findings in Table 1 and 2, it has been pointed out that the gross borrowing cost was significantly negative to corporate

governance according to proportion of independent director at 0.05 significance level. This could be that in Thai listed companies with high proportion of dependent director are more likely to have low borrowing cost. The investors may trust that the dependent director could deter the risky that may occur by the other boards who may work for their self-interests. These could facilitate the confidence to

investors as it means the companies have good corporate governance. As the result the companies could gain capital at low gross borrowing cost. The result is consistent with Coleman (2007) and Beiner, Drobetz, Schmid & Zimmerman (2003).

According to Table 3 and 4, the dividend payout ratio had negative relationship with the corporate governance in terms of remuneration for the board. There is probability that the Thai listed companies would have weak corporate governance at 0.05 significance level. In the other words, when the firms have high remuneration for the board, the net profit will be low, the dividend payout therefore will be low. As these result, the cost of capital are likely to be low respectively. This evidence is consistent with Gruszczynski (2006).

However, cost of capital in terms of cash flow for operation ratio was not significant as it showed in Table 5. That is, the cash flow operation ratio does not affect the expectation to have healthy corporate governance. Both low and high in cash flow operation ratio could have healthy corporate governance. Moreover, current ratio did not have relationship with corporate governance as it demonstrated in Table 6. In contrast, as the resulted from

previous studies, rigorous corporate governance leads to higher cash flow operation ratio and current ratio (Poramapojn, 2014).

Corporate governance is crucial for capital market. This research is aimed to investigate the relationship between corporate governance practices and cost of capital for Thai listed companies. The result found that cost of capital in terms of gross borrowing cost and dividend payout ratio are significantly negative to the corporate governance whereas cash flow from operation ratio and current ratio do not have any relationship. In other words, companies with higher proportion of independent director are more likely to be good at corporate governance. Furthermore, if listed companies have higher remuneration, the dividend payout for shareholders would be low.

SUGGESTION

1. Boards should always attach utmost importance to continuously improving its owned corporate governance to ensure that its standard of operation matched those of both nationally and internationally recognized standards in order to enhance low cost of capital.

2. The ratios used for access cost of capital are varies, therefore, in further research should take other ratios in order to provide better result.

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