

# Chapter 17

## Cash Holdings and Corporate Governance: Evidence From Turkey

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### **ABSTRACT**

*This chapter investigates the empirical factors affecting corporate cash holdings with special emphasis on corporate governance variables for a sample of Turkish-listed nonfinancial firms over the period 2006 to 2010. The findings reveal a significant non-linear relation between family ownership and cash holdings. In addition, while board structure does not significantly affect the level of cash holdings, tunneling increases cash reserves of firms. Furthermore, the results indicate that cash flow, leverage, other liquid assets that can be used as cash substitutes, the degree of tangibility of assets, and firm size are important in determining cash holdings among Turkish companies.*

### **INTRODUCTION**

One of the most important financial policies of a firm is the cash policy. Holding sufficient cash serves to maintain daily operations, finance profitable investment projects, decrease the likelihood of financial distress, minimize the costs of raising external funds and so on (Ferreira and Vilela, 2004; Uyar and Kuzey, 2014). That is why, cash represents a considerable asset for firms. For instance, cash forms 9% of the total assets in UK (Al-Najjar and Belghitar, 2011) and firms hold 18.5% of assets in cash in Japan (Pinkowitz et al., 2003).

Three commonly used theoretical models by previous studies to investigate cash holding of firms include the trade off theory, the pecking order theory and the free cash flow theory. While trade-off model states that the optimal level of cash holdings depends on the trade-off between the marginal

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benefits and the marginal costs of holding cash (Al-Najjar & Belghitar, 2011; Ferreira & Vilela, 2004), the pecking order argues that firms do not have target cash levels (Myers and Majluf, 1984). Finally, the free cash flow theory suggests that agency conflicts between managers and shareholders affect cash holding policy (Jensen, 1986).

Based on free cash flow theory the objective of this study is to examine the relationship between corporate governance characteristics and cash holdings in Turkish firms. Specifically, the influence of family involvement and excess control rights on cash policy will be explored. The chapter attempts to fill the following gaps in the literature.

First, the empirical literature regarding the determinants of corporate cash holdings has mainly focused on developed countries, such as United States (Opler et al., 1999; Dittmar and Mahrt-Smith, 2007; D'Mello et al., 2008), UK (Ozkan and Ozkan, 2004; Al-Najjar & Belghitar, 2011), and EU countries (Ferreira and Vilela, 2004). The decision of holding cash is still considered under-researched in emerging countries (Al-Najjar, 2013; Uyar and Kuzey, 2014). By providing empirical evidence from an emerging market, Turkey, the study attempts to contribute to the general literature on cash holding determinants.

Second, limited attention has been devoted to the question of whether agency conflicts between controlling and minority shareholders impact cash holding policy of firms, especially in family firms (Liu et al., 2015; Kuan et al., 2011). Indeed, Al-Najjar (2013) indicates the necessity of further discussion about the impact of internal corporate governance factors on corporate cash holdings in developing countries. Uyar and Kuzey (2014) also call a new research which incorporates corporate governance variables into the model that explains the determinants of cash holdings in Turkey. Therefore, the study attempts to contribute to the corporate governance literature by exploring the role of corporate governance factors in explaining cash holding policies of Turkish firms.

Third the cash holding policy of firms under family control remains unexplored in the literature except a few studies (e.g. Ozkan and Ozkan, 2004; Kuan et al. 2011; Liu et al., 2015). Despite that, the contribution of family firms to national economies is significant in many countries, and Turkey is no exception. Previous studies have revealed that family firms are complex, because, in addition to considering financial objectives, they have nonfinancial motivations such as the preservation of family dynasty and values, altruism toward family members (Lubatkin, Schulze, Ling, & Dino, 2005; Gomez-Mejia et al., 2011). Nonfinancial objectives shape their decisions and they have strong incentives to pursue activities that fit their personal interest but come at the expense of minority shareholders, especially in countries with poor investor protection (Claessens et al., 2002; Villalonga & Amit, 2006). Accordingly the final contribution of this study will on family firm literature.

The results reveal a non-linear relationship between family ownership and cash holdings. Board structure does not significantly affect the level of cash holdings but tunneling increases cash reserves of firms. In addition, the results indicate that cash flow, leverage, other liquid assets that can be used as cash substitutes, the degree of tangibility of assets and firm size are important in determining cash holdings of Turkish companies.

The remainder of the chapter is organized as follows. The next section contains a review of literature. The methodology is elaborated in the following section. Then, results of empirical analyses are discussed. The chapter concludes with a summary of main findings and implications.

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