Does Corporate Governance Affect Firm Liquidity? 
Empirical Evidence from Romania

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Abstract
This paper examines the relation between corporate governance and liquidity from Romanian firms. We construct a measure of corporate governance based on publicly available information for each firm listed on the Bucharest Stock Exchange over the 2006-2013 interval. Results of the study suggest a positive relationship between the liquidity and the corporate governance.

Key words: Corporate governance; Firm liquidity; Firm size
J.E.L. Classification: C10; G10; G30

Introduction
Corporate governance is the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its all stakeholders (financiers, customers, management, employees, government, and the community) (http://www.businessdictionary.com/).

According to Andrei Shleifer from Harvard Business School and Robert Vishny from the University of Chicago, “corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer and Vishny, 1997). Liquidity is the measure of the extent to which a person or organization has cash to meet immediate and short-term obligations, or assets that can be quickly converted to do this (www.businessdictionary.com). In other words, liquidity is the relationship between the cash which will be given to the company in a short time period and the cash which the company needs (Talebi, 1997).

The solvency ratio measures the size of a company's after-tax income, excluding noncash depreciation expenses, compared with the firm's total debt obligations. It provides a measurement of how likely it is a company can continue to meet its debt obligations (financial-dictionary.thefreedictionary.com).

Li et al. (2012) studied their paper examines the channel relationship of liquidity, corporate governance, and firm valuation for Russian firms over the period of 2005 to 2007. They tested the hypotheses that liquidity improves corporate governance, and better corporate governance enhances firm value. They formed the system of equations of liquidity measures (share turnover, market value...
turnover and the Amihud liquidity ratio), the transparency and disclosure (T&D) scores, and firm valuation (market value equity). Their results showed that liquidity has a significant positive effect on corporate governance for Russian firms, which consequently increases firm valuation. According to Gillan (2006) provides a broad overview of these issues and recent work in the area. The authors review the main prior research on the impact of corporate governance on liquidity and examine how the investor protection affect stock returns and firm value.

Chung et al. (2010) investigate the empirical relation between corporate governance and stock market liquidity. They find that firms with better corporate governance have narrower spreads, higher market quality index, smaller price impact of trades, and lower probability of information-based trading. They showed that changes in our liquidity measures are significantly related to changes in the governance index over time. These results suggest that firms may alleviate information-based trading and improve stock market liquidity by adopting corporate governance standards that mitigate informational asymmetries.

**Data and Methodology**

The aim of this study is to investigate the effect of corporate governance on liquidity. The data were sourced from the Annual Reports and Accounts of the random sample of 10 firms listed on the Bucharest Stock Exchange over the 2006-2013 interval. Analysis does not include the companies operating in financial sector due to their different financial structures.

**Measuring corporate governance**

We construct an overall governance index for each romanian listed firm to measure the quality of corporate governance based on disclosed governance-related information in their annual financial reports.

We classify the governance related information into 4 groups: Access and Content of the Information, board of directors, ownership structure, shareholders' rights and committees. These 4 groups consist of 24 variables in total. The construction of the index is straightforward, I first code the 24 questions as 1 or 0 depending on whether the firm has satisfactory corporate governance standards or not. Each positive answer adds one point to the index, and the companies present a quality of governance level that ranges, in theory, from 0 to 24.

**Size**

Size is considered a key factor that can influence the financial structure of the firm. Firm size has been suggested to be an important variable related to the leverage ratios of the firm. The variable Size of Firm is measured as logarithm of total assets.

**Leverage**

As it can be seen in the literature, various definitions of leverage exist. All these characterizations of leverage revolve around some form of debt ratio. The definitions depend on whether market value or book values are used. In addition, definitions also depend on whether short term debt, long-term debt or total debt is used. Firms have several types of assets and liabilities and there can be further
adjustments made to the definition. Leverage: Represents the value of debt divided by book value of total asset.

**Liquidity**
Firms prefer internal financing to external financing. Therefore, firms are likely to create liquid reserves from retained earnings. If the liquid assets are sufficient to finance the investments, firms will have no need to raise external funds. Hence, liquidity is expected to be negatively related to leverage. Here we use the current ratio (calculated as current assets over current liabilities) as a proxy of liquidity. The relation between corporate governance and firm liquidity is estimated using the fixed effect panel regression.

Our empirical model is specified as:

Liquidity = β0 + β1*CGI + β2*Size + β3*Leverage

**Results and discussion**
Descriptive analysis are presented in Table 1.

**Table 1- Descriptive statistics of the variables in the study**

<table>
<thead>
<tr>
<th></th>
<th>Lichiditate</th>
<th>IGC</th>
<th>Leverage</th>
<th>Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>4.800268</td>
<td>16.36667</td>
<td>0.248003</td>
<td>20.81282</td>
</tr>
<tr>
<td>Median</td>
<td>1.945631</td>
<td>17.00000</td>
<td>0.163962</td>
<td>20.15067</td>
</tr>
<tr>
<td>Maximum</td>
<td>29.17241</td>
<td>21.00000</td>
<td>0.773369</td>
<td>24.38117</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.918033</td>
<td>9.000000</td>
<td>0.013836</td>
<td>17.49698</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>5.803753</td>
<td>3.324112</td>
<td>0.208896</td>
<td>1.869654</td>
</tr>
</tbody>
</table>

Table 1 provides a summary of the descriptive statistics of the dependent and explanatory variables. As shown in Table 1, average liquidity of the firms listed in Bucharest Stock Exchange and reviewed in scope of the analysis is 4.80. The mean leverage of the firms is 0.24 with a maximum of 0.77. The average corporate governance index (CGI) is 16.36, with a standard deviation of 3.32.

**Results of regression analysis**

**Table 2: Results of Regression Analysis**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>IGC</td>
<td>0.4901</td>
<td>0.2275</td>
<td>2.1535</td>
<td>0.0356</td>
</tr>
<tr>
<td>Leverage</td>
<td>-17.1654</td>
<td>3.1586</td>
<td>-5.4344</td>
<td>0.0000</td>
</tr>
<tr>
<td>Size</td>
<td>-0.6360</td>
<td>0.3897</td>
<td>-1.6317</td>
<td>0.1000</td>
</tr>
<tr>
<td>C</td>
<td>14.2730</td>
<td>7.0772</td>
<td>2.0167</td>
<td>0.0485</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.3490</td>
<td>Mean dependent var</td>
<td>4.8002</td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.3141</td>
<td>S.D. dependent var</td>
<td>5.8037</td>
<td></td>
</tr>
<tr>
<td>F-statistic</td>
<td>10.0099</td>
<td>Durbin-Watson stat</td>
<td>0.7682</td>
<td></td>
</tr>
</tbody>
</table>
The results of estimating equation are reported in Table 2. The model explains almost 34% of variation in liquidity, with significant F-statistic. Thus, we can say that based on p-values, in our model for listed companies, corporate governance and leverage is statistically significant, is 0.0356 and 0.000 (sig. < 5%). The index of corporate governance is positively correlated with liquidity (0.49; Table 2) but it is statistically significant.

To test whether there is influence toward firm size to liquidity, t test is used. Through the result from data processing, the value of t statistic obtained is equal to -1.63, and the level of significance is 0.10 (sig.<10%). This shows that there is significant effect between firm size and liquidity. Thus, is significantly and negative at the 0.10 level. The results accepted any significant relationship between leverage and liquidity. This suggests that leverage of all companies significantly affects liquidity of firm. This indicates a high negative influence on liquidity.

**Conclusion**

Aim of this research was to explore the impact of corporate governance on its liquidity. This research observed a 10 firms listed over the 2006-2013 interval at the Bucharest Stock Exchange. Beside corporate governance variable the analysis included some other variables such as leverage and size. This paper studies the relation between corporate governance and firm liquidity. The positive relation between corporate governance and liquidity relieves the concern that enhancing corporate governance damps liquidity (Bolton and Thadden, 1998).

**References**


