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Investigating the Effect of Information Asymmetry on the Relationship between Corporate Reputation and Equity Costs in Companies Listed On Tehran Stock Exchange

By

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Abstract

This study examines the impact of information asymmetry on the relationship between corporate reputation and cost of equity in companies listed on the Tehran Stock Exchange. This research is applied research in terms of its purpose and descriptive correlation in terms of the research method. The statistical society population of this research includes the companies listed in the Tehran Stock Exchange as 193 companies operating in various industries over the years 2011 to 2019. The method of hypothesis testing in the present study is the use of multivariate regression, which was done using EViews software. The results of the research show that there is no significant relationship between corporate reputation and cost of equity, and information asymmetry does not moderate this relationship.

Keywords: corporate reputation, cost of equity, information asymmetry, companies listed on the Tehran stock exchange

1. Introduction

Currently, capital cost is one of the most significant tools in numerous financial and management decisions that are affected by several factors. Financial leverage, profitability, the composition of shareholders, the composition of the board of directors, the type of company activity, liquidity, and the size of the company are among the most significant factors [1]. Likewise, since the ability to attract capital and finance companies is one of the most important pillars needed to remain in today's competitive market, the capital market and the active and extensive presence of investors in such markets is one of the undisputable requirements for the growth of the national economy of countries. Among the items that make up the cost of capital, the cost of equity is the most significant element, so companies offer a high percentage of their capital from this place. Instead, in the last few decades, the business world has observed patterns, such as customer orientation and business excellence, and the decline of engineering orientation and technical excellence. In industry, mass production has vanished and lean

production has replaced it. However, the latest and most challenging model of managers today, whether in the fields of managing for-profit organizations such as manufacturing and service industries or in the fields of managing non-profit organizations such as the management of public sectors, is a good reputation. A good reputation is a concept that all stakeholders of the company benefit from, and its effect on all components of the organization can be detected. The concept of good reputation has been a well-known concept since the distant past. Most European and American managers believe that a good reputation is the most significant factor in their sales. They found that a company can hire more skilled employees and upsurge its intellectual capital with the help of its good reputation. The good reputation of a company is also very important in the valuation and cost of equity. Typically when new information about the company's status is available in the market, this information is analyzed by analysts, investors, and other users, and a decision is made based on it to buy or sell shares. In the case of confidential and heterogeneous information release, different reactions from investors will arise because of the existence of information asymmetry in the capital market, which will lead to improper and misleading analyzes of the current market situation. Here, small investors will not have the aspiration to invest, and this issue will eventually lead to an increase in the cost of the company's capital to the amount of risk that should be tolerated by fewer investors [2]. Easley and O'Hara [3] believe that information asymmetry affects prices and is an indicator of companies' capital costs. They declare that information asymmetry among market traders leads them to choose and hold different portfolios. So, traders with information will try to maintain assets that can compensate for the weakness caused by unequal information. This issue will lead to a decrease in the price of securities with a high level of information asymmetry, a decrease in their liquidity, and an increase in their transaction costs during buying and selling. Investors demand a higher reward for the extra transaction cost paid, and the cost of capital associated with these companies increases. The findings indicate a significant and positive relationship between corporate social responsibility (CSR) and corporate reputation[4]. However, contrary to Western research, a negative relationship between CSR performance and the cost of equity is not observed in a country like China. One possible explanation for this is that CSR activities in China only meet the minimum regulatory requirements set by the government, and therefore, the effects of CSR are not timely reflected in the capital market.[5]

Considering the stated content and considering that so far no empirical research has been conducted to investigate the effect of information asymmetry on the relationship between corporate reputation and cost of equity, finally, in the present research, the researchers are seeking an answer to this question. “Whether information asymmetry affects the relationship between corporate reputation and cost of equity or not?”

2. Research Literature

2.1. Theoretical Foundations

2.1.1 Cost of Equity

The aim of the company's management is to maximize the shareholders’ wealth and to attain the said goal, efforts are made to adopt suitable policies and decisions. Implementing evaluation models causes the calculation of the capital cost of the company. The cost of capital is the minimum rate of return that is necessary to maintain the company's market value (or its stock price). Managers, for such things as deciding related to capital budgeting, establishing the optimal capital structure, deciding on long-term or short-term rent, and working capital management, must have adequate information about the cost of capital, which is often called the expected rate of return. The cost of capital is calculated by the weighted average of the many components of the company's capital, such as debt, preferred stock, common stock, and

retained earnings [4]. The company's capital cost should be calculated according to the market value of the company's debt and equity, not its book value. Using the book value to calculate the cost of capital will lead to an underestimation of the cost of capital for companies and an overestimation of the added economic value [5]. Of course, the word capital in determining the cost of capital has a broader concept than the concept of capital in accounting, so it comprises not only equity but also long-term debt with a guaranteed interest. Copeland and Galai [6] believe that if the cost of capital is regarded from the perspective of opportunity cost, which investors used to convert the future value of the observed incomes to their current value, it means that both groups of creditors and shareholders of the company expect to receive returns for bearing the cost of their investment opportunity and compensating for its risk [7].

The focus on the cost of equity is justified because it represents a less expensive allocation of resources in the stock market, leading to increased company investment and economic growth. A lower cost of capital also promotes the continuity of capital flow and improves the efficiency of financial services in the real economy. Additionally, the cost of equity is the required expected rate of return for investors. When the return rate on company investment projects is higher than the cost of equity, the company will have a positive net present value. Considering the cost of debt financing, a lower cost of equity enables companies to have more choices in investment projects, increasing the value of the company and investor welfare [8]

2.1.2 Corporate reputation

Since corporate reputation is defined as an important strategic asset [8], executives need to know how their decisions affect corporate reputation. Corporate reputation can be defined from diverse viewpoints. Corporate reputation can be defined as (the identification of stakeholders from the evaluation of the social-economic-organizational potential of the company in the long term) [9]. According to Fombrun's viewpoint (1996), corporate reputation is defined as (a perceptual representation of past activities and prospects that describes all aspects of key components compared to competitors ahead). Corporate reputation is the public perception of a company's respect and dignity [10]. Because corporate reputation is defined as an important strategic asset [8], executives need to know how their decisions affect corporate reputation. Corporate reputation can be defined from different perspectives. Corporate reputation can be defined as (stakeholders' recognition of the company's social-economic-organizational potential in the long term) [9]. According to Fombrun (1996), corporate reputation is defined as (a perceptual representation of past activities and prospects that designates all aspects of key components compared to competitors ahead). Corporate reputation is the public perception of a company's respect and dignity [10]. This definition states that reputation is a general organizational characteristic that reflects how good the company is from the perspective of stakeholders. Barnet et al. [11] defined corporate reputation as (the collective judgment of observers about a company based on the evaluation of its financial, social, and environmental impacts over time) [11]. Among the benefits of a good reputation, we can mention the reduction of operating costs, the high rate of return of investors, and subsequently increasing the amount of sales and the possibility of increasing the price of products. Although numerous studies such as the review of Ingles et al. (2006) attested to the positive relationship between company reputation and financial performance, the attempt to explain the formation mechanism and the consequences of company reputation remains one of the significant and ponderable issues. It is impossible to understand the reputation of companies without the knowledge and understanding of the complexity of perceptions, opinions, and inferences about the company, and the above inferences are usually unpredictable. The

reputation of companies results from the interaction between the activities and reactions of the outside world to its actions and statements (Shareghi, 2018).

Corporate reputation, defined as the knowledge and emotions held by individuals about a company (Hall, 1992), has received significant attention and numerous studies have attempted to assess its impact on measures of financial success. This provides a rationale for companies' efforts to allocate resources towards systematic reputation management [12]

2.1.3 Information asymmetry

The theory of information asymmetry, for the first time in 1970, was presented by Akrelof et al. (1970). These researchers revealed that information asymmetry can cause an upsurge in contradictory choices in the markets, which occurs before the transaction occurs for individuals. They portray a type of market in which the seller has more information than the buyer. Tinik (1970) states that in the financial literature, the bid price for buying and selling stocks comprises three parts: order processing cost, inventory holding cost, and reverse option cost. Order processing cost is the amount that market makers spend to be ready to execute buy and sell orders (Tinik, 1972). Ho and Stol [12] who modeled the part of inventory holding cost, state that the transaction cost makes market makers maintain a diversified portfolio to cover their costs [12]. Last, the reverse selection proposed by Kapland and Galli (1983) and Golsten and Milgrom [13] represents compensation for traders to accept the risk of dealing with people who may have important and confidential information. Put differently, if a major part of the market comprises uninformed people, market makers increase the range of the difference in the bid and offer prices of stocks to compensate for the risk of adverse selection [13]. In the final summary of information models, the asymmetry of information makes the order flow (buying or selling) which was considered as an exogenous variable in the previous models be considered as an endogenous variable and the transaction itself has an information load. Therefore, research in market microstructure led to the analysis of the market maker's learning from the flow of orders and accordingly the formation of prices over time [14].

Tong et al[15] stated that information asymmetry is a common issue in financial markets. The literature has extensively examined and documented the importance of information asymmetry in initial public offerings (IPOs). The information gap is created or amplified by several behavioral factors, such as the tendency of company owners to filter their internal information before disclosing it to the public [16], the lack of credibility of top managers [17], the lack of independent board members [18], and information disclosure constraints [19] . A well-established approach to reduce information asymmetry in IPOs is to provide additional information resources to investors, such as pre-IPO audit results [20], expert analyst opinions [21], and strengthening the information provided by credit ratings [22].

2.2 Research background, expansion, and development of hypotheses

2.2.1 Corporate reputation and cost of equity

Fister et al. (2020) stated in their research that a high level of corporate reputation will lead to a lower level of cost of equity in the future. Cao et al. [15] concluded that the level of corporate reputation information is related to the cost of equity. Brammer and Pavelin [16], Graham (2000), and Shamsie [17] likewise concluded that a level of corporate reputation is related to industrial environment information. Jafari [18] in research concluded that there is a significant negative relationship between the corporation's reputation and the cost of capital. This means that as the corporation's reputation decreases, the company's need for financing borrowing and equity financing increases. Investors will not invest in low- reputation companies, and as a result, the company's need for financing will increase. So, more famous companies have lower costs of capital because a high reputation implies better company

quality, proper transfer of competencies, and doing business according to the interests of shareholders. Ghasempour [19] revealed that there is a significant relationship between corporate reputation and the choice of financing method.

In the study of the relationship between corporate reputation and the future cost of equity, a strong negative relationship between the levels of the two variables has been observed, while changes in reputation only have a significant impact on the future cost of equity in the event of reputational damage. Drawing on the findings of Kahneman and Tversky [23], we can consider different slopes of "reputation value functions" for shareholders in the profit and loss domains: taking into account that individuals are more influenced by losing a certain amount of money than gaining the same amount of pleasure, these key findings from the perspective of prospect theory can inform perspectives on corporate risk. The prior level of reputation for a company serves as a reference point, and an increase (profit) in reputation has a smaller impact on the risk proxy compared to a decrease (loss) in reputation. A competing explanation could be that reputational loss is implicitly associated with more severe or less forgivable scandals in the eyes of shareholders, while there is no equivalent mechanism for gaining reputation. [24]

So, the research hypothesis is formulated as follows:

First hypothesis: There is a significant relationship between corporate reputation and cost of equity.

2.2.2 Effect of information asymmetry on the Relationship between corporate reputation and Cost of Equity

Bhattacharya et al. [20] in their research indicated that the cost of equity has a significant effect on information asymmetry. Lambert et al. [2] state that under conditions of pure competition, the firm's cost of equity is completely governed by the average level of accuracy of investors' information, and the alteration in information asymmetry under these conditions can only affect the firm's cost of equity which will also affect the average change in the accuracy level of investors' information. Barth et al. [21] show that providing more transparent information decreases information risk and reduces information asymmetry (particularly the risk of adverse selection). Then, investors' uncertainty about the company's financial information is reduced and they demand lower returns, and finally, companies experience lower capital costs. Easley and O'Hara [3] in their research develop a rational expectations adjustment model with multiple assets that comprise public and private information and informed and uninformed investors. The significant features of his model are risk-averse investors, positive net supply (on average) of each risky asset, and imperfect markets. His model depicts how the quantity and quality of information in equilibrium affects the price of assets, which results in cross-sectional differences in the returns requested by companies. Abariki and Hashemi [22] concluded that the equity ratio has a significant effect on information asymmetry and the quality of financial reporting. The results of Ataie et al.'s research [23] indicated that the information asymmetry of equity cost has a positive and significant effect on the quality of financial reporting. Bolu and Hasani Alghar [24] revealed that there is a significant relationship between profit quality, information asymmetry, and cost of equity. Soufhasan et al. (2013) stated that the comparability of financial statements does not affect information asymmetry and the cost of equity.

The research by Dayong Dong et al, colleagues provides several key findings regarding the relationship between strategic information disclosure and the cost of capital. Firstly, it demonstrates a negative correlation between strategic information disclosure and the cost of

capital, indicating that increased transparency in disclosing strategic information is associated with lower costs of capital. Secondly, this negative correlation is more significant in non-governmental companies, high-value firms, and industries with higher levels of competition, suggesting that the impact of strategic information disclosure on the cost of capital is more pronounced in these contexts. Thirdly, the study finds that analyst forecasts and stock liquidity mediate the relationship between strategic information disclosure and the cost of capital. These intermediary factors play a role in influencing the impact of strategic information disclosure on the cost of capital. Additionally, the findings of this research support the notion that reducing information asymmetry contributes to the effect of strategic information disclosure on the cost of capital.[25]

So, according to the above, the research hypothesis is formulated as follows:

Second hypothesis: Information asymmetry has a significant effect on the relationship between corporate reputation and cost of equity.

3. Method

In terms of aim, the present research is applied, in terms of descriptive data collection method, it is a survey. The statistical population of this research was formed by the companies admitted to the Tehran Stock Exchange during the years 2011-2019. In the present research, the statistical population has been adjusted based on the conditions of systematicity. The subsequent characteristics were taken into consideration in the selection of companies:

a) The company in question is not one of the financial intermediary companies.
b) The company's shares have been traded during each of the years of the research period.
c) The company in question should be on the list of companies admitted to the stock exchange from the beginning to the end of the research.
d) All the data required for it should be available during the years 2011 to 2019.

The sampling method is the elimination, that after applying the above restrictions and based on Table 1, the number of statistical samples is determined:

Table 1. *Statistical sample of the research*

Description	Count
Number of companies admitted to the stock market until the end of 2019	523
Number of companies that were not active in the stock market during the research period	149
Number of companies that were part of holdings, investments, financial intermediaries, banks, or leasing	65
Number of companies whose fiscal year does not end at the end of March	70
Number of companies that have had a trading break of over three months in the period of the research	58
Number of companies whose information needed for the research was not available or incomplete during the research period	16
Number of sample companies	165

4. Results

The descriptive statistics of the research results are presented in Table 2. The number of investigated companies was 317 and the research period included the years 2011 to 2019,

which included 1749 usable unbalanced panel observations. To control the effects of outlier data, the continuous variables have been normalized at the level of 1%. The number of observations in each year and each industry is presented in Table 2.

Table 2. *Sample observations at the level of year and industry*

Industry/year	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total
Medicinal	14	10	22	24	26	30	32	34	15	192
Cars and parts	18	17	25	29	30	31	35	35	23	220
Basic metals	21	24	31	32	32	37	40	44	12	261
Chemical	19	20	31	31	39	38	40	41	21	259
Food except for sugar	8	13	19	20	19	19	28	33	11	159
Cement, lime, plaster	16	21	34	30	24	30	29	39	10	223
Machinery and equipment	7	5	9	10	9	11	12	11	8	74
Transportation, storage, and communication	9	13	12	17	20	22	31	35	10	159
Other	6	5	10	9	11	12	12	16	11	81
Total	118	128	193	202	210	230	259	288	121	1749

Table 3. *Descriptive statistics of research variables*

Continuous research variables						
Variable	**Sign**	**Mean**	**Median**	**Max.**	**Min.**	**SD**
Cost of equity	COE	0.104	0.126	1.330	-0.718	0.231
Information asymmetry	IA	0.029	0.029	0.083	0.001	0.010
Logarithm of the market value	LNMV	14.126	14.071	19.940	3.750	2.198
Financial leverage	LEV	0.568	0.557	9.002	0.007	0.348
Market risk	Beta	0.242	0.208	2.257	-3.419	0.600
Sales growth	Growth	0.813	0.179	558.074	-0.992	14.053
Market value to book	MTB	2.393	1.982	58.736	-31.912	3.360
Artificial variable						
Variable	Sign	Count 1		Count 0		SD
Corporate reputation	Reputation	257		1492		0.323

4.1 Hypothesis test results

In this section, the stated variables will be analyzed and the research hypotheses will be tested. Multiple linear regression was used to test the hypothesis of this research.

4.1.1 Testing research hypotheses

The first hypothesis of the research: there is a significant relationship between corporate reputation and cost of equity.

4.2 Checking the assumptions of classical regression

4.2.1 First and second assumptions: the normality of the distribution of model errors with zero mean

Since the model has an intercept, the assumption of zero average errors is accepted. Fig. 1 shows the distribution of model errors and the normality test of the distribution.

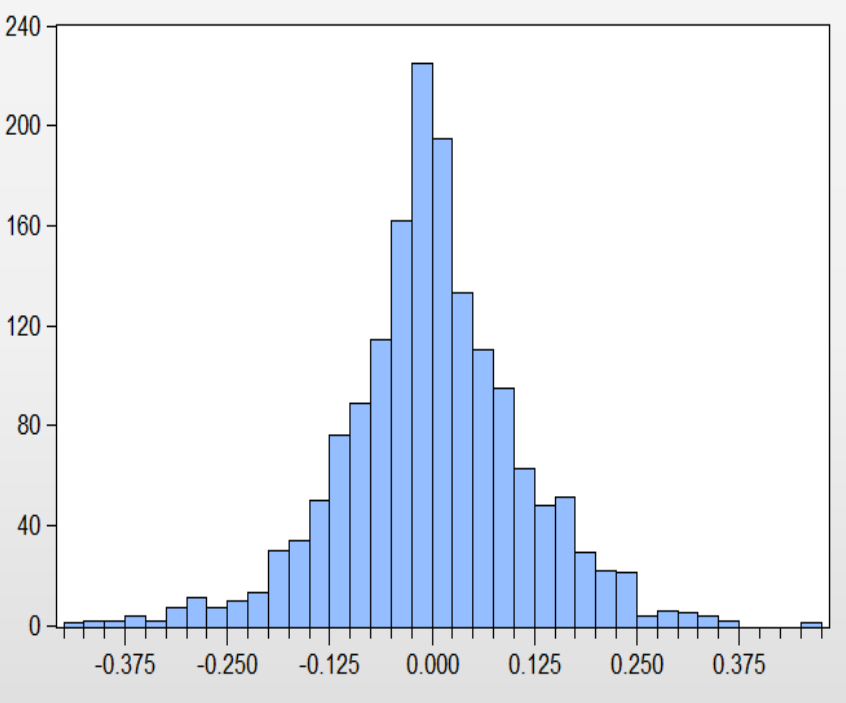

Fig. 1. *Distribution of errors of the first model*

According to Fig. 1, it can be perceived that the distribution of errors is like the normal distribution. The first assumption of classical regression is accepted.

Third hypothesis: the absence of first-order autocorrelation: since the model is not a time series and also, the role of time is considered using control variables, this assumption is not valid.

Fourth hypothesis: homogeneity of the variance of the model errors: due to the fact that White's robust variance was used in the estimation of the model, as a result, this assumption is also accepted from the research.

Fifth hypothesis: Non-existence of collinearity between independent variables: According to the results of Table 3, since VIF for all independent variables has values less than 10, as a result, this assumption is also accepted.

4.3 Examination of the model estimation results

Since all the hypotheses of classical regression are established, as a result, the results can be relied upon. The results of the research model estimation are presented in Table 2. According to the results of Table 4, the results show that the F statistic of the parent has a value of 494.275 and its significance is less than 0.05. The generality of the regression model is accepted. This means that there is a significant relationship between the independent variables and the dependent variable, and at least one independent variable has a significant relationship with the dependent variable.

Table 4. *Results of the estimation of the research model*

Title	Sign	Coefficint	SD	stat t	Sig.	VIF
Intercept	C	0.152	0.025	6.078	0.000	
Corporate reputation	Reputation	-0.025	0.018	-1.430	0.153	1.150
Logarithm of the company's market value	LNMV	0.002	0.002	1.131	0.258	1.298
Market value to book value	MTB	0.000	0.002	-0.275	0.783	1.144
Corporate leverage	LEV	0.025	0.024	1.036	0.301	1.021
Market risk	Beta	-0.307	0.008	-0.37911	0.000	1.052
Sales growth	Growth	0.000	0.000	-1.165	0.244	1.006
Year fixed effects			Controlled			
Industry fixed effects			Controlled			
Wald F-statistics	Sig. F	R^2 Model	R^2 Adjusted		Number of observations	
494.275	0.000	0.631	0.628		1749	

The variable coefficient of corporate reputation has a negative value equal to -0.025 and its t-statistic is equal to -1.430. Since the significance level of this statistic is over 0.05, we cannot accept the existence of a significant relationship between the variable of corporate reputation and the cost of equity. The first research hypothesis is not accepted.

The second research hypothesis is: information asymmetry has a significant effect on the relationship between corporate reputation and the cost of equity.

4.4 Checking the hypotheses of classical regression

First and second hypotheses: the normality of the distribution of model errors with zero mean.

Since the model has an intercept, the assumption of zero average errors is accepted. Fig. 2 depicts the distribution of model errors and the normality test of the distribution.

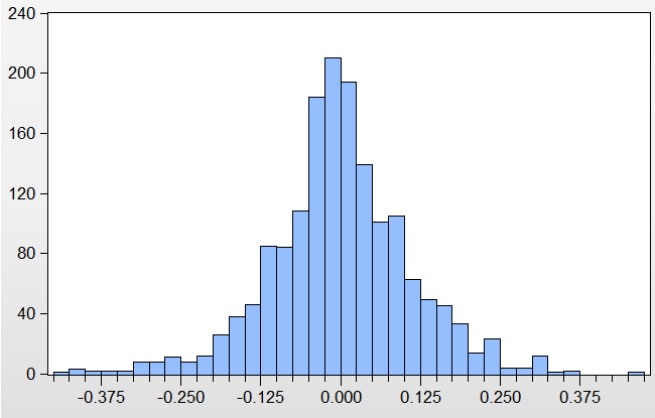

Fig. 2. *Distribution of errors of the first model*

Based on Fig. 2, it can be seen that the distribution of errors is similar to the normal distribution. The first assumption of classical regression is accepted.

Third hypothesis: the absence of first-order autocorrelation: since the model is not a time series and likewise, the role of time is also considered using control variables, this assumption is not valid.

Fourth hypothesis: homogeneity of the variance of the model errors: due to the fact that White's robust variance was used in the estimation of the model, as a result, this assumption is also accepted from the research.

Fifth hypothesis: the absence of colinearity between independent variables: according to the results of Table 5, since the VIF for all independent variables has values less than 10, as a result, this assumption is also accepted. It should be mentioned that the interactive effect variable and information asymmetry had a strong correlation, which was solved by using the mean-centering method.

4.5 Checking the model estimation results

Since all the hypotheses of classical regression are established, the results can be relied upon. The results of the estimation of the research model are presented in Table 5. Based on the results of Table 5, it can be seen that the F statistic of the parent has a value of 391.934 and its significance is less than 0.05. The generality of the regression model is accepted. This means that there is a significant relationship between the independent variables and the dependent variable, and at least one independent variable has a significant relationship with the dependent variable.

Table 5. *Results of estimation of the research model*

Title	Sign	Coefficient	SD	stat t	Sig.	VIF
Intercept	C	0.176	0.026	6.665	0.000	
Corporate reputation	Reputation	-0.046	0.081	-0.573	0.567	2.963
Information asymmetry	IA	-0.989	0.335	-2.954	0.003	1.152
Interactive effect	Reputation*IA	0.657	2.907	0.226	0.821	2.185
Logarithm of the company's market value	LNMV	0.002	0.002	0.983	0.326	1.301
Market value to book value	MTB	0.000	0.002	-0.228	0.820	1.145
Corporate leverage	LEV	0.034	0.025	1.371	0.171	1.079
Market risk	Beta	-0.299	0.009	-34.875	0.000	1.192
Sales growth	Growth	0.000	0.000	-1.114	0.266	1.007
Year fixed effects			Controlled			
Industry fixed effects			Controlled			
Wald F-statistics	Sig. F	R^2 Model	R^2 Adjusted		Number of observations	
391.934	0.000	0.634	0.631		1749	

The variable coefficient of the interactive effect has a positive value equal to 0.657 and the corresponding t-statistic is equal to 0.226. Since the significance level of this statistic is over 0.05, we cannot accept the existence of a moderating effect of information asymmetry on the relationship between the variable of corporate reputation and the cost of equity. The second research hypothesis is not accepted.

5. Conclusion and recommendations

According to the first hypothesis, it was predictable that there would be a significant relationship between corporate reputation and the cost of equity, but at large, the results show that the variable coefficient of corporate reputation is negative, and according to the significance level, it does not have the significance. The first research hypothesis is not

confirmed. The findings of the test results of this hypothesis are not in accordance with the research results of Fister et al. (2020), Cao et al. [15], and Jafari [18].

According to the second hypothesis, information asymmetry was expected to have a significant effect on the relationship between corporate reputation and cost of equity. The results reveal that the interaction effect coefficient is negative, which indicates the negative effect of information asymmetry on the relationship between corporate reputation and the cost of equity; which is not meaningful according to the significance level. Hence, the second research hypothesis is not confirmed. The test results of this hypothesis are not in line with the research results of Bhattacharya et al. [20], Lambert et al. [2], and Abariki and Hashemi [22].

Continuously taking steps to attain the goal is accompanied by limitations that make reaching the desired goal slow. Research, as a process towards attaining the goal of solving the research problem, is not exempt from this. So, in this part, via presenting the limitations of the research, we try to give this message to the reader so that he can act with more knowledge in generalizing the results of the research and make a fair judgment about the research process. The limitations of the current research can be mentioned as follows:

- Using the data available in Rahvard Navin and Tadbir Pardaz databases and the Kodal site and Stock Exchange Organization was the only source of data collection.
- The period of the current research is 8 years from 2011 to 2018, so, in terms of the time frame of the current research, it includes limitations.
- The current research was done using the data of companies admitted to the Tehran Stock Exchange, so the results attained cannot be generalized to all companies.

Based on the results of the research, the following proposal is presented for the use of the passing law and professional associations:

Because in the first hypothesis of the research, it was clarified that there is no significant relationship between corporate reputation and the cost of equity, so, it is recommended to the decision-making bodies of companies to seek other factors affecting the cost of equity.

Based on the result of the second hypothesis in this research, which established the effect of information asymmetry on the relationship between corporate reputation and cost of equity, it is suggested to the decision-making bodies of companies look for other moderating factors in this field.

During the research, new points were raised that can be a good idea for future research, these suggestions are as follows:

- Examining the relationship between corporate governance and corporate reputation.
- Examining the relationship between managerial weakness and corporate reputation.

Conflict of Interest

The authors declare that they have no conflict of interest.

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