

Evaluating the effect of venture capital on financing, financial leverage, performance and quality of financial reporting in small and medium companies listed on the Tehran Stock Exchange

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Abstract

This paper aimed to evaluate the effect of venture capital on financing, financial leverage, performance and quality of financial reporting in small and medium companies listed on the Tehran Stock Exchange. This research is applied in terms of purpose, is a quantitative research according to the type of data, and is descriptive of library type in terms of data collection method. The statistical population of the research included all companies listed on the Tehran Stock Exchange. Using the systematic removal method and considering conditions for the members of the research sample, finally 121 companies were selected as the sample, the data related to which in the period from 2011 to 2019 were collected by library and field methods. The stationarity of the variables was performed by the Levin–Lin–Chu test which showed the stationarity of all variables at the level. The pre-tests also indicated the correct use of the data panel model for data analysis. Finally, the results showed that venture capital affects financing through bank facilities, financing through stocks, financial leverage, company performance and financial reporting of companies listed on the Tehran Stock Exchange.

Keywords: Venture Capital, Financing, Financial Leverage, Company Performance, and Financial Reporting.

1. Introduction

Overinvestment affects financial leverage and provision of the financial system and the performance and importance of corporate financial reporting. A relationship is formed between leverage of large companies and overinvestment when the financial system liquidity is high, and this changes the role of financial leverage. A company's capital structure shows the relationship between debt and equity. Venture capital refers to a situation in which investment is made with risk in the hope of achieving the expected return above the market average (Qasedi Qazvini et al., 2017). In studies on venture capital, special attention is paid to the category of risk and return, so that it can be said that venture capital is not made in areas that have a very high risk and disproportionate to the return or have very low returns (Jalili & Ahmadi, 2006). The research literature describes venture capital as a driver in the entrepreneurial, creative process of core value that drives survival and economic growth. Venture capital is the best way to finance start-ups and innovative companies, because other methods because of their nature cannot fill the gap in financing companies (Drover et al., 2017). In this case, it is important to evaluate capital structure and performance of the company affected by venture capitals. The effect of venture capital affects the degree of financial leverage and the quality of financial reporting. The degree of financial leverage in the company's capital structure affects the choice of the type of operating activities of companies, which in turn affect the company's performance (Parsons & Titman, 2009). Therefore, changes in the capital structure of companies affect their value. Merton (1995) offers a definition of financing theory that is perhaps the shortest and the most accurate of its kind: Studying the behavior of brokers in the process of allocating and distributing resources from both dimensions of place and time in uncertain conditions forms the basis and foundation of financing theory. Time and uncertainty are the main elements affecting financial behavior (Merton, 1973). One of the most important methods of financing among joint-stock companies operating in the stock market are long-term bank loans and the issuance of ordinary shares. Chavoshi et al. (2015), in a study in the field of corporate financing decisions, concluded that there is no significant relationship between management overconfidence and financing decisions. Also, the relationship between helplessness risk and financing decisions is significant (Dadsrasht and Khosravi Pour, 2019). As mentioned, companies can use financial leverage instead of increasing the number of investors to raise new funds. One of the advantages of using financial leverage over issuing new shares and inviting investors is that the increased profits from new investments are not distributed among a large number of shareholders. Using financial leverage not only causes individuals or companies to gain higher returns, it also increases their investment risk. The more the financial leverage is used, the higher risk individuals have to take. Therefore, it is very important to pay attention to financial leverage of companies to analyze them; because financial leverage indicates how much of a company's growth has been generated by the company's development plans and activities or borrowed from financial resources. Many analysts use the degree of financial leverage to investigate corporate analysis (Rahimian, 2001). Another important issue is the quality of financial reporting. The quality of financial reporting is defined as the ability of financial statements to convey information about a company's operations and, in particular, to predict its expected cash flows to investors, based on the view that accruals improve the information value of profits by reducing the effect of unstable fluctuations in cash flows (McNichols, 2002; Biddle et al., 2009). The quality of financial reporting is the criteria that distinguish useful and beneficial information from other information and enhances the usefulness of information. Also, the quality of financial reporting means the degree of usefulness of financial statements for investors, creditors, managers, and other people associated with the

company. Financial reporting is not just a final product, but a process consisting of several components that can affect various factors and be affected by many factors as well. Given that the quality of financial reporting has a significant effect on capital markets and affects the decision-making of users of financial reports, the correct discovery and identification of factors affecting the quality of financial reporting from the perspective of various groups can make financial reports as an important source of reliable information for users (Jalili and Ahmadi, 2006). According to research, investment policies can effectively affect the continuation of activities, financing structure and value of companies. Since none of the limited research conducted in Iran so far has studied either the effect of venture capital on the operational and financial indicators of companies or the separation of small and medium enterprises, while these groups are the main axis of the country's developing economy, the present research aims to evaluate the effect of venture capital policy on financing, financial leverage, performance, and quality of financial reporting in small and medium companies listed on the Tehran Stock Exchange.

2. Theoretical Foundations

Many researchers in their models have identified the company's financial leverage as a variable indicating the company's risk or financial condition. From the point of view of complete capital market, as long as there are investment projects with a return exceeding their required cost, the company will use the retained earnings to finance them, and if the firm's earnings remain after financing all investment opportunities, the earnings would be distributed among shareholders. But if the investment opportunities are more than earnings of the firm, the company would have to issue new shares or take out loans. The main goal of for-profit companies is to make a profit and maximize the wealth of shareholders, therefore, they make their decisions and policies to achieve such a goal. Meanwhile, investment decisions and determining appropriate policies in this area are of greater significance because of the effect of the return caused by the company policies on the future performance of the company, the value of the company, the method of financing, and ultimately the wealth of shareholders (Mohammadzadeh, 2014). Meanwhile, managers of business units take different actions and policies in various situations and conditions to manage investments, and of course these policies can be venturous, which results in gaining more profit (accrual). The importance of investment stems from the fact that its levels affect the profitability and the level of risk that the company can bear and ultimately affect the value of the company. The position of venture capital in Iran according to the statistics that are published from time to time by some governmental and non-governmental organizations, these figures can be trusted and cited (Mir Hafez et al., 2019).

According to published reports, 700 to 800 billion tomans of venture capital have been provided in startups to date. The statistics of 1396 (2017) show that about 350 billion tomans of capital attraction has occurred in Iran's startup ecosystem. Due to the economic shock caused by similar markets being more attractive and less risky, a large part of the expectations for attracting capital did not materialize in the first six to seven months of 1397, and it seems that about 50% less capital will be attracted in 1397 compared to 1396. In 1396, there were 95 participations in stocks worth more than 2.975 billion rials and 56 participations in projects worth more than 103 billion rials. In any case, whatever the statistics, it shows the growing importance of venture capital and promises a better and friendlier relationship of investors with risk taking. In recent years, along with the growth in the number and scope of activities of enterprises, the volume of demand for facilities has increased and the pressure on the banking system to finance economic actors has increased, so that according to the Central Bank, the ratio of banks' paid facilities to

their attracted deposits was about 82.2% at the end of 1393. Although this ratio was calculated at 97.8% in 1390, the optimal and standard ratio for the Iranian economy is approximately 80%. This indicates that the issue of financing has become one of the most important issues facing firms. The results of the Global Competitiveness Report in 2014 on the Iranian economy show the problems of the industrial sector in the field of financing (Nemati et al., 2016).

3. Research background

Research background includes foreign research and domestic research, some examples of which are mentioned:

- Foreign research

The study by Hua et al. (2016) investigated the effects of venture capital on the performance and innovation of small and medium-sized enterprises (SMEs) in China. The results showed that venture capital not only innovates in the Chinese market, but also has a positive effect on financial performance.

The study by Yang et al. (2016) investigated the relationship between venture capital, financial leverage and the performance of Chinese companies. Their results showed that venture capital has a positive relationship with company performance and that financial leverage has a negative relationship with company performance. In addition, further studies showed that this negative relationship would be larger and more significant while a medium-term period is considered for the study.

The study by Hand (2004) investigated the value of financial statements in venture capital markets. The results showed that in the venture capital market, financial statements are very important in terms of value. The signs of the relationship between stock value and financial statement data in such markets are similar to those in the stock market, even if there are structural differences between them. The results also showed that as companies mature, the value of financial statements increases.

- Domestic research

Noroush and Yazadani (2010) in a study investigated the relationship between leverage and investment decisions in companies listed on the Tehran Stock Exchange. The results show that there is a significant negative relationship between leverage and investment. The results also show that the leverage-investment relationship is stronger for companies with less growth opportunity than for companies with more growth opportunity. Finally, the strength of the estimates is tested. For this purpose, the variables are adjusted using the industry average. The results of using the variable adjustment approach based on the industry average were similar to the previous results.

Tavakolnia et al. (2014) in a study investigated financial leverage and its relationship with financial ability, growth and heavy investment in fixed assets of companies listed on the Tehran Stock Exchange and deciding on the structure of capital is one of the most difficult and challenging issues facing companies. The results show that growth has no effect on financial leverage and the positive effect of financial ability on financial leverage. Also, the results show

that there is a u-shaped relationship between investing in fixed assets and financial leverage in companies listed on the Tehran Stock Exchange.

Dadashzadeh and Saadati (2019) in a study investigated the relationship between venture strategy and investment security mediated by information asymmetry. The results show that there is a positive and significant relationship between venture strategy and investment security. Also, the positive relationship between venture strategy and investment security is stronger for companies with high information asymmetry than for companies with low information asymmetry.

Seyed Jamali and Doaei (2018) in a study investigated the relationship between the quality of financial reporting on investment efficiency with respect to the moderating role of two variables of information asymmetry and ownership structure. The results show that there is a positive and significant relationship between the quality of financial reporting and investment efficiency of companies listed on the Tehran Stock Exchange. The results also indicate the significant role of the moderating variable of information asymmetry on the relationship between the quality of financial reporting and investment efficiency and the significant role of ownership structure on this relationship.

Vahidi and Mohammadi (2018) in a study investigated the decline in overinvestment, cash margin value and management systems of companies listed on the Tehran Stock Exchange. The results of this study showed that there is an inverse and significant relationship between the market value of cash investment and overinvestment of the company, but the government system did not affect the inverse and significant relationship between the market value of cash investment and overinvestment.

4. Research hypotheses

Sub-hypotheses

- Venture capital policies have a significant effect on financing through the shares of small and medium companies.
- Venture capital policies have a significant effect on financing through banks of small and medium companies.

Main hypotheses

- Venture capital policies have a significant effect on the financial leverage of small and medium companies.
- Venture capital policies have a significant effect on the financial performance of small and medium companies.
- Venture capital policies on the quality of financial reporting
-

5. Statistical population and sample

The statistical population of the present research includes all member companies of the Tehran Stock Exchange from 1393 to 1398 (2014 to 2019) for 6 years and the sample is selected based on systematic removal so that they have the following features:

- Their fiscal year has ended on Esfand 29 (March 20),
- They have been listed on the Tehran Stock Exchange at least until the end of 1393,
- The companies have not changed their financial period,
- These companies have not had a trading halt for more than three months, they are not financial intermediation companies (banks, insurance and holding companies),
- The companies are non-consolidated and audited,
- Financial statements and explanatory notes about them are fully available. Also, to separate small and medium companies from the companies in the sample companies based on the sampling conditions mentioned, the natural logarithm of the total book value of assets of each company (as a factor of size) in each year of the financial period is calculated. Then, using the quartile technique, three quartiles are created based on the size of the companies, so that the first quartile includes small companies, the second and third quartiles include medium companies.

6. Research models

To investigate the research, as in the research by Wu and Zhou (2020), the effect of venture capital on the dependent variables of financing, financial leverage, performance and quality of financial reporting is fitted as described in Model 1. It is worth mentioning that the present research is fit by the correlation regression method. The main research equation is:

$$\text{Stock Finance}_{i,t} = \beta_0 + \beta_1 VC_{i,t} + \beta_2 \text{Age}_{i,t} + \beta_3 \text{Growth}_{i,t} + \varepsilon_{i,t} \quad \text{Model (1)}$$

The following is an operational definition of the variables and how to calculate them:

➤ Dependent variables:

$\text{Stock Finance}_{i,t}$: Financing through ordinary shares of company i at time t , financing through ordinary shares, which is calculated by dividing the ordinary shares issued by the total assets of the company (Razmjoui et al., 2015).

$$\text{Stock Finance}_{i,t} = \frac{\text{ordinary shares}}{\text{total assets}}$$

➤ Independent variable:

$VC_{i,t}$: Venture capital policy of company i at time t , venture capital policy: equals the ratio of current assets to total assets (Onwumere et al., 2012).

$$VC_{i,t} = \frac{\text{Current assets}}{\text{Total assets}}$$

➤ Control variables:

Due to the control of the effects of the independent variable on the dependent variables, as in Onwumere et al. (2012), company age and company growth were considered as control variables.

Age_{i,t}: Age of company i at time t

Growth_{i,t}: Growth of company i at time t

7. Research findings

7.1. Descriptive statistics

According to the descriptive statistics table, the mean venture capital of the sample companies is equal to 0.13 and its minimum and maximum values are equal to 0.011 and 0.56. If the distribution is normal, these coefficients must tend to zero. If the skewness is zero, the distribution is normal. Regarding kurtosis, the curve is normal when the kurtosis is zero. Examination of skewness and kurtosis of this variable, which must be 0.46 and 3.39, respectively, for the variable to have a normal distribution, shows that this variable does not have a normal distribution. Therefore, according to the degree of skewness and kurtosis of the research variables, none of the variables are normal.

Table (4-1): Descriptive statistics of research variables

Symbol	Variable	Mean	Max	Min	Std. Deviation	Skewness	Kurtosis
VC	Venture capital policy	0.13	0.56	0.011	0.12	0.46	3.39
SF	Debt financing	0.120	0.387	0.071	0.042	2.329	7.487
BF	Financing of bank facilities	0.133	0.764	0.133	0.208	0.195	1.997
LEV	Financial leverage	0.628	0.925	0.120	0.246	-0.679	2.415
Rq	Total accruals	0.123	9.00	3.00	1.15	0.59	2.87
Perform	Financial performance	0.369	0.769	0.059	0.281	-0.23	2.15
Age	Company age	0.569	0.820	0.097	0.143	1.09	3.79
Growth	company growth	0.348	0.473	0.027	0.059	-1.015	2.468

Source: Research Findings

7.2. Data analysis and pattern selection for research model

7.2.1. Determining the type of panel data

In this section, the panel unit root tests (using the Levin–Lin–Chu test and the Im-Pesaran-Shin test) were used in order to detect the stationarity of variables and the lack of dependence between the variables and the Chow test was used in order to determine the fixed and random effects of

the variables and also the Hausman test was also used to select a better model from random effects and fixed effects.

- Panel unit root test for reliability of variables

The unit root test is used to detect static variables. The foundation of the unit root test is based on the logic that when $b = 1$ in an autoregressive process, then the variable Y_t has one single root, and this is an example of a non-static variable. Before estimating the research model, it is necessary to test the stationarity of all variables used in the estimates. Because the stationarity of variables in both time series data and panel data causes false regression. In the present study, the Levin-Lin-Chu and the Im-Pesaran-Shin tests are used to evaluate the stationarity of the research variables. The results of each of the two tests are presented in the table below. As can be seen, the null hypothesis of the Levin-Lin-Chu test that all variables have no significance is rejected at the 95% probability level. Therefore, all variables are stationary at level.

Table (4-6): unit root test

Abbreviation	Levin-Lin-Chu statistic	Probability value	Stationary at level
	-38/01	0/000	Stationary at level
	-42/43	0/000	Stationary at level
	-28/48	0/000	Stationary at level
	-75/37	0/000	Stationary at level
	-63/18	0/000	Stationary at level
	-46/04	0/000	Stationary at level
	-43/12	0/000	Stationary at level
	-53/17	0/000	Stationary at level

Source: Research Findings

- Pesaran test (residual cross-section dependence)

The Pesaran test statistic follows the standard normal distribution and can be used in balanced and unbalanced panels and fixed and random effect models. The test also provides a residual correlation matrix. The null hypothesis in this test is that the residuals are not correlated and therefore there is no cross-section dependence. The results of the Pesaran test are presented in the table below:

Table (4-9): Pesaran test for research model

Dependent variable	Pesaran statistic	Probability value
Common Stock Financing (SF)	568/14	0/532

Banking Facility Financing (BF)	423/52	0/125
Financial Leverage (LEV)	325/32	0/321
Financial Performance (Perform)	469/56	0/123
Total accruals (Rq)	652/42	0/185

Source: Research Findings

The null hypothesis of Pesaran test is not rejected. As a result, residuals are not correlated between cross sections and cross sections have no dependence.

- Chow test (F-Limer)

The F-Limer test statistic is calculated based on the following equation and compared with the F-value of the table:

$$F_0 = \frac{(RRSS - URSS)/(N - 1)}{URSS / (NT - n - k)}$$

N is the number of cross sections and companies and t is the time period and k is the number of explanatory variables of the model. The results of the fixed effects model estimation are given in the table below. To test the Chow test after estimating the model with fixed effects, the F-Limer statistic must be calculated in order to judge between the fixed effects method and the ordinary least squares.

Table (4-7): Chow test results

Chow test		Statistic	Probability
The first model	Cross-section F	3/42	0/001
	Cross-section Chi-square	532/42	0/012
The second model	Cross-section F	2/75	0/000
	Cross-section Chi-square	325/14	0/000
The third model	Cross-section F	4/36	0/014
	Cross-section Chi-square	563/42	0/023
The fourth model	Cross-section F	2/74	0/000
	Cross-section Chi-square	423/19	0/000
The fifth model	Cross-section F	2/17	0/000
	Cross-section Chi-square	386/18	0/000

Source: Research Findings

The results show the confirmation of the fixed effects against the integrated least squares method.

- Hausman test and selection of fixed or random effects

If the null hypothesis is rejected and the alternative hypothesis is accepted, the fixed effects method is compatible and the random effects method is incompatible, and we must use the fixed effects method. The Hausman test statistic has an X^2 distribution, and if its probability value is less than 0.05, the fixed effects model is accepted at the 95% confidence level. The statistic of this test is as follows:

$$H = (b_1 - b_0)'(Var(b_0) - Var(b_1))^{-1}(b_1 - b_0)$$

If the calculated test statistic is greater than the value in the table, H_0 is rejected and there is a correlation, so the fixed effects method should be used. In this test, the null hypothesis is rejected and indicates the confirmation of fixed effects versus random effects. Because the probability value is less than the standard value of 0.05%. Therefore, the model of this research should be estimated as fixed effects.

Table (4-8): Hausman test results

Hausman test		Statistic	Probability
The first model	Cross-section random	19/28	0/000
The second model	Cross-section random	23/04	0/000
The third model	Cross-section random	19/23	0/000
The fourth model	Cross-section random	17/74	0/000
The fifth model	Cross-section random	16/96	0/000

Source: Research Findings

7.3.2. Test of heteroscedasticity and autocorrelation

- Test of fixed variance of disturbance terms (Breusch-Pagan)

Breusch-Pagan test is used to prove the lack of autocorrelation between the residuals of the models. What is important here is that the model residuals lack autocorrelation. According to the results of Breusch-Pagan test and considering the level of significance and considering that the probability value is more than 0.05, the null hypothesis of the research that there is no autocorrelation in the model residuals is accepted. Also, according to the F-statistic as well as the multiplication statistic of the number of observations in the coefficient of determination, we conclude that there is no autocorrelation between the residuals of the model.

Table (4-5): Breusch–Pagan test

Research model	Statistic	Calculated statistic	Sig. level
The first model	F-statistic	5/24	0/096
	Obs*R-squared	58/84	0/56
The second model	F-statistic	3/71	0/42
	Obs*R-squared	42/29	0/18
The third model	F-statistic	6/13	0/41
	Obs*R-squared	53/14	0/32
The fourth model	F-statistic	4/21	0/42
	Obs*R-squared	75/14	0/31
The fifth model	F-statistic	7/13	0/23
	Obs*R-squared	59/18	0/47

Source: Research Findings

7.4. Model estimation using Generalized Least Square (GLS) method

According to the results of the tests performed, the variables are stationary at level, using the data panel model is appropriate to estimate the model, random effects must be used to estimate the model. Therefore, according to the specifications that we estimated for the model, we estimate the model. According to the results obtained from F and Hausman tests, we estimate the model by the generalized least square (GLS) method in the framework of weighted cross-section regressions and taking into account the random effects. In general, the generalized least square controls the collinearity between the residual terms. Therefore, for all i, j, s, t where $i \neq j, s \neq t$, we can consider:

$$E(\varepsilon_{it} \cdot \varepsilon_{jt} | X_i^*) = \delta_i^2$$

$$E(\varepsilon_{is} \cdot \varepsilon_{jt} | X_i^*) = \delta_i^2$$

The results of estimating the research models using the random effects model method are presented in the following table:

Model for Hypothesis 1:

$$\text{Stock Finance}_{i,t} = \beta_0 + \beta_1 \text{VC}_{i,t} + \beta_2 \text{Age}_{i,t} + \beta_3 \text{Growth}_{i,t} + \varepsilon_{i,t}$$

Table (4-10): Panel test results for the first research model

Variable	Coefficient	t-value	Sig. level
VC	0/68	3/46	0/000
Age	0/56	2/47	0/000
Growth	0/42	5/08	0/352
$D.W = 1.58$ $probF = 0.000$ $R^2 = 0.83$			

Source: Research Findings

The result of Hypothesis 1: As the determination coefficient of the model shows, the independent variables were able to predict 83% of the changes in the dependent variable. In other words, the explanatory power of the model is 83%. The F-statistic and the related significance level and its comparison with the error level (0.000) indicate that the model is significant at the 99% confidence level. The Watson-Durbin statistic is also equal to 1.58, which rejects the existence of serial (first-order) autocorrelation between regression disturbance components. The rejection of serial (first order) autocorrelation between the regression disturbance components indicates that the model regression coefficients and the coefficient of determination are not false. The results also showed that there is a positive and significant relationship between venture capital policy and financing through ordinary shares of companies. Because the probability value obtained (0.000) is less than the standard value of 0.05%.

8. Suggestions

Based on the findings of the research, the following suggestions are provided:

- It is suggested to managers that when they feel financial constraints in the company, by adopting a working venture capital policy, they first reduce the level of liquidity and invest the liquidity to increase the credit, and then by receiving facilities or capital, they increase the level of liquidity and reduce the constraint by increasing the level of liquidity and dividends and the market value of the company and reducing the debt of the company.
- Companies facing financial constraints are suggested to adopt supervising mechanisms for managers' behaviors. This is because managers in companies with financial constraints have venturous behaviors and may spend most of the company's resources investing in projects. As a result, there may not be enough resources for the company's other decisions and companies may face liquidity problems.
- It is suggested that researchers, by investigating the financial condition of companies in terms of financial constraints, be able to identify and analyze ways to escape the financial constraints.

- Managers are suggested to identify their situation in terms of financial constraints to be able to make decisions to improve the company's financial situation and to move out of the list of companies with financial constraints and they can also compete with companies in their group.

9. Conclusion

In this research, the research methodology and tests related to data panel method were expressed. In this regard, in order to investigate the stationarity of variables, we used two tests of Levin–Lin–Chu and Im-Pesaran-Shin, which confirmed the stationarity of the variables at the level, which, of course, was not far from the mind given the proportion of the variables. Then, Chow test was used to test the significance of fixed effects. Hausman test was also used to select the appropriate model from the fixed and random effects. Pesaran test was used to evaluate the lack of dependence between the variables, and finally, using the GLS approach, we investigated the relationship between the research variables in companies listed on the Tehran Stock Exchange.

As it was observed, the null hypothesis of the Levin–Lin–Chu test that there is no stationarity for all variables was rejected at the 95% probability level. Therefore, all variables are stationary at the level. The null hypothesis of the Im-Pesaran-Shin that there is no stationarity for all variables was rejected at the 95% probability level. According to the Chow test results, the probability value indicated the rejection of the null hypothesis on using the pooling model. Therefore, we used the data panel model for the model. The result of Hausman test for research models indicated the acceptance of the null hypothesis that the random effects model is appropriate, therefore, we used the random effects model to estimate the model.

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