

The impact of IAS19 on Corporate Capital Structure

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Background

In the traditional labour-economic literature the existence of employer-sponsored pension plans is mainly attributed to:

- the employers' ability to control through pension plans the workers' effort, quality and turnover;
- the employees' taxation and economies of scale benefits; and
- the employees' insurance and consumption smoothing needs (Gustman et al., 1994; Barr and Diamond, 2006).

So employees are willing to forgo part of their salary now in exchange for a future payment (lump sum or annuity).

Background

In the case of Defined Benefit Plans (DBP) this future payment is a-priory determined and is unrelated with the return of funds that the firm set aside for its pension obligations.

Unless there is a legal minimum funding requirement, the firms are flexible in deciding the amount and timing of pension contributions, which are tax deductible in most of the cases. However, a potential inability to pay pension liabilities might trigger bankruptcy.

Conclusively, DBP share significant characteristics of debt.

Prior Literature – Motivation

Shivdasani and Stefanescu (2009) argue that pension liabilities are a substitute for debt liabilities; and that managers take into account pensions when balancing the tax shield benefits of leverage against the increase in firm's distress risk.

More specifically, they show that an 1 percentage point increase in the pension liability to total assets ratio is associated with a 0.36 percentage points decrease in the leverage ratio.

Prior Literature - Motivation

Prior literature has shown that pension assets and liabilities are value and credit relevant (e.g. Landsman, 1986; Maher, 1987 ; Barth, 1993; Brown, 2004; Fasshauer and Glaum, 2009). Moreover, Jin, Merton and Bodie (2006) provide evidence that pension-related risk is incorporated in the equity risk of firms.

However, some researchers argue that equity holders and analysts do not fully understand pension accounting information (Franzoni and Marin, 2004; Picconi, 2006; Doskeland and Kinserdal, 2009)

Hypothesis Development

Most of the above studies use US samples and data present on the face of financial statements or in the footnotes.

However, some European countries had no pension accounting standard or had very obscured standards prior to IFRS introduction (e.g. France, Germany, Italy).

Thus, it was very difficult for investors and debtholders to estimate the actual pension liability prior to IFRS; and the adoption of IAS19 has potentially revealed significant new information about firm leverage.

Differences between Local GAAP and IFRS

	<u>PBO</u>			<u>Unfunded Pension Liabilities</u>			<u>Finance Leases</u>		
	Mean	Median	St. Deviation	Mean	Median	St. Deviation	Mean	Median	St. Deviation
Austria	70,300	9,367	160,000	2,834	2,581	6,161	-	-	-
Belgium	314,000	17,400	804,000	1,060,000	1,060,000	1,490,000	5,918	230	15,700
Denmark	68,300	42,200	79,600	-	-	-	22,900	100	54,400
Finland	-	-	-	-	-	-	7,083	1,000	11,800
France	300,000	11,200	1,530,000	60,400	15,500	244,000	34,800	584	133,000
Germany	128,000	838	726,000	113,000	-15	534,000	197,000	84	600,000
Ireland	-9,941	1,000	53,100	-138	464	28,200	185	0	4,768
Netherlands	23,000	11,000	294,000	21,000	18,300	172,000	111,000	446	834,000
Portugal	111,000	17,800	209,000	160,000	0	279,000	510	17	1,547
Spain	-	-	-	-	-	-	-3,068	-422	21,600
Sweden	23,100	210	44,300	79,900	-820	167,000	8,405	1,219	19,600
United Kingdom	7,525	3,745	259,000	3,159	1,694	247,000	56,800	2,223	280,000

Hypothesis Development

In the light of this new information managers might have had to reconsider the firm's capital structure. Either due to

- a change in the perception of firm fundamentals (i.e. increased cost of capital) that led the firm away from its adopted “optimal” leverage; or

- a decrease in the information asymmetry between managers and debtholders that pushed the former to adjust overall leverage in order to comply with contractual agreements.

H_1 : The increase in pension liabilities caused by IFRS adoption is negatively associated with leverage (excluding pension liabilities).

Contribution

Prior literature considers capital structure as a determinant of accounting choices; but there is limited evidence on how accounting affects capital structure decisions.

We add to a growing stream of literature examining the relation between pensions and corporate financial policies.

We extend prior literature on unintended economic consequences of IFRS.

Potential Research Approach

Use a control pre-IFRS sample, to predict the level of financial debt.

Estimate unpredicted change in financial debt leverage for post-IFRS sample.

Regress unpredicted changes in financial debt on changes in pension liabilities.

Issues to be considered

One country sample VS international study.

Long term debt (investment needs) VS Short term debt (working capital needs).

Time window over which we expect the changes to take place.

Pension termination substitution effect.