



Agency Costs and Sukuk Issuance: Evidence from Excess Cash Holdings and Bank Guarantees in Iran

Dr. Parisa Saadat Behbahaninia^{1*}, Zahra Najafi²

1. Associate Prof, Department of Accounting, Faculty of Social Sciences and Economics, Alzahra University, Tehran, Iran.

2. MSc., Department of Accounting, Faculty of Social Sciences and Economics, Alzahra University, Tehran, Iran.

1. Introduction

The development of Islamic financial instruments has increasingly attracted the attention of policymakers, investors, and researchers as an alternative to conventional interest-based financing systems. Among these instruments, Sukuk have emerged as one of the most important Sharia-compliant securities, playing a pivotal role in mobilizing financial resources and fostering capital market development, particularly in emerging economies (Mousavian, 2007). Unlike conventional bonds, Sukuk are structured on ownership rights over underlying assets, usufructs, or projects, rather than fixed interest obligations. This structural distinction results in different implications for risk-sharing, transparency, and corporate governance (Tohidi & Yarmohammadi, 2019; Tohidi, 2022).

In recent years, Sukuk issuance has expanded beyond purely religious motivations and has increasingly been driven by economic, institutional, and governance-related factors such as financing constraints, information asymmetry, and firm-level characteristics (Nagano, 2017; Ashraf et al., 2018; Sadallah, 2025). Prior studies emphasize that corporate governance

mechanisms and ownership structures significantly influence firms' decisions to issue Sukuk (Halim et al., 2017; Putri & Lubis, 2022). Consequently, understanding the determinants of Sukuk issuance has become a central research agenda within the Islamic finance literature.

From a corporate finance perspective, financing decisions are inherently linked to agency theory, which highlights conflicts of interest arising from the separation of ownership and control (Jensen, 1986; Childs et al., 2005). Agency costs emerge when managers pursue personal objectives at the expense of shareholders, leading to inefficient investment decisions, suboptimal resource allocation, and value erosion (Oded, 2020; Behmaninia, 2022). One of the most critical manifestations of agency problems is the accumulation of excess cash holdings, which enhances managerial discretion and increases the likelihood of opportunistic behavior and inefficient use of corporate resources (Ha, 2019; Dabbousi, 2024).

The literature suggests that excess cash holdings are closely associated with agency costs and are influenced by governance mechanisms such as ownership structure, institutional monitoring, and auditor selection (Kim et al., 2019; Behmaninia, 2022). In the context of debt financing, firms facing higher agency costs may deliberately choose financing instruments that impose external discipline and constrain managerial discretion over free cash flows (Childs et al., 2005; Nazir et al., 2021). As a result, capital structure and debt capacity function as governance tools for mitigating agency conflicts (Behnaninia et al., 2018; Behnaninia et al., 2018).

Recent studies extend this argument to Islamic debt instruments, suggesting that Sukuk may serve not only as a financing mechanism but also as a corporate governance device. Due to their asset-based structure, mandatory disclosure requirements, and restrictions on fund utilization, Sukuk issuance can enhance transparency and reduce information asymmetry between managers and investors (Halim et al., 2017; Kiaei & Soleimani, 2019). Empirical evidence indicates that firms with higher agency costs are more likely to issue Sukuk as a means of disciplining managerial behavior and signaling financial commitment to the market (Ashraf et al., 2018; Santoso et al., 2023).

In the Iranian capital market, Sukuk issuance has gained increasing importance due to banking credit constraints, regulatory reforms, and the introduction of new financial instruments under the Law on Development of New Financial Instruments and Institutions and the Securities Market Law

of the Islamic Republic of Iran. However, a distinctive feature of the Iranian Sukuk market is the widespread use of bank guarantees, which play a critical role in enhancing investor confidence and facilitating issuance (Hassanzadeh et al., 2021; Tohidi, 2022). While bank guarantees reduce perceived default risk, their presence may also influence how market participants perceive firm-level agency problems and financing incentives.

Despite the growing body of literature on Sukuk and corporate governance, empirical evidence on the role of agency costs—proxied by excess cash holdings—in shaping Sukuk issuance decisions in Iran remains limited. Moreover, the potential moderating effect of bank guarantees on the relationship between agency costs and Sukuk issuance has not been sufficiently explored. Addressing these gaps, the present study examines how agency costs influence both the likelihood and the volume of Sukuk issuance, while also investigating the moderating role of bank guarantees in the Iranian capital market. By doing so, this study contributes to the Islamic finance and corporate governance literature by providing firm-level evidence from an emerging Islamic capital market.

2. Hypotheses

Based on agency theory and Islamic finance literature, the following hypotheses are developed:

H1: Agency costs significantly affect the likelihood of Sukuk issuance.

H2: Agency costs significantly affect the volume of Sukuk issuance.

H3: Bank guarantees moderate the relationship between agency costs and Sukuk issuance.

3. Methods

This study adopts an applied, descriptive-correlational research design and utilizes panel data analysis. The statistical population consists of firms listed on the Tehran Stock Exchange and Iran Fara Bourse over the period 2019–2023. Firms operating in financial intermediation sectors—such as banks, insurance companies, leasing firms, and investment holdings—are excluded due to their distinct financial structures. Additional screening criteria include data availability, fiscal year consistency, and profitability.

The final sample comprises 169 firm-year observations, including 41 instances of Sukuk issuance, reflecting the relatively nascent stage of Sukuk

utilization in the Iranian capital market. Financial data were obtained from the Rahavard Novin database and the Codal disclosure system. Agency costs are operationalized using excess cash holdings, following the methodology of Dittmar and Smith (2007) and Opler et al. (1999). Expected cash holdings are estimated through a regression model incorporating firm size, free cash flow, net working capital, market value, research and development expenditures, and year fixed effects. Excess cash is calculated as the residual from this model. Firms in the top two quartiles of excess cash are classified as having high agency costs. To test H1, a logistic regression model is employed, where the dependent variable equals one if a firm issues Sukuk in a given year and zero otherwise. To test H2 and H3, ordinary least squares regression models are used, with the logarithm of total Sukuk issuance volume as the dependent variable. The moderating effect of bank guarantees is examined through an interaction term between agency costs and a binary indicator for bank guarantee usage. Control variables include asset tangibility, leverage, firm size, and return on assets. All analyses are conducted using Stata software. Diagnostic tests confirm the absence of multicollinearity, heteroskedasticity, non-normal residuals, and autocorrelation.

4. Results

The empirical findings demonstrate that agency costs have a positive and statistically significant effect on the likelihood of Sukuk issuance. Firms with higher excess cash holdings are more likely to issue Sukuk, supporting the argument that Sukuk serve as a governance mechanism to mitigate agency conflicts.

Consistent with this result, agency costs also exhibit a positive and significant relationship with the volume of Sukuk issuance. Firms facing more severe agency problems tend to issue Sukuk in larger amounts, possibly to impose stronger financial discipline, signal commitment to transparency, and secure sufficient funding for investment projects.

Furthermore, the presence of a bank guarantee has a direct positive and significant effect on Sukuk issuance volume, indicating that guarantees enhance firms' access to Islamic debt markets and reduce financing constraints. However, the interaction between agency costs and bank guarantees is not statistically significant, suggesting that bank guarantees do not materially alter the agency-driven motivation for Sukuk issuance.

Overall, the results indicate that while bank guarantees facilitate Sukuk issuance, they do not substitute for or significantly amplify the governance role of Sukuk in addressing agency problems.

5. Conclusion

This study provides robust evidence that Sukuk issuance in the Iranian capital market is strongly influenced by agency considerations, particularly excess cash holdings. Firms with higher agency costs are more likely to issue Sukuk and to do so at a larger scale, underscoring the role of Sukuk as both a financing instrument and a governance mechanism.

While bank guarantees play a critical role in enhancing issuance capacity and investor confidence, they do not significantly moderate the relationship between agency costs and Sukuk issuance. These findings highlight the importance of firm-level governance incentives over external guarantees in shaping Islamic financing decisions.

The study contributes to the Islamic finance and corporate governance literature by extending agency theory to the context of Sukuk issuance in an emerging market. Practically, the results suggest that managers can strategically use Sukuk to mitigate agency conflicts; investors may interpret Sukuk issuance as a signal of financial discipline, and policymakers should strengthen institutional infrastructures—such as credit rating agencies—to reduce overreliance on bank guarantees and promote sustainable development of Islamic debt markets

Keywords: Agency cost, Banking Guarantor, Islamic Financial Instruments, Sukuk.