The Effect of Debt Balancing on Cash Dividend

Abolfazl Ghadiri Moghaddam, Accounting Associated Professor, Accounting Department, Mashhad Branch, Islamic Azad University, Mashhad, Iran

Fatemeh Yousefzadeh*, Accounting Department, Mashhad Branch, Islamic Azad University, Mashhad, Iran
Najmeh Dehghan, Accounting Department, Mashhad Branch, Islamic Azad University, Mashhad, Iran
Mahdieh Abdollahi Zeiaoddini, Accounting Department, Neyshabor Branch, Islamic Azad University, Neyshabor, Iran
Zeinab Kakhki, Accounting Department, Mashhad Branch, Islamic Azad University, Mashhad, Iran

Abstract

The purpose of this study was to investigate the relationship between corporate debt with dividend policy and corporate profits payments. For this purpose corporate dividend policy was measured using the ratio of cash dividend to dividends payment. Also in the study the control variables such as firm size, firm growth, earnings before interest and taxes, cash and the ratio of retained earnings to equity were used. The study was conducted for a period of 5 years (2008-2011). Also the variables were analyzed using regression method and Eviews software. The results of the first hypothesis indicate that the correlation coefficient between independent variables (liabilities) and dependent variable (dividend policy) is equal to 0.3472. So there is a significant relationship between these two variables. But the evidence of hypothesis suggests that there is no significant relationship between two variables of debt and companies that pay dividends.

Keywords: Dividend Policy, Creditor, Debt.

1. Introduction

Dividend policy provides environment for the study of how companies manage simultaneously competing interests of shareholders and creditors. Dividends reduces the shareholders concerns about expropriation by managers, while will intensify concerns creditors about expropriation by shareholders. Dividend policy over time has always been a source of confusion for financial investigators. Managers maintain the company profits to re-invest and reducing the cost of financing for investment opportunities to a reasonable level or declare part of it as dividends that profits distributed as that would reduce available resources for investment. Cash flow distribution between business owners often is an important issue in the capital market. Companies can distribute their cash flow in different ways. One of the ways that many studies

* **Corresponding Author**

pay attention to them, are distribution of cash dividends. Dividend policy of a company plays an important role in the value of its stock. Many theories about dividend policy provided that each focus on the specific issues and focus on that aspect. For example, the theory of a bird in the hand or cash slapping is better than credit halva say that shareholders prefer high dividends to capital gains, because they feel that capital gains will depend on various factors, especially tax and it is better to get your profits at the end of the fiscal year. Different people have different prospects and investment of profit firms is important. On the other hand, creditors are based on the belief that if the company will pay lower dividends can better act the company's own debt collection. Purposes of corporate are different from the payment of dividends and may be for attracting certain customers or to convey information to the market or be just for cash returns for shareholders. For this reason, none of the other theories of dividends are not successful alone compare to other theories. And its cause probably returns to different incentives to pay dividends.

2. Review of literature

Dividend policy is one of the most important issues in financial management; because dividends represent the major cash payments of company and one of the most important choices and dividend decisions, and how much is reinvested in the form of retained earnings in the firm. Despite of the payment of dividends will directly benefit shareholders, and affect the company's ability in accumulate the profits to take advantage of the growth opportunities (Baker & powel, 2005: pp. 402). Moreover, the policy of in the stock market has information content. Its changes contain the information for Shareholders. Depending on the preferences of each investor, shares will be purchased that dividend policy considers it desirable. The amount of proposed dividend by the board of directors often contains important information concerning expectations of the company's future profitability (Jahankhani & parsayian, 2005: pp. 421). The dividend policy is one of the aspects that are affected by agency conflicts (Haradavenguen, 2006 & Jahankhani & qorbani, 2005). In general, there are two different perspectives in content of dividends and agency contrasts. At first perspective, dividends are solution for reduction agency conflicts between managers and shareholders, and in the second approach dividends is an alternative to agency problems (cookies and Gizani, 2009). Generally, the relationship between dividends and earnings per share represent firm dividend policy (Cooper and Ijiri, 1983: pp. 179; Mansinly and Ozkan, 2006; Imanipoormoghadam, and Ghalibafasl of 1997, 2007: p 21). Dividend policy is one of the most important issues of corporate finance literature. Many researchers have brought the theoretical and empirical evidence related to dividend policy measures. However, the issue of dividend policy is still unresolved and there are not specific guidelines on the optimal dividend policy (Nakoor et al, 2006). However, corporations usually adopt certain policies about dividend. In formulating this policy, several factors are considered such as the policies used in other similar companies, the past dividend policy, stability of profitability and legal constraints. Despite numerous policies, many companies often use in practice from policies such as dividing the sum of fixed amount, assigned a fixed percentage of profits, dividends plus variable margin and excess dividend (Beiker & powel, 2005: pp. 423 and Jahankhani & parsayian, 2005: p 423) .

2.1 Dividend policy *objectives*

The payment of earning is one of methods that firms effect on stockholder wealth directly.

So, the goal of dividend policy is determining the role that it plays to maximize shareholder wealth. Since dividend policy is influenced by several factors, dividend payments to shareholders would be meaningless to maximize shareholder wealth.

The factors that effect on dividend policies are as following:

Retained earnings as a source of financing

Composition of the capital structure

Shareholders need

Legal constraints

2.2 Dividend policy

Successful companies earn earnings; hence, there are four modes for these benefits:

Re-investment in operational assets

Apply for purchasing

Use for debt payment

May distribute between stockholders

2.3 Research background

Chen & Strang examined the effective factors on capital structure on in accepted firms on Tehran Exchange stock at 2003 in Shanghay & Shenzenchin. They concluded there is reverse relationship between profitability and capital structure (debt ratio).

Dittmar et al with studying more than 11000 firms from 45 countries concluded in countries that support from stockholder right Companies twice companies active in the countries with strong support from shareholders, attempting to hold their cash.

Asadi et al (2010) examined the relationship between capital structure and ownership structure. The empirical evidence showed there is negative significant relationship between capital structure and ownership structure.

Foroughi et al (2010) examined the effect of earnings quality on the amount of cash maintenance. . His study concluded there was a significant negative relationship between quality of earnings and the amount of cash held using data of 10 years between the years 2000 to 2008. The results demonstrate that 85% change in cash holdings described by the changes in the independent and control variables in the models.

Arbabian and Graily (2009) conducted a study entitled, "The effect of capital structure on profitability of listed companies in Tehran Stock Exchange". The results showed positive relationship between short-term debt to assets ratio and profitability of the company and also the ratio of total debt to assets ratio and negative relationship between profitability and long-term debt to asset and profitability.

Jensen et al (1992) investigated the relationship between ownership structure and debt policy and dividend. Results indicated that the level of local ownership (management) varies between companies and firms with high inside ownership choose low debt and dividend levels. Furthermore, the impact of profitability, growth and capital expenditures on debt and dividend policy support of a modified hierarchical model.

Lin & Rowe investigated the profitability of Chinese companies. They consider factors such as the growth rate of non-stock corporations, dormant assets, liabilities rates and international trade and concluded that the growth of non - stock corporation is negatively correlated with profitability in stock corporation.

Abdossalam et al (2008) investigated the effect of board composition and ownership structure on dividend policy. In this regard, the 50 Egyptian companies within the time period 2003 to 2005 were addressed. The results indicate that firms with a higher rate of return on equity and institutional ownership divided greater profits. In addition, there is a significant relationship between board composition and dividend policy.

Giovan Nye (2009) investigated the relationship between institutional ownership and dividend policy. The results of study of U.S. industrial firms for the period 1980 to 2002 suggests that institutional ownership has a direct relationship with the amount of interest payments.

Kooki & Gizani (2009) also investigated the effect of ownership structure on dividend policy in Tunisian companies. Our findings suggest that firms with centralized ownership distributed more profits. Negative and significant relationship between the level of institutional ownership and dividend distribution exists and the relationship between dividend policy and state ownership is positive.

Sawa (2006) investigated the hypothesis messaging dividends on German Stock Exchange and gained evidence confirming the link between reduced dividend and future performance of the company. But he finds evidence of increasing cash dividends contain information of endorse the company's future operating performance.

3. Research Methodology

3.1. Statistics population

The population is accepted firm in Tehran Stock Exchange during 2007-2011. Due to the nature of the topic, investment companies, financial intermediaries and banks are excluded from the sample. For the sampling first the firms in the industries listed above will be removed from the population and then the remaining firms has the following conditions shall be elected as members of the population.

1. The information necessary to calculate variables and testing hypotheses can be extracted from the public report issued for the stock.
2. The fiscal year ended to 29 March to ensure comparability and avoid heterogeneity and should not have changes in fiscal year between years of 2005-2011.

3.2 Research hypotheses

1- There is a significant relationship between the amount of debt and dividend policy
2- There is a significant relationship between the amount of debt and the firms that have dividend.

Research models are as following

$$\text{Policy dividend}_{i,t} = B0 + B1Dbet + B2Size_{i,t} + B3Growth + B4Profit + B5Cash + B6\, {RE}/{TE} + B7\, Yeardummies + B8\, industrydummies$$

$$\text{payer}_{i,t} = B0 + B1Dbet + B2Size_{i,t} + B3Growth + B4Profit + B5Cash + B6\, {RE}/{TE} + B7\, Yeardummies + B8\, industrydummies$$

3.3 Research variables

3.3.1 Dependent variables

Policy Dividend: is calculated from dividend by its payment

Payer: earning payment, dummy variable that is 1for firm that has dividend and is 0 for firm that has not divident.

3.3.2 Independent variables

Debt: The amount of debt that is equal to sum of current and long term debt.

3.3.3 Control variables

Size: natural logarithm of firm assets

Growth: natural logarithm of net sale

EBIT: earnings before interest and tax

RE/TE: retain earnings/ equity

Cash: the sum of cash and short term investment

Year Dummies: is equal to zero and one in order to examined year

Industry Dummies: is equal to zero and one in order to examined industry

4. Research results

Table 1: the summery of first hypothesis testing

Variables	Coefficients	s.d	t- statistic	level of Significance
β_0	-0.215	0.481	-0.446	0.655
$Debt$	-7.760	5.3866	-1.440	0.150
$Cash$	1.514	0.000	2.634	0.008
$Size$	-0.013	0.036	-0.359	0.7194
$Growth$	-0.001	10.00	-1.887	60.0
$profit$	-0.221	0.181	-1.221	0.223
RE/TE	-0.074	0.0372	-2.0098	0.045
$industryeffects$	No	No	no	No
$Yeareffects$	Yes	Yes	yes	Yes
Coefficient of determination	0.1206			
Adjusted Coefficient of determination	0.0682			
F statistic	2.3025			
Durbin-watson	1.7852			
Significance of model	0.0056			

The correlation coefficient between independent variables (liabilities) and the dependent variable(dividend policy) is equal to 0.3472 and the probability of meaningful review is equal to 0.0056, which is smaller than 0.05. Therefore, with certainty of 0.95 percent it is exclude evidence that there is no relationship between the volatility of debt and stock dividends. So it can be stated that there is correlation between the volatility of debt and dividend policies.

Table 2: the summery of second hypothesis testing

Variables	Coefficients	s.d	t- statistic	level of Significance
β_0	0.151	0.252	0.599	0. 55
$Debt$	0.744	0.000	0.026	0.979
$Cash$	-3.537	0.000	-1.1776	0.24
$Size$	0.04061	0.01913	2.1229	0.0348
$Growth$	-2.1748	2.9686	-0.732	0.4645
$profit$	0.4968	0.0946	5.2503	0.000
RE/TE	0.1004	0.019	5.16	0.000
$industryeffects$	Yes	Yes	Yes	Yes
$Yeareffects$	Yes	Yes	Yes	Yes
Coefficient of determination	0.572			
Adjusted Coefficient of determination	0.568			
F statistic	324.189			
Durbin-watson	1.990			
Significance of model	0.000			

The second hypothesis examined in various industries. According to table 1 we find that the model was significant with 95% confidence. In the case of debt variables as independent variables and the payer, there was no significant association. However, control variables such as size, profitability, ratio of retained earnings to equity industry and studied years have a meaningful relationship with the dependent variable.

4.1 Discussion and Conclusion

4.1.1 Limitations

This study, like other descriptive research is limited in time and place. Therefore, we should have accuracy in generalize the results to other times and other statistical societies. Accounting research is often part of the post-event and hence it is not permitted to be present at the time variables; although it must be said, it is possible in no research even science research complete control of variables. Political, economic, cultural and psychological climate prevailing on the Tehran Stock Exchange and awareness among participants in the capital market impact on supply and demand, the volume of transactions and boom or bust in market and affect on research variables that deserves attention in future research.

4.1.2 Recommendations

• due to the irrelevance some of the information in financial statements that make difficulty historical cost with their current values, the analysis of financial leverage and asset growth, it is suggested that using incentive policies, companies are encouraged to provide data related to the current values.

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