Studying the Relationship between Dividend Policy and Future Profits of Companies Listed On Tehran Stock Exchange

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ABSTRACT

Background and Objective: The aim of this paper is to provide some evidence in response to this question "why some companies payout more stock cash dividends comparing to other companies?" This question has attracted less attention to itself so far, because previous empirical studies have generally been conducted by focus on changes in cash dividend stocks not on stock dividend. In fact previous studies have more answered this question that "why companies change their stock cash dividends?" So many of the previous empirical studies have studied the effective factors on the company decision regarding distribution or non-distribution of stock cash dividends, but in these studies the factors effective on decisions regarding determination of stock cash dividends to be distributed by companies have not been studied. In this paper we will study the relationship between dividends policy and future profits of companies listed on Tehran Stock Exchange. **Results:** The obtained results indicate that no significant relationship (p<0.05) exists between future profits and stock cash dividends of companies and also there is a significant relationship (p<0.05) between retained earnings to equity of companies to dividends (the amount of dividends paid by them) ratio and a significant relationship (p<0.05) has been observed between investment opportunities of companies and the amount of dividends paid by them.

INTRODUCTION

Profit making of companies have been always at the center of attention of beneficiary people in companies and the future profitability of these companies and their prediction power can make so many useful helps to their decision makings in buying and selling stock and giving credit to companies and also warning to managers for improving their performance. In financial management the use of techniques, methods and scientific models generally has been promoted strongly in line with making rational decisions in financial affairs of companies and other organizations. On one hand, rapidly advancing technology has increased the economic growth and on the other hand the increasing competition among companies has limited achieving profit and has increased the risk of bankruptcy. In this way financial decision making has become more strategic than before and following it so many accounting and financial studies have been conducted toward creating a model for prediction of financial and economic statues of companies. In this regard financial ratios are the most important means in prediction of financial statues, activity stop and financial crisis of companies. Available evidences indicate the existence of a linear combination of the ratios both regarding financing and investment and profit making and growth & cash flows is efficient in financial evaluations and with the use of it we can distinguish healthy companies from the unhealthy ones Hashemi and Akhlaghi (2010).

The company's dividends policy and the effective factors on it is a topic which has attracted the attention of investors, managers, experts, users of financial statements and theorists in financial and accounting fields, in this way that so many of financial theories have described this topic and so many of empirical studies have been conducted with focusing on this topic. More than half a century before Lintner as the first serious effort in the field of empirical study of dividends and the effective factors on it, with conducting a fundamental study have been the pioneer of the series of studies conducted in this field. In this regard multiple factor has been

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recognized as determining elements of companies' dividends policy, although so many of the previous empirical studies have indicated to the existence of a relationship between net profit and company's dividends. However one factor that has received less attention is the expectations regarding future profits of the company.

In Stock Exchange if investors will be able to predict the future profits of different companies successfully and buy and keep the stock of those companies which have a good potential of profitability in a near future then they can be able to get good returns from their stock portfolios. However in an environment with information asymmetry, the investors outside a company cannot get access to the internal information of companies easily or they don't get access to this information on time. Due to this reason studying dividends policy as one of the sources of company information regarding the expected future profit of a company from the internal decision-makers of a company perspective can be useful for reducing the mentioned information asymmetry. Previous studies regarding the role of dividends changes in communicating information such as expected corporate profits in the near future have reached different and contradictory results (Rezwani *et al*, 2009).

Consistent with the information content of dividend theory, decision makers in making dividends policy of the company put their basis on their predictions regarding company's future profits. In this way that when a company predicts an increase in its future profits, the company will increase its dividends and vice versa. The reason for this is that stock cash dividends have a high cohesion and those companies who will decrease their dividends will face a significant decline in the value of their stock. Therefore, for avoiding from this companies will avoid distributing their high dividends until they will not make sure of their companies ability for maintaining their dividends.

In short companies in establishing their dividends policy, due to dividends cohesion, will consider their ability in maintaining their dividends considering their predictions of future profits. The studies conducted by Lintner indicate that managers will consider the sustainability of their profits as one of the most effective factors on their decision regarding stock cash dividends distribution.

Brav *et al* (2005) based on a study show that more than two third of financial managers of the companies who distribute cash dividends consider sustainability and stability of profit and future cash flow as an effective and so much important factor in their decision makings (Modares and Abbaszadeh, 2008).

Based on the above, in this paper we want to study the relationship between dividends and future profits of the company among companies listed in Tehran Stock Exchange for testing the above stated theories and generalizing the previous empirical studies results in this regard and in the following we will review the empirical literature of the research and then we will present the hypotheses, research methodology and the research results.

Literature review:

Chen *et al*., in their research conducted on companies listed in Taiwan Stock Exchange have studied the relationship between future profits and dividends policy. Their sample for this study includes companies listed in Taiwan Stock Exchange and Taiwan OTC (over the counter) market during 1996 to 2009. Specifically he has studied the relationship between dividends and dividends in forms of currency, stock dividends and future profits among Taiwan companies. The results indicate that dividends have a relationship with real profits of two future years of the company and they have interpreted this finding in the form of existence of information content in dividends for investors.

Cheng & Hollie (2008) have studied the elements of cash flows with the use of a model of cash flows prediction and their results indicate that the main and secondary cash flows have always role in predicting cash flows and will increase the prediction power of the model.

Bani Mahd and Asghari (2011) have studied "effect of company leverage on dividends policy of companies listed on Tehran Stock Exchange". The results of this study indicate that financial leverage doesn't have a significant relationship with dividends. But the company size and operational cash flows have a significant and positive relationship with dividends policy. The results of this study are consistent with some other conducted studies abroad. This indicates that probably developing market such as capital market of Iran, in dividends, due to lack of efficiency of efficacy theory, no attention is given to leverage ratio (debt ratio) and hence there is no relationship between them.

Hashemi and Akhlaghi (2010) have studied "the effect of financial leverage , dividends policy and profitability on company's future value". The results of data analysis confirm both the research hypotheses with the use of tabular data. In other words, there is a significant and positive between financial leverage, dividends policy and profitability with company value. Also there is a significant and positive relationship between the variables under study with company future value. In addition to this, the findings indicate that the probability of increase in company future value will become more with rise of financial leverage ratios, dividends policy and profitability.

Khodadadi *et al*. (2009) with the use of Bareth, Cram and Nelson models (2001) in a 5 year period (2001-2006) have studied the prediction power of future cash flows and commitment elements of past profits and have found that cash flows and accrual components of profit models have more power of prediction comparing to

profit model. The results confirm that adding accrual components of profit to the model of cash flows will increase the prediction power of the model.

Rezwani *et al*. (2009) have studied "the relationship between free cash flows and dividends policy in companies listed in Tehran Stock Exchange". The results indicate that both in large companies and in companies with low investment opportunities there is a significant and positive relationship between free cash flows and changes of dividends. This in turn indicates that the managers of these companies consider three important factors while making decisions of dividends policy namely, free cash flow, investment opportunities and the size. In general the results of this study support the theories of free cash flows according to the extracted information from financial statements of the companies under study, the Jenson theory is also confirmed in Tehran Stock Exchange.

Modares and Abbas zadeh (2008) have study the predicting power of profit and cash flows as well as their mutual effect on each other and have found that cash flows have more power in predicting profits and that we can predict cash flows with the use of profits and with the use of cash flows we can predict profits.

Research hypotheses:

Hypothesis 1: there is a significant relationship between future profits and dividends policy of companies.

Hypothesis 2: there is a significant relationship between cumulative profit to equity ratio and dividends distributed by them.

Hypothesis 3: there is significant relationship between investment opportunities of companies and the amount of dividends distributed by them.

Methodology and data collection method:
Research methodology:

The current study is applies from aim point of view; is correlation – descriptive from method point of view and is survey research from conduct point of view.

Research population and sample:

The sample of the current research includes companies listed in Tehran Stock Exchange have been selected with the use of elimination method and based on the following criteria:

For homogenization of the sample in the years under study, the companies should have been listed in Tehran Stock Exchange before 2005 and shouldn't have been exited from the list until the end of 2011;

For increasing the comparison power, their fiscal year ending should be in the month of Esfand and during the above mentioned years they shouldn't have changed their fiscal year;

Haven't had loss during any of the mentioned years and at the date of balance sheet of any of the mentioned fiscal year doesn't have any accumulated loss;

Since for calculating the company investment opportunities we need to determine market value of its equity, hence the stock of the company should have been traded at least once during the month of Esfand in each year;

Information about audited financial statement of them should be available for the period under study;

Due to the specific nature of activity the company shouldn't be one of active companies in financial intermediary industry.

Data collection tools:

In this research two tools have been used for data collection:

For collecting general data about organizations including history, number of employees, education statues, regulations and … the method of reviewing documents has been used. Also for other information regarding literature of the topic, theoretical frame determination and indicators we have used resources available in libraries which include books , journals, theses and academic reports.

The information and data required for this study include various groups. Data about previous studies conducted in this field and also similar fields have been gather with referring to libraries and both inside and outside databases. Data about sample companies under study have been gathered through referring to yearly audited financial statements of companies and also referring to libraries and Tehran Stock Exchange website.

Research model:

$DV/E_{i,t} = ß0 + ß1 EPS_{i,t+1} + ß2 EPS_{i,t+2} + ß3\ RE/TE_{i,t} + ß4\ MBR_{i,t} + ß5\ Log(TA) + ß6\ EPS_{i,t} + \varepsilon_{i,t}$

Where $ß0, ß2,…, ß6$ indicate parameters estimation and $\varepsilon_{i,t}$ indicates error phrase. Measurement way of the used symbol in the above model is as per the following.

$DV/E_{i,t}$ = result of current period's dividends divided by net profit of the current period
$EPS_{i,t+1}$ = dividend of company in the next fiscal year

$EPSi,t+2$ = dividend of company in the two next fiscal year
$RE/TEi,t$= result of cumulative profit dividends divided by total equity
$EPSi,t$ = dividend of company in the current year
MBR = result of dividing market stock value to book value of equity of company in the end of fiscal year
Log (TA) = logarithm of the total assets of the company at the end of fiscal year.

Results:
Research findings:

Table 1: descriptive statistics of the research variables.

Variable	Number of observations	Mean	Standard deviation	Min.	Max.	Skewness	Strain
Dividends ratio	560	.0650	.04801	0.00	.50	1.616	12.633
Dividend during the next year	560	615.5650	1081.19882	-3925.80	9204.19	2.286	12.983
Dividend during next 10 years	560	598.0500	1091.49938	-4002.61	9204.19	1.833	13.031
Cumulative profit to equity	560	.0459	.28741	-.71	4.61	7.578	106.744
Growth opportunities	560	2.0010	4.62456	-13.58	59.00	5.672	51.402
Company size	560	495384.5000	6886256.03452	42688.00	73406804.00	7.495	63.435
Dividend during the current year	560	697.1150	1059.94158	-3925.80	9204.19	2.380	11.922

As it can be seen in table 1, mean of the dividends of the sample companies which has been measured by dividends to net profit ratio of company is equal to 0.0650% and the Min. and Max. of it are 0% and 50% respectively. Evaluating the skewness and strain of this variable, which should be 0 and 3 for the variable to have a normal distributions, indicate a normal distribution.

The mean of dividends during the next year of the sample companies during the time span of the research are equal to 615.5650 in a way that the most value of dividends during the next year among the sample companies is equal to 9204.19 and the Min. amount of dividends during the next year among the sample companies is equal to -3925.80 and the mean of dividends during the two next year of the sample companies during the time span of the research is equal to 56805 in a way that the Max. dividends during the next two year among the sample companies is equal to 92004.19 and the Min. dividends during the next two years among the sample companies is equal to -4002.61. Also the mean of cumulative profit dividends to equity ratio of the sample companies during the time span of the research is equal to 0.0459 in a way that the Max. cumulative dividends to equity ratio among sample companies is equal to 4.61 and the Min. cumulative dividends to equity ratio among sample companies is equal to -0.71. Finally the mean of the growth opportunities ratio of the sample companies during the time span of the research is equal to 2.001 in a way that the Max. growth opportunities ratio among sample companies is equal to 59.00 and the Min. growth opportunities ratio among sample companies is equal to -13.58.

The company size also due to the presented descriptive statistics in table 1 have a mean equal to 459384.5 and the mean of the dividends of the current year of the sample companies during the time span of the research is equal to 697.1150.

Inferential results of hypotheses:
Research hypothesis 1 test results:

The aim of this test is to study the relationship between future profit and the amount of dividends of the companies and our hypothesis is defined as below:
H0: There is no positive and significant relationship between future profits and dividends amount of companies.
H1: There is a positive and significant relationship between future profits and dividends amount of companies.

This hypothesis is estimated and tested with the use of model (1) and if β_1 and β_2 coefficients will be significant at the certainty level of 90%, then it will be confirmed.

$$DV/E_{i,t} = \beta_0 + \beta_1 EPS_{i,t+1} + \beta_2 EPS_{i,t+2} + \beta_3 RE/TE_{i,t} + \beta_4 MBR_{i,t} + \beta_5 Log(TA)_{i,t} + \beta_6 EPS_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$\begin{cases} H_0 : \beta_1, \beta_2 = 0 \\ H_1 : \beta_1, \beta_2 \neq 0 \end{cases}$$

For determining where the use of panel data method in model estimation is efficient or no, we will use Chow test or F bound and for determining which of the methods of fixed effects or random effects are more proper for estimation (identifying whether the differences of cross-sectional units are random or fixed) Hausman test has been used. The results of Chow test have been presented in table 2.

Table 2: Results of Chow test for model (1).

Test	Statistics	Statistics value	Freedom degree	P-Value
Chow	F	0.920127	(109,276)	0.6891

Due to the fact that the obtained P-value from Chow test is equal to 0.6891 and is more than 0.05 we will use combined data method and there is no need of Hausman test for determining which method (fixed effects or random effect) is more proper for the estimation (identifying whether the differences of cross-sectional units are random or fixed). Due to the results obtained from Chow test and its P-value, H0 hypothesis is confirmed at certainty level of 95% and indicates that the combined data method should be used which can be both be possible to calculate with SPSS software and Eviews software, however in this study we have used Eviews.

For testing the model validity and testing classic regression assumption it is necessary to perform some tests regarding normality of residuals, homogeneity of variances, independence of residuals and absence of clear error model (model linearity) in addition to testing absence of absence of multicollinearity between the independent variables entered in the model. For testing the normality of error phrases we can use different tests which one of them is Jarque-Bera test which has been used in this study. The results obtained from Jarque-Bera indicate that the obtained residuals from the research model estimation is at the certainty level of 95% and therefore has a normal distribution, in a way that the probability of this test (0.2528) is larger than 0.005. Another statistical assumption of classic regression is homogeneity of residual variances. If the variances will be incoherent, the linear estimator is not unbiased and therefore will not have the lowest variance. In this paper for studying the variances Cut-Pagan test has been used. Due to the fact the importance level of this test is smaller than 0.05 (0.0001), H0 hypothesis stating the presence of homogeneity of the variance is rejected and it can be said that the model has the problem of incoherent variance. In this study for solving this problem in estimation we have used Generalized Least Squares (GLS) estimation method. Also in this study for testing the lack of residuals correlations, which is one of the analysis and regression analysis assumptions called self-correlation, the Durbin-Watson test has been used. Considering the primary results of the model estimation statistics of Durbin-Watson is equal to 1.82 and indicates the absence of self-correlation among the model residuals. Since the value of Durbin-Watson statistics (1.82) is between 1.5 and 2.5 it can be concluded that we don't have the problem of residuals self – correlation and they are independent from each other. In addition to this for testing the linearity of the model and whether the model has been established correctly from the point of view of linearity and non-linearity we have use the Ramsey test. Due to the fact that the significance level of Ramsey test (0.0515) is more than 0.05, then H0 hypothesis of this test stating the linearity of the model is confirmed and the model doesn't have assert error. The summary of the above tests have been presented in table 3.

Table 3: Results of testing the statistical assumptions of the model (1).

Jarque-Bera statistics		Breusch-Pagan statistics			Durbin-Watson statistics	Ramsey statistics
χ^2	$P-Value$	F	$P-Value$	D	F	$P-Value$
4.25	0.2528	4.84	0.0001	1.82	3.815	0.0515

Due to the obtained results from Chow test as well as the results of statistical assumptions of classic regression test, Model (1) of the research has been estimated with the use of combined data method. The results of the model estimation have been presented in table 4. The estimated model with the use of Eview will be as the following:

$$DV/E_{i,t} = 0.0802 + 3.5506EPS_{i,t+1} - 9.4107EPS_{i,t+2} - 0.03508RE/TE_{i,t} + 0.0008MBR_{i,t}$$

$$- 4.9110Log(TA)_{i,t} + 2.9808EPS_{i,t} + 0.528$$

In studying the significance of the whole model due to the fact that the value of the F statistics probability is smaller than 0.05 (0.000), the whole model is confirmed at the certainty level of 95%. The model's determining coefficient also indicates that 52.8% of the changes in companies' dividends ratio are explained by the variables interred in the model.

Table 4: Results of research hypotheses test with the use of combined data method.

Dependent variable : dividends ratio				
Number of observations : 392 year – company				
Variable	Coefficient	t statistics	P-Value	relationship
Fixed element	0.080253	26.24552	0.0000	Non-significance
Dividends in the next year	3.5506	1.055333	0.2919	positive
Dividends in the next two years	-9.4107	-0.383001	0.7019	negative
cumulative profit to equity	-0.035087	-5.049637	0.0000	negative
Growth opportunities	0.0559-	1.917664	0.0008	negative
Company size	-4.9110	-1.680524	0.0937	negative
Dividends during the current year	2.9808	0.013774	0.9890	positive
Model determining coefficient				0.528059
F statistics $(P-Value)$				5.203889 (0.000)

In studying the coefficient significance due to the presented results in table 4, since the probability of t statistics for coefficient of the variable of dividends for the next year is bigger than 0.05 (0.29190 , also since the probability of t statistics for the variable of dividends in the next two year is bigger than 0.05 (0.7019), therefore the significance relationship between companies' dividends and stock dividends during the next year and the two next years is not confirmed at the certainty level of 95%. Therefore the research hypothesis 1 is not accepted and with certainty level of 95% it can be said that there is no significant relationship between companies' dividends and dividends of the next year and the two next years of the companies. The fact that the coefficient of the variable of the dividends of the next year is positive (3.5506) indicate to an indirect and positive relationship between companies' dividends and dividends of the next year of the companies. The fact that the coefficient of the variable of the dividends of the two next years is negative (-94107) indicate to an indirect and negative relationship between companies' dividends and dividends of the two next years of the companies.

Results for testing research hypothesis 2:

The aim of testing the research hypothesis 2 is to study the relationship between ratio of cumulative profit to total equity and the amount of companies' dividends. Its statistical hypothesis is as per the following:

H0: Ratio of cumulative profit to total equity doesn't have a positive and significance relationship with companies' dividends.

H1: Ratio of cumulative profit to total equity doesn't have a positive and significance relationship with companies' dividends.

This hypothesis is estimated with the use of model (2) and in case β_3 coefficient will be significant at certainty level of 95%, then it will be accepted.

$$DV / E_{i,t} = \beta_0 + \beta_1 EPS_{i,t+1} + \beta_2 EPS_{i,t+2} + \beta_3 RE / TE_{i,t} + \beta_4 MBR_{i,t} + \beta_5 Log(TA)_{i,t} + \beta_6 EPS_{i,t} + \varepsilon_{i,t} \quad (2)$$

$$\begin{cases} H_0 : \beta_3 = 0 \\ H_1 : \beta_3 \neq 0 \end{cases}$$

In studying the coefficients significance considering the presented results in table 4, since the probability of t statistics for the coefficient of the variable ratio of cumulative profit to total equity is smaller than 0.05 (0.0000), therefore the existence of a significance relationship between companies' dividends and the variable of the ratio of cumulative profit to total equity is confirmed at the certainty level of 95%. Therefore the research hypothesis 2 is accepted and with certainty level of 95% it can be said that there is a significant relationship between companies' dividends and the variable of ratio of cumulative profit to total equity. The fact that the coefficient of the variable of the ratio of cumulative profit to total equity is negative, (-0.0355087) indicate to a direct and negative relationship between companies' dividends and the variable of the ratio of cumulative profit to total equity.

Results for testing research hypothesis 3:

The aim of testing the research hypothesis 3 is to study the relationship between investment opportunities and the amount of dividends of companies. Its statistical hypothesis is as per the following:

H0: investment opportunities don't have an adverse and significance relationship with the dividends of companies.

H1: Investment opportunities have an adverse and significance relationship with the dividends of companies.

This hypothesis is estimated with the use of model (3) and in case β_4 coefficient will be significant at certainty level of 95%, then it will be accepted.

$$DV / E_{i,t} = \beta_0 + \beta_1 EPS_{i,t+1} + \beta_2 EPS_{i,t+2} + \beta_3 RE / TE_{i,t} + \beta_4 MBR_{i,t} + \beta_5 Log(TA)_{i,t} + \beta_6 EPS_{i,t} + \varepsilon_{i,t} \quad (3)$$

$$\begin{cases} H_0 : \beta_4 = 0 \\ H_1 : \beta_4 \neq 0 \end{cases}$$

In studying the coefficients significance considering the presented results in table 4, since the probability of t statistics for the coefficient of the variable investment opportunities is smaller than 0.05 (0.0008), therefore the existence of a significance relationship between companies' dividends and the variable of investment opportunities is confirmed at the certainty level of 95%. Therefore the research hypothesis 3 is accepted and with certainty level of 95% it can be said that there is a significant relationship between companies' dividends and the variable of investment opportunities. The fact that the coefficient of the variable of investment opportunities is negative, (-0.0559) indicate to an adverse and negative relationship between companies' dividends and the variable of investment opportunities.

Discussion and conclusion:

Regarding the importance of companies' dividends it is sufficient to say that scholars name it as one of the 10 unsolved issues in financial management field. Due to theoretical evidences and the results of previous studies it is expected that due to cohesion of dividends and information content of dividend theory, there would be a relationship between predicted future profits of companies and the distributed dividends amount by them.

So far none of the conducted empirical studies in Iran have studied the topic of future profits and its relationship with dividends distributed by companies; hence conducting a study which would test this relationship and provide evidences regarding the existence of this relationship and also the intensity of it and in case the relationship would be confirmed can contribute to extend the literature and empirical evidences regarding dividends by companies and moreover it will help investors and those active in the market on one hand, and decision makers of dividends of companies on the other hand, to have a better understanding of the importance of dividends as a signaling tool and its information content. The aim of this paper is to study the relationship between dividends policy and future profits of the companies listed in Tehran Stock Exchange. For testing the research models first we have used Chow test to determine whether we should use panel method or combined method and finally the fitted model and the results obtained from classic regression assumption for research models were presented. The results of the study indicate that in the relationship of the research hypothesis 1, there is no significant relationship between dividends and stock profit of the next year and the two next years of the companies and the existing evidences indicate to an indirect and positive relationship between dividends of companies and stock profit of their next year and the negative coefficient of the variable of stock profit of the next two years indicate to an indirect and negative relationship between dividends of companies and their stock price in the next two years. The results of the research regarding the 2nd hypothesis indicate that there is a significant relationship between dividends of companies and the variable of ratio of cumulative profit to total equity of companies, which indicate to existence of a direct and negative relationship between companies dividends and the variable of ratio of accumulative profit to total equity of companies. Finally the results of the research regarding the 3rd hypothesis of the research indicate that there is a significant relationship between companies' dividends and the variable of investment opportunities. The fact that the coefficient of the variable of investment opportunities is negative, indicate that there is a reverse and negative relationship between companies dividends and the variable of investment opportunities of companies.

Conclusion:

After conducting the stages of a scientific study, if the study has been conducted in systematic approach, the researcher can provide some opinions regarding the findings and the results of the study as well as some recommendations for improvement and extension of future studies. For this reason in the following we will provide some recommendations based on the research results.

1- Stock Exchange organization can publish more comprehensive information regarding the relationship between dividends policy and future profits, especially for its small shareholders, considering the results of this study and similar studies.

2- Since the financial policies of companies, especially dividends, can have a significant effect on the investors decision making, in this regard providing comprehensive and clear information from the management in the field of dividends policy will be so much useful.

3- It is better that financial analysts active in capital market and consultants of investment in stock market, performe some specific analyses base on the stature of dividends of companies considering common ownership

structures in companies in different industry levels and economical units beside their normal analyses and techniques.

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